Legal comparison 
between 
the South African 
Close Corporation and 
the German 
'Gesellschaft mit beschränkter Haftung'

by 
Christoph Jaehne, LL.M., MEAM 

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in order to meet the requirements for the degree 
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of the 
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at the 
University of the Free State 

Promoter 
Professor Dr. J.J. Henning
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<td>AG</td>
<td>Aktiengesellschaft, in general it resembles a public (limited) company.</td>
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<td>AktG</td>
<td>Aktiengesetz, Companies Act.</td>
</tr>
<tr>
<td>AnfG</td>
<td>Anfechtungsgesetz, Act of Contesting.</td>
</tr>
<tr>
<td>ApothG</td>
<td>Apothekengesetz, Pharmacy Act.</td>
</tr>
<tr>
<td>BayObLG</td>
<td>Bavarian High Court, higher regional court of appeal in the province of Bavaria.</td>
</tr>
<tr>
<td>BayObLGZ</td>
<td>Entscheidungen des Bayerischen Obersten Landesgerichts in Zivilsachen, decisions of the BayObLG in civil affairs.</td>
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<td>BEE</td>
<td>Black Economic Empowerment.</td>
</tr>
<tr>
<td>BEE Act</td>
<td>Broad-Based Black Economic Empowerment Act.</td>
</tr>
<tr>
<td>BFH</td>
<td>Bundesfinanzhof, Federal Fiscal Court.</td>
</tr>
<tr>
<td>BGB</td>
<td>Bürgerliches Gesetzbuch, German Civil Code.</td>
</tr>
<tr>
<td>BGB-Gesellschaft</td>
<td>Bürgerliches Gesetzbuch - Gesellschaft, Civil law partnership according to BGB.</td>
</tr>
<tr>
<td>BGBI.</td>
<td>Bundesgesetzblatt, Government Gazette or Federal Law Gazette.</td>
</tr>
<tr>
<td>BGH</td>
<td>Bundesgerichtshof, Federal Supreme Court, highest court in Germany in civil and criminal matters (not to be confused with the Federal Constitutional Court).</td>
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BGHZ = Entscheidungen des Bundesgerichtshofes in Zivilsachen, Federal Supreme Court decisions in civil affairs (Reports of the Federal Supreme Court in civil matters).

BilrG = Bilanzrichtlinien Gesetz, Accounting and Reporting Act.

BilReG = Bilanzrechtsreformgesetz, Gesetz zur Einführung internationaler Rechnungslegungsstandards und zur Sicherung der Qualität der Abschlussprüfung, Act on International Accounting and Audit.

BJM = Bundesministerium der Justiz, Federal Ministry of Justice.

BMF = Bundesministerium der Finanzen, Federal Ministry of Finance.

BRAO = Bundesrechtsanwaltsordnung, Federal Rules for Lawyers.

BVerfG = Bundesverfassungsgericht, Federal Constitutional Court.

CA = Companies Act.

CalPERS = California Public Employees' Retirement System.

CCA = Close Corporation Act.

CIPRO = Companies and Intellectual Property Registration Office.

CRIC = Coordinating Research Institute for Corporate Law (Standing Subcommittee of the Standing Advisory Committee on Company Law).

DMBiG = Gesetz zur Änderung des D-Markbilanzgesetzes und anderer handelsrechtlicher Bestimmungen, Act to amend the Deutsche-Mark Balance Act and other provisions of Commercial Law.
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<td>ECJ</td>
<td>European Court of Justice.</td>
</tr>
<tr>
<td>eG</td>
<td>eingetragene Genossenschaft, registered co-operative. Registered co-operatives play a certain role in agriculture and handicrafts supply, distribution and banking.</td>
</tr>
<tr>
<td>EGInsO</td>
<td>Einführungsgesetz zur Insolvenzordnung, Introduction Act to the Insolvency Act.</td>
</tr>
<tr>
<td>EuroEG</td>
<td>Gesetz zur Einführung des Euro, also called Euro Einführungsgesetz, Euro Introductory Act.</td>
</tr>
<tr>
<td>EPC</td>
<td>European Private Company.</td>
</tr>
<tr>
<td>ERJuKoG</td>
<td>Gesetz über elektronische Register und Justizkosten für Telekommunikation, Act on Electronic Registers and Legal Costs for Telecommunication.</td>
</tr>
<tr>
<td>FGG</td>
<td>Gesetz über die Angelegenheiten der freiwilligen Gerichtsbarkeit, Act relating to Matters on Non-Contentious Jurisdiction.</td>
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<tr>
<td>GbR</td>
<td>Gesellschaft bürgerlichen Rechts, Civil law partnership according to BGB.</td>
</tr>
<tr>
<td>GewO</td>
<td>Gewerbeordnung, Trade, Commerce and Industry Regulation Act.</td>
</tr>
<tr>
<td>GewSt</td>
<td>Gewerbesteuer, Trade Tax.</td>
</tr>
<tr>
<td>GG</td>
<td>Grundgesetz, Constitutional Law.</td>
</tr>
<tr>
<td>GmbH</td>
<td>Gesellschaft mit beschränkter Haftung, company with limited liability.</td>
</tr>
<tr>
<td>GmbHHG</td>
<td>Gesetz betreffend die Gesellschaften mit beschränkter Haftung, Act concerning the Companies with limited Liability.</td>
</tr>
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<td>GmbH &amp; Co. KG</td>
<td>Limited partnership (KG) with a limited liability company (GmbH) as general (personally liable) partner (Komplementär) and the shareholders of the GmbH (alone or with others) as</td>
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limited partners (Kommanditist). It differs from the limited partnership in that the general partner is a Kapitalgesellschaft, which is almost always a GmbH. There is no special Act dealing with this legal form (which belongs to the category of commercial partnerships).

GWB = Gesetz gegen Wettbewerbsbeschränkungen, Law against Restraints of Competition, called also Law on Restrictive Practises.

HGB = Handelsgesetzbuch, Commercial Code.

HrefG = Handelsrechtsreformgesetz, Act on Commercial Law Reform.

HypBG = Hypothekenbankgesetz, Mortgage Banks Act.

InsO = Insolvenzordnung, Insolvency Act.

JSE = Johannesburg Stock Exchange.

KapCo-RiLiG = Kapitalgesellschaften-& Co Richtlinie-Gesetz, Act on Partnerships with a Limited Company as General Partner.

KapErhG = Kapitalerhöhungsgesetz, Act Regulating the Raising of Capital.

KG = Kommanditgesellschaft, limited partnership (belongs to the category of commercial partnerships).

KGaA = Kommanditgesellschaft auf Aktien, company limited by shares.

KO = Konkursordnung, Bankruptcy Act.

KSt = Körperschaftssteuer, Corporation Income Tax.


LLC = Limited liability company.
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<td>LLP</td>
<td>Limited Liability Partnership.</td>
</tr>
<tr>
<td>LLPA</td>
<td>Limited Liability Partnership Act 2000 (UK).</td>
</tr>
<tr>
<td>OHG</td>
<td>Offene Handelsgesellschaft, unlimited/general partnership (belongs to the category of commercial partnerships).</td>
</tr>
<tr>
<td>OJ</td>
<td>Official Journal of the European Communities.</td>
</tr>
<tr>
<td>PartG</td>
<td>Partnerschaftsgesellschaft, partnership association.</td>
</tr>
<tr>
<td>RDP</td>
<td>Reconstruction and Development Programme.</td>
</tr>
<tr>
<td>RGZ</td>
<td>Entscheidungen des Reichsgerichtshofes in Zivilsachen, decisions of the Imperial Court of Justice of the German Reich in civil affairs.</td>
</tr>
<tr>
<td>SAC</td>
<td>Standing Advisory Committee on Company Law.</td>
</tr>
<tr>
<td>SADC/SADEC</td>
<td>Southern African Development Community.</td>
</tr>
<tr>
<td>SA DTI</td>
<td>South African Department of Trade and Industry.</td>
</tr>
<tr>
<td>SE</td>
<td>Societas Europaea.</td>
</tr>
<tr>
<td>SMME</td>
<td>Small, medium and micro enterprise.</td>
</tr>
<tr>
<td>SolZ</td>
<td>Solidaritätszuschlag, Solidarity surcharge.</td>
</tr>
<tr>
<td>StBerG</td>
<td>Steuerberatungsgesetz, Tax Advisory Act.</td>
</tr>
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UK DTI = United Kingdom Department of Trade and Industry.

UmwG = Gesetz zur Bereinigung des Umwandlungsrechts, Umwandlungsgesetz, Act Regulating the Conversion of Companies.

UWG = Gesetz gegen den unlauteren Wettbewerb, Unfair Competition Act.

VAG = Versicherungsaufsichtsgesetz, Insurance Regulation Act.

VergIO = Vergleichsordnung, Composition Act.

WPO = Wirtschaftsprüferordnung, Public Accountants Act.

WZG = Warenzeichengesetz, Trademark Act.
In a short personal résumé in connection with this research project, I wish to express my greatest thankfulness to Professor Henning for his patient guidance in the best academic tradition, demanding and at the same time rewarding, but at all times with a stimulating humour that kept me laughing long after. He is 'liable' for arousing my interest in company law and without his invaluable help, enthusiasm and unlimited scholarship this comparison would not have been written. Unforgettable will also be the meetings and fruitful discussions in London at the Institute of Advanced Legal Studies and in the inspiring atmosphere at Jesus College, University of Cambridge.

My stay at the Faculty of Law at the University of the Free State will be a lifelong enrichment for me and I am more than grateful for the warm welcome and support I received from all the colleagues there. Baie, baie dankie!

In addition I can only recommend the Centre for Business Law at the Law Faculty as inexhaustible source for research in this field and say thank you to the friendly and most helpful staff there and at the very efficient UFS-SASOL library. The same appraisal can be given to the personnel at the Institute of Advanced Legal Studies, London.

The admirable tolerance and constant encouragement of my wife Kirsten are both valued deeply by me. Only she knows how many hours after work, on weekends or during holidays have been spent writing these pages.

I dedicate this thesis to her and to my parents, without their loving support this study would not have been possible. And, of course, little Kilian and Annika can now stop wondering why daddy is spending so much time "playing with the computer".
INTRODUCTION

In the process of creating an appropriate legal form for small business entities in South Africa, of which the close corporation\(^1\) was the result, the German 'Gesellschaft mit beschränkter Haftung' was reviewed.\(^2\)

Notwithstanding their different legal\(^3\) and socio-economic backgrounds these two legal entities have a common point of departure and share similar objectives.

This common point of departure is that the existing business forms were deemed inappropriate for the needs of small business ventures. Thus, both forms of enterprises aim at providing alternative legal options for small business enterprises, giving them a simpler and less expensive legal structure, which satisfies their need for flexibility while still guaranteeing both liability limitations and continuity.

Both these enterprise forms have the same background. They were preceded by legislation either inhibiting or exceeding the objectives of small business enterprises. In particular, the existing enterprise forms proved to be problematic in the following aspects: (1) personal limited liability, (2) perpetual succession, (3) obtaining of (public) funding and (4) complicated provisions tailored for businesses with numerous members and a continuing fluctuate membership.

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\(^1\) The usual abbreviation for the close corporation is CC or BK (Beslote Korporasie), however, it is also possible to use any name of the other official languages, see chapter 5.4.1, 'Name'.

\(^2\) Hereafter GmbH, translated as a "company with limited liability".

\(^3\) One must bear in mind that the close corporation has its place in a mixed system combining both civil law and common law whereas the 'Gesellschaft mit beschränkter Haftung' is rooted in the civil law system alone. See Zimmermann/Visser, "South African Law as a mixed legal system", in Zimmermann/Visser (eds.), Southern Cross – Civil Law and Common Law in South Africa (1996).
When the close corporation as business form was introduced in South Africa, this was seen as a historic event in the development of the South African legal system, which, as was submitted at that stage, took a leading position in the western world in this field.\footnote{See Venter, "Die Ontstaan en Eienskappe van die Wet op Beslote Korporasies, 1984", 1984, TRW 109, 112. Henning speaks of a "geskiedkundige oomblik (...) in die ontwikkeling van die Suid-Afrikaanse ondernemingsreg" (historic moment in the development of the South African Business Law) in "Ondernemingsreg Deel II: Beslote Korporasiereg", 1988, 8 Med LSO, p. 7. With regard to the international perspective, \textit{cf.} Naudé, "The need for a new legal form for small business", 1982, \textit{MB} 5, 7 \textit{et seq}.; "The South African Close Corporation", 1984, TRW 117, 119 \textit{et seq}., 122.} Given the current winds of change in the South African company law through the most recent reform proposals of the South African Department of Trade and Industry,\footnote{Abbr. SA DTI.} it is not clear whether the close corporation will remain to be subjected to its own act. Therefore, it is also interesting to note that reforms in Germany never challenged the necessity of an own special act for the GmbH.

Bearing the common departure points and objectives in mind, the following discussion indicates the general similarities and differences between these two business entities. Such a comparison may serve as a first introduction dealing with two business forms, which are very popular in their respective contexts.

This comparison reflects the law as on 31 March 2005. However, information regarding developments taking place shortly after this date is also included.

References appear in the footnotes. The footnotes in each chapter start with “1”. Subsequent footnotes for the same source in this thesis simply include a shortened reference. In the bibliography at the end of the thesis a list of all literature cited is included allowing the reader to quickly identify a full quote.

Regarding such a comparison, at this stage it is also important to point out that the legal terminology of different legal systems are at best comparable to each other and very often are not equivalent. Therefore, one has to be cognisant that English expressions or the translation of German terminology occasionally may
miss or neglect differences in detail as well as it may cause misleading associations. Although the author of this thesis is not a native English speaker but engaged professional translation services ensuring proper use of terminology, I would like to caution that some misunderstandings may still occur. Subsequently, misunderstandings cannot be prevented entirely and therefore any mistakes (or as one should rather say in the given context: ‘liabilities’) are mine.

Nevertheless, it is rewarding as well as it widens one’s horizon to learn how different legal systems offer their solutions to sometimes similar questions. It is equally interesting to discover that some of these solutions are not so far apart as it may sometimes seem.
CHAPTER ONE

1 ECONOMIC IMPORTANCE

1.1 INTRODUCTION

In this chapter statistical data will be supplied to show the relevance of these two legal forms within their respective economies. GmbH and close corporation are the preferred instruments for entrepreneurs wishing to use as legal form one with, i.a., limited liability.

1.2 IMPORTANT ROLE IN RESPECTIVE ECONOMIES

Both the GmbH as well as the close corporation play an important role in their respective economies. This is not necessarily a surprise, because according to Butler, President of Columbia University, "the limited liability company is the greatest single discovery of modern times. Even steam and electricity are less important than the limited liability company".1

In Germany, the GmbH is by far the most popular form of incorporated business entities. While at the end of 2001 approximately 13,598 'Aktiengesellschaften'2 existed, the number of GmbHs was approximately 935,005.3

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1 Cited according to Dine/Hughes, EC Company Law, Looseleaf collection, 2004, 1 (1).
2 Abbreviated AG. In general it resembles a public (limited) company. In the Anglo-American legal context it is also referred to as a joint stock company.
3 Regarding the figures, see Hansen, "Der gestiegene wirtschaftliche Stellenwert der GmbH", 2004, GmbHR 39, 41. Cf. for recent developments, see also Hansen, "Die Rechtsformen deutscher Unternehmen und ihr wirtschaftliches Gewicht", 2003, GmbHR 22 et seqq.; "Die GmbH als weiterhin umsatzstärkste Rechtsform", 2002, GmbHR 148 et seqq.; "Fast die Hälfte der steuerpflichtigen Umsätze entfallen auf die GmbH und GmbH & Co. KG", 2001, GmbHR 24, 286 et seqq. Note that after 1993 the 'Statistisches Jahrbuch für die Bundesrepublik Deutschland', (Statistical Yearbook FRG) stopped covering the registration according to a differentiation between companies, and now registers them
Impressive was the significant rise in numbers due to German Unification. On 31 December 1992 there were about 3,200 'Aktiengesellschaften', (including Kommanditgesellschaft auf Aktien). AG and KGaA possessed a stock capital of about 174 million DM. The year before, in West Germany alone the number of AGs (including KGaA) was about 2,800 with a stock capital of about 154 million DM. The number of GmbHs on 31 December 1992 was nearly 549,660; their share capital amounted to about 246 million DM (covering united Germany). The year before in West Germany the numbers were about 466,000 GmbHs and 209 million DM.

Generally speaking, the GmbH is used for small or medium-sized enterprises. However, the GmbH is also used as a form of business enterprise by large enterprises. As early as in 1980 there were also 126 "GmbH-giants" with a share capital of 'Deutsche Mark' 100 million or more each.

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4 Abbreviated KGaA. This legal form can be explained as company limited by shares.
6 Statistical Yearbook FRG, ibid.
7 As Mueller et al., GmbH-Law (1981), 11, point out, this counted then for 95 per cent of all existing GmbHs. In 1980 less than 5 per cent of the GmbHs had a share capital of DM 0.5 million or more. At the end of 1986 only 0.6 per cent had a share capital of 10 million DM or more; in 1989 there were 0.7 per cent with more than 10 million DM and 3.1 per cent with a share capital between 1 and 10 million DM, see Baumbach/Hueck, GmbHG introduction, note 23. In 1979 the total share capital of GmbHs (then 225,209) exceeded that of AG/KGaA (then 2,190) with being 92.4 billion compared to 88.6 billion, Baumbach/Hueck, ibid. note 22. Regarding the economic importance, see also Scholz-Westermann, GmbHG introduction, note 29 et seq.
8 E.g., IBM Deutschland (1.4 billion DM share capital), Deutsche Unilever (537 million DM share capital) and Allgemeine Deutsche Philips Industrie (500 million DM share capital), see Mueller et al. (1981), 12. In 1984 among the 100 biggest German enterprises there were 20 GmbHs, 70 AGs or KGaA, Baumbach/Hueck, GmbHG introduction, note 24.
The development of the close corporation is equally remarkable. In his "Small Business Proposal" Naudé stated that at that time approximately 92 per cent of the then 177,000 registered companies were private ones and according to his assessment, about 44 per cent of these private companies were estimated to convert into a close corporation. A nearly accurate guess was made with the expectation that some 20,000 companies would convert and about 20,000 close corporations per year would be founded.

From the date of enactment, the close corporation proved to be a popular form of business. Interesting data for the starting period show that from 1 January 1985 until 31 March 1988 nearly 80,000 close corporations have been registered, of which approximately 20,000 have been conversions, while in the same period only about 20,000 companies have been registered. Given the especially difficult economic situation at this time in South Africa this is quite remarkable.

The years of intensive discussion about South Africa’s future and a notable uncertainty during this period of "talks about talks" subsequently also slowed down the establishment of businesses.

But even the years from 1 January 1989 until 31 December 1993, after the first rush, show clear advantages for the close corporation. In this period for about five close corporations only one company was registered. From 1 January 1989 until 31 December 1993 an additional 170,000 close corporations have been registered (total 250,000). The numbers for the company in this period were 35,000 (total 60,000). Conversions in this time from company to close

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9 Naudé, 1982, MB 5, 10. With regard to the numbers then, Geldenbloem gives a number of about 170,000 companies still operating, "Die Administrasie van die Wet op Beslote Korporasies en die Maatskappywet in die lig van die Doel en Funksies van die Registrasiekantoor vir Maatskappye", 1984, TRW 132. See also Ribbens, "Quo vadis corporate personality and partnership: why not the incorporated partnership proper?", 1983, TSAR 118, 124 fn. 274, with regard to the percentage of private companies.
10 Geldenbloem, 1984, TRW 132 and 141.
11 Henning, 1988, 8 Med LSO, p. 7, 8 et seqq., table A, table B.
corporation were 11,000 (34,000 total), while 3,414 (4,000 total) close corporations changed to the form of a company.

After the elections in April 1994 and the establishment of politically more stable structures, the pace immediately began picking up again with about 11,000 more close corporations registered in 1994 than in the previous year.

Since 1994 until the end of 1999 every year about 65,000 close corporations were registered and the total cumulative registration of close corporations at the end of 1999, amounted to approximately 680,000. However, the number of companies also increased moderately and the former ratio of five to one changed then to about three to one. At the end of 1999, there was a total of approximately 190,000 registered companies.

The number of close corporations registered per year has risen remarkably since. While in 2000 the number was 77,000, in 2002 the number increased to 107,300 close corporations and in 2004 the number of registered close corporations reached 128,749. The relevant numbers for the private company also have been rising from 29,649 in the year 2000 and 29,650 in 2002 to 33,787 in the year 2004. At the end of July 2005, the total cumulative registration of close corporations amounted to 1,092,428 and the number of private companies reached 382,863. The ratio remains about three to one. This, nevertheless, does not endanger the position of the close corporation as being the most popular form of incorporated businesses in South Africa.12

12 The relevant data was kindly supplied by F. Manickum and J. Cilliers, Registrar of Close Corporations, Pretoria. See also the data at http://www.cipro.co.za/about_us/registration_stats.asp. Note that the function of the former Registrar of Close Corporations (as well as of the Registrar of Companies) has been taken over by the Companies and Intellectual Property Registration Office (CIPRO), Pretoria. Cf. also regarding detailed figures, Henning, "The future of entrepreneurial law: the SAC’s proposed strategic framework for reform", 1999, JJS 58, 74 et seqq. See also Ribbens emphasizing that the figures collected through the Registrar of Companies date back to 1860, while those of the Registrar for Close Corporations only to 1985. Thus the growth of the close corporation "has been phenomenal", in "What’s in a name?", 1995, De Rebus 709, 713.
1.3 CONCLUSION

The dominance of these two legal forms for entrepreneurs looking for a legal form with, i.a., limited liability is shown in the statistical data. In Germany, the GmbH is by far the most popular form of incorporated business entities. While at the end of 2001 approximately 13,598 'Aktiengesellschaften' existed, the number of GmbHs was approximately 935,005. This gives the GmbH a clear advantage compared to the AG, the ratio being approximately seventy GmbHs to one AG. The numbers regarding the close corporation are also more than remarkable. At the end of July 2005, the total cumulative registration of close corporations amounted to 1,092,428 while the number of private companies reached 382,863. After a previous period where the ratio with five to one was even higher, it dropped now slightly to about three to one. This, nevertheless, does not endanger the position of the close corporation as being the most popular form of incorporated businesses in South Africa.
CHAPTER TWO

2 LEGAL FRAMEWORK OF THE GMBH

2.1 INTRODUCTION

The GmbH is the subject of its own specific Act, called the 'Gesetz betreffend die Gesellschaften mit beschränkter Haftung' of 1892, which came into force on 19 May 1892.¹

This chapter introduces the legal framework surrounding the GmbH. Being a legal form which in the beginning was viewed rather suspiciously, it quickly satisfied the specific needs of its target community. Within the GmbH context it is important to also mention other legal forms to conduct business, the most relevant being the partnerships and the Aktiengesellschaft. Other developments to be mentioned regarding business forms will be on the one hand those within the German legal system. However, with Germany being a major player within the European Union, on the other hand very relevant for the future of the GmbH are developments on the European level through ECJ judgments on the legal form of companies. These cause a heated discussion on the competition of jurisdictions within Europe. This discussion also brings about reform ideas regarding some features of the GmbH, i.a., on minimum share capital. Also influencing company law developments in Germany are the findings of the High Level Group of Advisors and the discussion regarding good governance. For a reader not so familiar with these aspects of European legal integration it is therefore important to introduce some facets of this virulent discussion. Accordingly, in the following chapter these aspects will also be discussed.

2.2 GMBH: FROM 'OFF LIMITS' TO 'NO LIMITS'

At the beginning of its inception the entity was viewed upon critically by some who thought it would be a fast track to bankruptcy.²

¹ 'GmbH-Gesetz' (Act concerning the Companies with limited Liability), subsequent usage will be abbreviated to GmbHG. For a brief overview regarding amendments, see Lutter-Hommelhoff, GmbHG introduction, note 6 et seqq.

²
However, the GmbH has proven its critics to be wrong. This entity is regarded as the outstanding German contribution to the field of company law. Its concept of a closely held corporation has been adopted by many other nations and has been copied by legislatures all over the world. It has also been declared as Germany's "most successful export article in the field of law."

After the fall of the iron curtain, the GmbH was introduced or reintroduced in a number of Middle and Eastern European countries (e.g., in Hungary).

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2 See, e.g., Lutter-Hommelhoff, GmbHG introduction, note 3.
3 Ribbens, 1982, TSAR 50, 52 et seq. with further references.

For a comparative list from the office of revenue viewpoint, see a decree of the Finanzministerium Nordrhein-Westfalen (Ministry of Finance North Rhine-Westphalia) in which international business-related legal forms are assigned to their German counterparts. In connection with South Africa, however, the close corporation is not mentioned in this decree, "Vergleichende Zusammenstellung aus- und inländischer Rechtsformen", 1993, RIW 1052 et seq. See also Lutter-Hommelhoff, GmbHG § 12, note 11 for a list (the contents of the regulations in § 12 GmbHG have been transferred into §§ 13 – 13(h) 'Handelsgesetzbuch', abbr. HGB (Commercial Code) since 1 November 1993).


However, it is interesting to note that there are different developments in France and The Netherlands, which are two of Germany's biggest trading partners. In France the 'société à responsabilité limitée' (SARL), deviating from the original GmbH, i.a., in that it has a fixed time scale of 99 years and a maximum membership of 50, was already enacted in 1925 (now contained in the Law on Commercial Companies 1966 and the subsequent Decree on Commercial Companies 1967). The Netherlands introduced the 'Besloten Vennootschap met Beperkte Aansprakelijkheid' (BV) in 1971 only in response to EU-legislation regarding annual financial statements of companies and publicity.7

2.3 GERMAN BUSINESS FORMS

As mentioned above, in Germany and South Africa the other forms in which business can be conducted were aimed at or developed for purposes inappropriate for "smaller" businesses, be it to conduct business in the form of a sole proprietorship, partnership, trading co-operative or company.8


8 Only the most commonly used forms to conduct business are mentioned. Regarding alternatives to the GmbH, cf. Beck GmbH-HB (1995), § 1 note 15 et seqq., note 73.
2.3.1 Distinction between 'Personen- and Kapitalgesellschaften'

German law distinguishes between 'Personengesellschaften', which are partnerships, and 'Kapitalgesellschaften', which are companies with a share capital. In this study the German terminology is used to highlight necessary distinctions.

2.3.1.1 'Personengesellschaften'

'Personengesellschaften' (partnerships) rely on personal involvement, -management and -liability.

With regard to partnerships one has to distinguish between civil law partnerships and commercial law partnerships.

In Germany, a civil law partnership is called 'BGB-Gesellschaft'. Commercial partnerships, in turn, are divided into 'Offene Handelsgesellschaft', 'Kommanditgesellschaft', 'stille Gesellschaft' and 'GmbH & Co. KG'.

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9 The term 'Gesellschaft' encompasses both incorporated and unincorporated associations.

10 Instead of "share capital" the expression "capital stock" is also used in the legal terminology.

11 For a short introduction, see Foster/Sule, German Legal System & Laws (2003), 492 et seqq.

12 It is important to know that while the BGB (abbr. for 'Bürgerliches Gesetzbuch', the German Civil Code) applies to all, the 'Handelsgesetzbuch' (abbr. HGB, Commercial Code) only applies to merchants. If somebody is a merchant ('Kaufmann') both Acts apply and the latter imposes two important duties on him: registration in the commercial register kept by the local court and the duty to keep books of account.

§ 1 HGB describes the mercantile activities, which make someone a merchant. With regard to the GmbH, see chapter 4.2, 'Lawful purpose, certain restrictions'.

13 Another term is also 'Gesellschaft bürgerlicher Rechts', abbr. GbR, § 705 et seqq. BGB.

14 Abbr. OHG, (unlimited/general partnership), § 105 et seqq. HGB.

15 Abbr. KG, (limited partnership), § 161 et seqq. HGB.

16 Undisclosed/silent partnership, § 230 et seqq. HGB.
The 'Europäische wirtschaftliche Interessenvereinigung', a European Union-born legal form, should be added to this list. This entity resembles the structure of an OHG with GmbH-management. The EEIG may be formed by persons from at least two Member States. It must not have the making of profit as its primary purpose and it may only employ 500 employees. The EEIG was introduced for self-employed professions in order to facilitate the border-crossing cooperation on the economical field between firms and members of such professions, within the European Community. The EEIG has been utilized as a specific instrument for the cross-border cooperation between large national legal firms. To date more than 800 EEIGs have been established. In the context of the EEIG's creation, one of Oliver's thoughts must be cited, stating way back in 1986, "that we may well have a European company before we have a European man - surely the first time in history that the juristic person has won the race for existence against his human creator".

This short overview of civil law and commercial law partnerships gives an impression of possible legal forms choosing a partnership approach.

17 Limited partnership (KG) with a limited liability company (GmbH) as general (personally liable) partner ('Komplementär') and the shareholders of the GmbH (alone or with others) as limited partners ('Kommanditist'). It differs from the limited partnership in that the general partner is a 'Kapitalgesellschaft' which in most cases is a GmbH. There is no special Act dealing with this legal form (noteworthy, however, that in the Co-determination Act of 1976, which applies only to 'Kapitalgesellschaften', provision is made in § 4 for the GmbH & Co. KG). See chapter 16, 'GmbH & Co KG'.


20 Dine/Hughes (2004), 1 (32); see Dine/Hughes also for a detailed description of the EEIG at ch. 7.

However, notwithstanding the distinction between civil partnerships and commercial partnerships it must be kept in mind that both fall under the heading of 'Personengesellschaften' in contrast to 'Kapitalgesellschaften'.

2.3.1.2 'Kapitalgesellschaften'

With regard to 'Kapitalgesellschaften' (i.e., companies with a share capital), only the capital participation is, generally speaking, important while personal involvement is not relevant. Furthermore, no personal liability exists and management is carried out by one or more directors in the normal cause of events.

Companies belonging to this category are the 'Aktiengesellschaft', 22 the 'Kommanditgesellschaft auf Aktien', 23 'eingetragene Genossenschaft' 24 and the 'GmbH'.

Compared to the GmbHG, the provisions of the 'Aktiengesetz', 25 which pertain to the AG, are significantly more detailed than those of the GmbH. Moreover, they

22 For a German-English synopsis of the 'Aktiengesetz', see Zschocke, Das deutsche Aktiengesetz/The German Stock Corporation Law (2001). Hereafter the 'Aktiengesetz' will be abbreviated as AktG. This is translated as "Companies Act", however, the term "Stock Corporation Act" is also used by jurists as an interchangeable term.

23 Abbr. KGaA, as mentioned above, it translates as a company limited by shares. Compare the provisions in § 278 et seqq. of the AktG. This form is a mixture between an AG and a KG. As an AG it enjoys juristic personality and consequently the shareholders, known as 'Kommanditaktionäre', are not personally liable for the debts and obligations of the company. Their liability is restricted to the unpaid amounts of their shares.

In addition, like in the KG, the KGaA has at least one general partner whose liability is unlimited (§ 161 et seqq. HGB apply). Cilliers/Benade submit that the KGaG is a similar business form to the 'private company with unlimited concurrent joint and several liability of the directors', cf. Cilliers/Benade, Introduction to Company Law (1985), 3.07 (footnote 42). See also Halasz/Kloster/Kloster, "Die GmbH & Co. KGaA", 2002, GmbHR 77 et seqq.

24 Abbr. eG. This is a registered co-operative. Registered co-operatives play an important role in the agriculture and handicrafts supply and distribution industry as well as in the banking sector. Regarding the European context, see Blomeyer, "Auf dem Weg zur (E)europäischen Genossenschaft", 2000, BB 1741 et seqq.
are to a much greater extent compulsory and offer far less flexibility. The purpose of the AktG is to protect the general public, in particular the investors, since the AG is designed for large enterprises with an indefinite number of shareholders.

2.3.1.3 GmbH

The GmbH was supposed to take the position of a legal entity between the existing partnerships and the AG. Or as Ribbens points out, to "create a type of company midway between a partnership characterised by the *intuitus personae*, and a joint stock company operated on a purely capitalist *intuitu pecuniae* principle."\(^{26}\)

The GmbH was introduced because nineteenth-century legislation on public companies in Germany had become increasingly strict. A need for a limited liability alternative to the AG arose as a result of the reforms effected in the AktG in 1884.\(^{27}\) These reforms made it particularly burdensome and expensive to organize and operate an AG, introducing provisions especially designed for a large enterprise with a constantly shifting body of shareholders.\(^{28}\) It was felt at the time that these provisions were required to prevent the kind of corporate abuses which had arisen during the period immediately following the Franco-Prussian War.\(^{29}\) However, it was also felt that smaller enterprises established by owners personally known to each other and perhaps more committed to a long-term association with the enterprise should not be forced to

\(^{25}\) As mentioned above, abbr. as AktG.

\(^{26}\) Ribbens, 1982, TSAR 50, 53 *et seq.*, citing the Zweigert/ Goldman "Report On the Possibility Of Harmonising Member States’ Legislation On Private Limited Companies (or Similar Bodies)" (1969); cf. Ribbens also *op. cit.* 57.


\(^{29}\) 1870-1871.
choose the vehicle of an unincorporated entity and thereby assume the risk of unlimited liability which accompanies this form of doing business.30

In the process of searching for a suitable answer regarding the legal form, in particular two solutions were proposed. On the one hand the so called individualistic solution,31 aiming at giving small businesses (which often used the legal form of a partnership) some form of limited liability. On the other hand the so called collectivistic solution,32 aiming at a sort of industrial union model.33

To get information from practitioners on these ideas, the Prussian Ministry for Trade and Commerce in April 1888 initiated a request to all Chambers of Commerce34 and Mercantile Associations35 regarding the need for a legal form between the AG and the OHG. The majority of answers were in favour of a new legal form and pointed at the individualistic solution. Taking the proposal of the Council of the Eldest of the Berlin Mercantile Association36 as blueprint, the 'Reichsjustizamt'37 released a draft law in January 1891. With minor amendments this became a bill, subsequently passed the parliamentarian proceedings, strongly supported by MP Oechelhäuser and finally resulted in the GmbHG.38

The GmbH created by the legislature in 1892 was without a predecessor. It was an artificial creation by the legislature,39 a juridical "homunculus",40 intended to fill

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30 Baumbach/Hueck, GmbHG introduction, note 2 et seqq. See also Priester/Mayer (2003), § 1 note 2 for population and industrial statistics of this time.
31 'Individualistische Lösung'.
32 'Kollektivistische Lösung'.
33 Priester/Mayer (2003), § 1 note 8 et seqq., giving interesting information regarding the proposals of MP Oechelhäuser, Esser on one side and Parisius, Ring and Simon/Weber/Riesser on the other side. See also Kübler (1998), 222. Scholz-Westermann, GmbHG introduction, note 45 et seq.
34 'Handelskammern'.
35 'Kaufmännische Korporationen'.
36 'Die Ältesten der Kaufmannschaft von Berlin'.
37 'Imperial Office of Justice', the precursor to the Imperial Ministry of Justice.
38 Priester/Mayer (2003), § 1 note 11 et seq., with further references. See also Scholz-Westermann, GmbHG introduction, note 45 et seq.
39 Schmidt describes the GmbH as „Kunstschöpfung“ (artificial creation), Gesellschaftsrecht (1997), 984.
the gap where the AG, with all its complexity, was not a suitable corporate vehicle and to provide a form of incorporation suitable and acceptable for the small and medium-sized business enterprise. It was shaped as a company requiring a small share capital only, simple to form, easy to administer, designed for a small group of shareholders with close personal ties to each other, not needing easy transferability of their shares, but desiring great flexibility to deviate from the statutory model in order to create an entity tailor-made for their own particular interests.41

The GmbH thus fulfilled a very specific need and filled a gap in the then existing corporate legislation by providing a more flexible limited liability vehicle for the smaller enterprise.42

The GmbH is a 'Kapitalgesellschaft' (i.e., a company with a share capital) and although its basic legal structure shows some resemblance with that of the AG, it can be organized in such a way that it resembles a partnership ('Personen-gesellschaft').43 The variable rules of the Act offer great flexibility. Consequently, the GmbH can be modelled in such a way that it operates as a kind of 'Aktiengesellschaft' or, if emphasis is put on the personal relationship, its structure resembles that of a partnership or something in between these two extreme scenarios.44 Nevertheless, the German legislature "went to considerable length

40 Zöllner, "100 Jahre GmbH", 1992, JZ 381.
41 Baumbach/Hueck, GmbH introduction, note 3.
42 See for numbers of the incorporated GmbHs in these early years, Priester/Mayer (2003), § 1 note 18 et seq. Zöllner, 1992, JZ 381. For a brief explanation on the legal history of the GmbH, see Scholz-Westermann, GmbH introduction, note 45 et seq.; Hachenburg-Schilling, GmbH general introduction, note 1 et seqq.; see also Baumbach/Hueck, GmbH introduction, note 11 et seqq. for more recent developments and at note 31 regarding the legal situation after unification in the former East Germany; Lutter-Hommelhoff, GmbH introduction, note 2 et seq. For some interesting empirical viewpoints, see Limbach, Theorie und Wirklichkeit der GmbH - Die empirischen Normaltypen der GmbH und ihr Verhältnis zum Postulat von Herrschaft und Haftung (1966), 16, 21 et seq. with reference to the proposal of the 'Reichsjustizamt'.
43 See Baumbach/Hueck, GmbH introduction, note 16 et seqq.; Limbach (1966), 22.
44 See Baumbach/Hueck, ibid. See also Ribbens, 1982, TSAR 50, 57 mentioning, in particular, Immenga and his research on the GmbH in the form of a
to invent for the GmbH a terminology different from that of the Aktiengesellschaft".45

The GmbH is also described as to be so flexible that it is possible for it "to adapt to a great extent to the structure of any other type of company" so that already in 1915 it was concluded that the GmbH "is an offene Handelsgesellschaft with limited liability, a Kommanditgesellschaft without Komplementär, an Aktiengesellschaft without shares, a company with one member."46

Schmitthoff, on the other hand, defines the GmbH as a "form of business organization sui generis, a legal person in form and a partnership in essence, economically a hybrid between a company and a partnership".47

Throughout the existence of the GmbH there have been attempts trying to change its provisions. The White Paper,48 proposed in 1971, aimed at reforming the GmbH by creating a GmbH very similar to the AG, was the strongest initiative for amendment.49

45 See Schmitthoff, "New Concepts in Company Law", 1973, The Journal of Business Law 312, 313. For example, the shares in the GmbH are called "Geschäftsanteile" (business interests/shares) and not "Aktien" (stocks) and the managers "Geschäftsführer" (managing directors) and not "Direktoren" (directors), Schmitthoff, ibid.

46 Limbach (1966), 9 and on 10 citing Fränkel, Die Gesellschaft mit beschränkter Haftung (1915), 252, who expresses that the GmbH is able to adapt to a great extent to the structure of any of the mentioned company forms, ("weitgehend die Struktur jeder anderen Gesellschaftsform anzunehmen (...). Die GmbH ist eine offene Handelsgesellschaft mit beschränkter Haftung, eine Kommanditgesellschaft ohne Komplementär, eine Aktiengesellschaft ohne Aktie, eine Gesellschaft mit einem Gesellschafter.").


48 'Regierungsentwurf', document presented by the government, broadly comparable to a White Paper.

49 'Bundestags-Drucksache' (BT-Drs.) 595/71; see with regard to the background of the reform Scholz-Westermann, GmbHG introduction, note 47 et seqq. Note that in this process, i.a., also a company on deposits ("Handelsgesellschaft auf
Due to the strong criticism these ideas received, e.g., "Murder of the GmbH"\textsuperscript{50}, other more lenient drafts were submitted. These drafts finally resulted in the so-called "kleine Reform" (small reform), which came into effect on 1 January 1981.\textsuperscript{51}

In addition to various minor amendments,\textsuperscript{52} other significant amendments addressing accounting, audit and transparency for certain forms of enterprises, in particular the GmbHs, were introduced through the 'Bilanzrichtlinien-Gesetz',\textsuperscript{53} which came into effect on 1 January 1986.

In this context one must also mention the new 'Umwandlungsgesetz',\textsuperscript{54} the 'Insolvenzordnung'\textsuperscript{55} and the 'Gesetz zur Einführung des Euro'.\textsuperscript{56}

\begin{footnotesize}
\begin{itemize}
\item Einlagen') was suggested as an alternative to the GmbH & Co. KG. However, without success; see Arbeitskreis GmbH (ed.), \textit{Die Handelsgesellschaft auf Einlagen – eine Alternative zur GmbH & Co. KG} (1971).
\item Act Regulating the Conversion of Companies ('Umwandlungsgesetz', enacted 1 January 1995; transferring regulations of different Acts into a new one and easing
\end{itemize}
\end{footnotesize}
Notwithstanding these changes, the most important parts of the Act remain unchanged and, therefore, it can be concluded that the GmbH has withstood the test of time.\footnote{57}

Apart from the contributions by the courts and the legal literature concerning the application and interpretation of the Act,\footnote{58} certain statutory rules are also important. For the GmbH, \textit{inter alia}, the Commercial Code,\footnote{59} and the legislation concerning co-determination are also of importance. Co-determination is the involvement of the firm's employees in the decision-making process, and is an important underlying concept in German corporate law. However, not all corporations meet the requirements for co-determination, and there are various Co-determination Acts. The applicability of the Co-determination Acts depends on the kind of business a corporation is engaged in, and the number of its employees.

At this stage it is necessary to briefly explain the concept of co-determination. Co-determination means 'Mitbestimmung'. The traditional structure of a GmbH consists of the managing director(s) and the members. However, a supervisory board may be installed through the articles. Such a supervisory board is

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relevant provisions). So the previous 'Umwandlungsgesetz' of 1969 has been replaced by the new 'Umwandlungsgesetz' 1995. \textit{Cf.} chapter 13.2, 'GmbH'.

Also due to these changes the Act Regulating the Raising of Capital ('Gesetz über die Kapitalerhöhung aus Gesellschaftsmitteln und die Verschmelzung von GmbH', 'Kapital Erhöhungsgesetz', abbr. KapErhG), has been abrogated. The relevant provisions have been transferred to the GmbHG.

\footnote{55} Abbr. InsO (Insolvency Act with the corresponding 'Einführungsgesetz zur Insolvenzordnung', abbr. EGInsO, Introduction Act to the Insolvency Act). Partly enacted already in 1994, now fully in force since 1 January 1999. See chapter 12.2.4, 'Insolvency'.

\footnote{56} Abbr. EuroEG, (also called 'Euro Einführungsgesetz', Euro Introductory Act). In force since 1 January 1999. See chapter 5.2.2, 'Contribution to the share capital'.

For recent developments, see chapter 2.3.1.4, 'Recent developments'.


\footnote{57} 'Handelsgesetzbuch', as mentioned above, abbr. HGB.
\end{flushright}
compulsory for those GmbHs to which one of four Co-determination Acts applies. These Co-determination Acts provide for employee participation at the supervisory board level. They make the creation of a supervisory board mandatory and provide for parity, near-parity or one-third employee representation on such boards.

These Acts are

- 'Montan Mitbestimmungsgesetz 1951' (Coal and Steel Co-determination Act 1951), which is applicable to certain enterprises in the industries of mining and coal and steel production and which creates a so-called parity co-determination;
- 'Mitbestimmungsergänzungsgesetz 1956' (Supplemental Act to the Coal and Steel Co-determination Act 1956), which is applicable to certain holding companies which own enterprises in the industries of mining and coal and steel production and which creates a so-called parity co-determination;
- 'Mitbestimmungsgesetz 1976' (Co-determination Act 1976), which is applicable to enterprises with certain types of legal structures, including GmbHs, which employ more than 2000 individuals and which creates a so-called near-parity co-determination; and
- 'Betriebsverfassungsgesetz 1952' (Shop Constitution Act 1952), which is applicable to enterprises with certain types of legal structures, including GmbHs, which employ more than 500 individuals and which creates a so-called one-third co-determination.60

As far as the just mentioned influence of legal literature in Germany is concerned, it is noteworthy that this literature plays an important part in legal discussions. Comparing the situation in Germany to the one in the United Kingdom, which is as South Africa a country dominated by case-law, Foster makes an interesting observation, stating that "academic legal opinion and, in

general, legal publication and literature hold a much more influential position in Germany than in the UK. In addition he submits, "in the UK it is only rarely that the work of academic writers will be referred to by legal council in a case, and even rarer that a judge or the court will refer to discussion in a legal textbook." He sees the situation in Germany very different, "in that legal academic writing is quoted keenly in courts of all levels (...). The work of highly reputable authors can carry considerable persuasive authority." This authority is so important, "that it would even serve to overrule previous decisions on the matter. Courts frequently refer to and discuss the views of writers, and more so, in fact, in the higher courts when novel points of law are under discussion." One could add that one explanation for this is the fact that in Germany university professors of law, in addition to their regular work, frequently also sit on the bench of higher courts. For the author, coming from a German legal education, such practice seems reasonable, as this discourse helps in answering questions which might arise and promotes progress of law as such.

Regarding the situation in South African company and close corporation law, one gets the impression that parallels to the situation in the UK can be drawn. However, generally, the South African legal system is seen as on the same level with other western countries and its commercial law equipped to deal with highly complicated economic structures.

2.3.1.4 Recent developments

2.3.1.4.1 Developments caused by intra-German influences

Some interesting developments are worth mentioning here concerning the legal surroundings of the GmbH, which attempt to address the diverse needs of businesses.

Foster in German Legal System & Laws (1996), 120 et seq.
Foster, ibid.
Foster, ibid.
Foster ibid.
Because the GmbH could not be used by a number of professions, the solution was thought to be a new Act, namely the 'Partnerschaftsgesellschaftsgesetz'.

The PartGG aims at providing a suitable form for the special needs of the self-employed. The 'Partnerschaftsgesellschaft' is seen as a "sister figure to the OHG".

Keeping in mind the South-African legal discussion regarding the creation of the close corporation, it can be stated that by means of this Act, Ribbens' demand for separate statutes "on the principle of suum cuique" somehow found its way into the minds of German legislators.

It was generally accepted that the PartGG brought an end to the discussion whether certain professional groups, such as lawyers, could practice as a GmbH. However, two landmark decisions, on dentists and lawyers wanting to practice in form of a GmbH, came to a different conclusion.

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66 See chapter 4.2, 'Lawful purpose, certain restrictions'.
67 Abbr. PartGG, (Act on the Partnership Association), Act of 25 July 1994, BGBl. I 1994, 1744, coming into force on 1 July 1995. Compare Schmidt, "Partnerschaftsgesetzgebung zwischen Berufsrecht, Schuldrecht und Gesellschaftsrecht", with interesting alternatives, i.a., describing the situation in Austria, 1993, ZIP 633 et seqq. See Hülsmann, "Welche Gesellschafter sind heute noch 'Partner'?", 1998, NJW 35 et seqq. referring to a 'Bundesgerichtshof' decision (in NJW 1997, 1854) dealing with the question if already existing 'Kapitalgesellschaften' after the introduction of the PartGG may still include the words 'und Partner' or 'Partnerschaft' into their name and be registered accordingly. The 'Bundesgerichtshof' restricted the use of these words now for the PartG. 'Bundesgerichtshof' (abbr. BGH, Federal Supreme Court), is the highest court in Germany in civil and criminal matters, not to be confused with the 'Bundesverfassungsgericht' (abbr. BVerfG, the Federal Constitutional Court).
68 In the South African context it seems that the problems of professions were already solved in 1968 with the introduction of s 6 (b) Companies Act, creating a special kind of private company catering for the needs of the professions. See chapter 4.2, 'Lawful purpose, certain restrictions'.
69 Discussed in chapter 3.3.1.3, 'Close corporation' in this thesis.
70 Ribbens, 1983, TSAR 118, 125.
Arguing that Article 12 of the 'Grundgesetz' also grants juristic persons the right to freely choose a profession ('freie Berufswahl') the BGH had no objection allowing dentists to practise as a GmbH.

As a reaction to this ruling, a number of federal states have expressly prohibited medical professionals from practising as a GmbH.

The 'Bayerisches Oberlandesgericht', referring to the above-mentioned Federal Supreme Court judgement and the new 'Bundesrechtsanwaltsordnung', concluded that lawyers were permitted to practise as a GmbH, provided that certain conditions were met.

Due to the ruling of the BayObLG, which was especially interesting for lawyers, a new situation arose. To avoid legal uncertainty, the Federal Government reacted and promulgated legislation, permitting lawyers to practise as a GmbH beginning 1 March 1999. This company form is known as the 'Anwalts'-GmbH.

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71 Abbr. GG (Constitutional Law).
72 As explained above, the Federal Supreme Court, ('Bundesgerichtshof', abbr. BGH).
73 BGHZ 124, 224 et seqq. = 1994, GmbHR 325 et seqq.
74 Cf. Dauner-Lieb, "Durchbruch für die Anwalts-GmbH?", 1995, GmbHR 259, 261 footnote 41 with further references.
75 Bavarian High Court, abbr. BayObLG, higher regional court of appeal in the province of Bavaria.
77 BayObLG, 1995, GmbHR 42 et seqq.
The GmbH is only affected indirectly through the 'Gesetz für kleine Aktiengesellschaften und zur Deregulierung des Aktienrechts'. The objective of this Act is not to create a new legal form, but rather to give medium-sized enterprises an incentive to choose the AG as their business form in deregulating company law for small stock corporations. This allows easier access to capital resources for medium-sized enterprises and further simplifies listing on the Stock Exchange for them. By means of amendments to the AktG a number of provisions, dedicated to AGs which do not trade on the Stock Exchange, were simplified. Therefore this new Act allows single member AGs. Furthermore it:

(1) eases many of the formal procedures governing company meetings;
(2) improves shareholders’ right to dividend by limiting the Board of Directors right to retain funds for reinvestment; and
(3) reduces employee participation in companies with less than 500 employees.

As a result one must now distinguish between the 'public AG' and the 'kleine AG' (small AG), respectively, listed and non-listed AGs. Whether the 'kleine AG' can become a serious competitor for the GmbH remains to be seen. However, as a result of these developments, plans to open the GmbH for trading at the Stock Exchange have lost their relevance.

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82 Milman (1999), 30.
84 Cf. Lutter-Hommelhoff, GmbHG introduction, note 13; Scholz-Westermann, GmbHG introduction, note 73.
To mention are also some developments on the European company law level which directly or indirectly have an influence on German company law and/or the GmbH respectively.

2.3.1.4.2.1 European Company Law

When discussing company law in Europe one has to keep in mind that there is no European company law as such, but that company law in Europe is essentially the national law of the Member States. There are some Treaty provisions that directly affect company law, while the European Community has enacted secondary legislation directed, most of the time, to national legislators.85 Wymeersch states that "paradoxically, the harmonisation mandate was interpreted by the founding member states as allowing the introduction of a cartel like mechanism, whereby 'harmonisation' was used as an instrument for reducing competition among the states and forbidding them to offer more flexible, less taxing requirements."86 Traditionally, and according to the harmonisation philosophy, the European Community mainly addressed the larger companies, i.e., the public companies limited by shares. Therefore in several Directives the private companies (those comparable to the GmbH) were not addressed.87

85 Wymeersch in Ferrarini et al., Reforming Company and Takeover Law in Europe (2004), 145, 160. See also Hopt, "Company law in the European Union: Harmonisation and/or subsidiarity?", 1999, ICLJ 41, 45 et seqq. for the influence of national company law on European company law. Regarding the possibility of a legal doctrine of European company law, see Schön, "The concept of the shareholder in European company law", 2000, EBOR 3, 8 et seqq.
86 Wymeersch in Ferrarini et al. (2004), 145, 162.
87 Wymeersch in Ferrarini et al. (2004), 145, 171. The objective of the Directives is diverse, the Second, Third, and Sixth Directives are applicable to public companies limited by shares only. The Accounting Directives (Forth and Seventh) apply to all active companies, while the First and the Eleventh (branches) apply to public companies limited by shares and to GmbH types of companies. The Twelfth Directive on one man companies applies to GmbH types of companies only.
Within this European context it is noteworthy that the programme for harmonisation of company law envisaged the completion of the co-ordination of company laws by the end of 1963.\(^88\) This objective has not been achieved so far, some 40 years later. The attempt to harmonise company law has encountered substantial problems.\(^89\)

The difficulties of harmonisation is shown, e.g., in the fact that only after more than three decades of discussions on the European level, the *Societas Europaea*\(^90\) finally became available as legal form.\(^91\) According to article 70, the Council Regulation came into force on 8 October 2004.

By means of this Regulation, an optional business vehicle for companies with some presence in more than one Member State has been provided.

The *SE* can be seen as a public limited-liability company governed by the law of the Member State in which it has its registered office.\(^92\) The *SE* can be characterised by different elements, (1) the *SE* is a supranational legal form with national roots, (2) the incorporation of an *SE* is characterised by a mandatory cross-border element, (3) the *SE* is designed for large enterprises with a certain minimum size which may be quoted on the exchange by giving a minimum


\(^{89}\) For reasons, see Dine/Hughes (2004), 1 (8). The relevant provisions regarding Company law harmonisation are Art 3(1)(c), Art 3(1)(h), Art 43(3)(g), Art 44, Art 94, Art 95 of the Treaty of Rome (EC Treaty).

\(^{90}\) Abbr. *SE*.


\(^{92}\) Article 3 of the Council Regulation.
capital of 120,000 Euros, (4) the corporate structure offers the choice between two systems (one-tier and two-tier board).93

However, aiming for a Community-wide acceptance of common principles and rules, an increasingly complex apparatus has emerged, created mainly via Harmonisation Directives.94

Thus, the Commission's approach to company law harmonisation has been criticized.95 However, harmonisation is seen as important to avoid the ‘Delaware effect’. This means that companies will look for the least regulated environment. In the United States they found this environment in the state of Delaware. This

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94 Wymeersch in Ferrariini et al. (2004), 145, et seq., see footnote 1 for further references regarding criticism of the harmonisation policy pursued.

95 Dine/Hughes (2004), 1 (10).
state has attracted many companies, including many of the largest in the States to incorporate there, regardless of where their operations are based. The reasons for this are low taxes and maximum flexibility in the applicable state laws regarding company operations.96

As early as 1968, the six (founding) Member States signed the Convention on the Mutual Recognition of Companies and Legal Persons,97 which was based on Art 220 of the EC Treaty (now Art 293 EC). However, this Convention never became law.98

Also worth mentioning is that the Commission is working on a Draft proposal for a Fourteenth Directive. This Draft Directive deals with the movement of companies from one jurisdiction to another. The attempt is to permit companies to transfer their registration or ‘de facto head office’ from one Member State of the EU to another.99

The Commission is also considering the extension of the Second, Third and Sixth Directives to private limited companies and has commissioned a study on these matters.100

96 This is also seen as a ‘race to the bottom’, Dine/Hughes (2004), 9 (28); also at 1 (11).
98 See for the background Dine/Hughes (2004), 1 (30).
100 Dine/Hughes (2004), 1 (41). The Second Directive lays down minimum requirements for the formation of the company and the maintenance, increase
However, as Ferran states, "from the foundation of the European Community, company law has been regarded as having an important role to play in promoting economic integration. Alongside this, and linked to it, early European initiatives in company law were characterised by a paternalistic desire on the part of the lawmakers to protect those who dealt with companies from the dangers that lurked in such activities. Europe-wide co-ordination of these protections was required, it was thought, as a response to the spreading activity of companies outside their national borders."\(^{101}\) The development of company law has also been described by him as follows: "After an initial burst of enthusiasm in the 1960s and 1970s for the creation of harmonised European company laws, things slowed down considerably. Whilst there were some new company law initiatives in the 1980s many of these tended to be narrowly focused. In the 1990s European company law stagnated virtually to the point of standstill. The adoption of the European Company Law Statute in 2001, although a noteworthy event in itself, is not something that we should regard as signalling a reversal of the trend."\(^{102}\)

Regarding harmonisation, Hertig/McCahery submit that EU company law "can be viewed largely as an incomplete and rather ineffective set of provisions."\(^{103}\) Dine/Hughes state that, \textit{inter alia}, the "mode of harmonisation by Directive will not create a completely uniform set of laws and a completely 'level playing field'."\(^{104}\) They see the Directives as too detailed and inflexible. In addition, the harmonisation by Directive has been unable to create a 'European outlook' for companies and is unlikely to do so, "because implementation is by incorporation into domestic laws."\(^{105}\) Seeing the EEIG as an alternative approach, they submit "that a European Company Statute introduced by Regulation could achieve

\begin{itemize}
  \item and reduction of capital. The Third Directive regulates mergers between companies where the assets and liabilities of the acquired company are simultaneously transferred to the acquiring company. The Sixth Directive covers the division of an existing company into entities.
\end{itemize}

\(^{101}\) Ferran in Ferrarini \textit{et al.} (2004), 417, 420.
\(^{102}\) Ferran, \textit{ibid}.
\(^{103}\) Hertig/McCahery in Ferrarini \textit{et al.} (2004), 21, 24.
\(^{104}\) Dine/Hughes (2004), 2 (20).
\(^{105}\) Dine/Hughes, \textit{ibid}.  

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harmonisation in the sense that all countries would have available the same basic structure for a company."\textsuperscript{106} They see the SE as unlikely to achieve this aim, because the laws of the Member States are relied on heavily to fill in gaps left by the Statute. As a good example for the strengths and weaknesses to create a framework for corporation law the EEIG is mentioned, where, \textit{inter alia}, one major difficulty was worker participation.\textsuperscript{107} However, measures in connection with worker participation also played an important part in the discussion surrounding the creation of the SE.\textsuperscript{108} The deadlock in, \textit{inter alia}, this field even led to the installation of a Working Group and a subsequent report.\textsuperscript{109} The final text of the Directive\textsuperscript{110} is seen as an "even more diluted version of the recommendations of the Davignon Group."\textsuperscript{111}

\subsection*{2.3.1.4.2.2 Competition between jurisdictions}

Within the European Union context, the combination of new decisions by the European Court of Justice (ECJ) and the legislative blockage in the EC's company law harmonisation program\textsuperscript{112} has stimulated considerable interest in

\begin{footnotesize}
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\item[106] Dine/Hughes, \textit{ibid.}
\item[107] Dine/Hughes (2004), 7 (1), other problems mentioned are tax and insolvency regulations.
\item[108] Dine/Hughes (2004), 9 (4 et seqq.).
\item[109] Davignon Group Report, (named after its Chairman), see the report at Dine/Hughes (2004), A9 (2). For a detailed overview regarding the worker participation in the Member States in the administrative or supervisory bodies and works councils, see the Davignon Group Report, Annex III. The Group took as a starting point the importance of the involvement of the workforce in company decision-making, "globalisation of the economy and the special place of European industry raises fundamental questions regarding the power of social partners within the company. The type of labour needed by European companies – skilled, mobile, committed, responsible and capable of using technical innovations and of identifying with the objective of increasing competitiveness and quality – cannot be expected simply to obey the employer’s instructions. Workers must be closely and permanently involved in decision making at all levels of the company," Davignon Group Report, para 19.
\item[111] Dine/Hughes (2004), 9 (7).
\end{enumerate}
\end{footnotesize}
the competition between jurisdictions. While the real seat doctrine continues to restrict firm mobility, the ECJ’s recent judgements in Centros, Überseering and Inspire Art may, in the short term, encourage the introduction of competitive lawmaking within the European Union.\textsuperscript{113} In the Centros Case it was decided that companies formed in accordance with the law of a member state and having their registered office, central administration or principal place of business within the Community are entitled to carry on their business in another Member State through an agency, branch or subsidiary. The Court ruled that the mere fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other member states cannot, in itself, constitute an abuse of the guaranteed right of establishment. Neither does the fact that the company does not conduct any business in the Member State in which it has its registered office and pursues its activities only in the Member State where its branch is established.\textsuperscript{114} 

\textsuperscript{113} However, the Thirteenth Directive has been adopted in the meantime, Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, Official Journal No. L 142/12 of 30 April 2004.

In the Überseering case the Court ruled that a company incorporated in the Netherlands with only German shareholders, cannot be denied legal standing in German courts and cannot be required to re-register as a German company solely because it has moved its real seat from the Netherlands to Germany.\textsuperscript{115}

The Inspire Art case deals with an English limited company, which set up a branch in the Netherlands without engaging in activities in the UK. A specific Dutch Act imposes various obligations on a company with legal personality formed under laws other than the laws of the Netherlands and carries on its activities entirely or almost entirely in the Netherlands and has no real connection with the state in which jurisdiction it was incorporated. A formally foreign company, therefore, is registered in the Netherlands and has legal standing there, and is subject to certain provisions of Dutch company law. The Court ruled that certain disclosure requirements under the Dutch Act are contrary to

the disclosure requirement for branches as laid down in the Eleventh Directive.\textsuperscript{116}

In commenting on the judgements, Winter sees a potentially far-reaching effect. In his view the judgements create a clear competitive advantage for the Member State of which the company law is less restrictive. So "nobody wishing to start a small business in, for example, the Netherlands or Germany needs to set up a Dutch or German company subject to strict minimum capital and capital maintenance rules and relatively severe penalties for directors for non-compliance; one can incorporate an English limited company and do business in the Netherlands or Germany without these burdens. It is to be expected that at least for this lower end of the market for incorporations, a distinct level of competition between the company laws of Member States will follow."\textsuperscript{117}

This development has to be seen before the background that under the real seat doctrine, which is followed by most Member States, a corporation must be incorporated in the Member State where it has its central administration. Therefore these decisions "could be setting the stage for (...) competition among Member States by their undermining of the real seat doctrine."\textsuperscript{118}

However, it is submitted that the seat doctrine is "invalidated only in as far as freedom of establishment is concerned, not for other purposes" and that it will


\textsuperscript{117} Winter in Ferrarini \textit{et al.} (2004), 3, 10 \textit{et seq}. See Winter also at footnote 9 where he refers to Mr. Donner, the Dutch Minister of Justice, who had expressed that the Netherlands should have the ambition to try to win the competition with legal forms of other states. For the question of whether such companies must comply with the German co-determination, see Müller-Bonanni, "Unternehmensmitbestimmung nach 'Überseering' und 'Inspire Art'", 2003, \textit{GmbHR} 1235 \textit{et seqq}., arguing that by transferring their seat to Germany they do not fall under the scope of German co-determination laws, at 1238.

\textsuperscript{118} Hertig/McCahery in Ferrarini \textit{et al.} (2004), 21, 25. In note 26 they claim that in this context, "the UK could become the leading jurisdiction for European incorporations."
serve as the "connecting factor for specific legal issues, including the connecting factor for non-EU companies."\textsuperscript{119}

Regarding the certainly expected competition between jurisdictions, Wymeersch foresees development in the field of harmonisation. "On the one hand, Member States with the highest degree of regulation will undoubtedly call for more harmonisation in Europe. This will meet with opposition from Member States with less rigorous company law burdens. The final outcome of competition (...) might well be more regulation."\textsuperscript{120}

Dealing at length with whether and in which way company law interventions should take place regarding unlisted companies, Wymeersch argues that intra-European mobility should be formally introduced. He claims that "the recent developments in ECJ case law, even if welcomed, still leave too much room for discussion and yield too little legal certainty."\textsuperscript{121}

Regarding competition and harmonisation, Winter concludes that "the original legislative approach to harmonise company laws in Europe in order to avoid ‘bad’ competition between Member States, has been supplemented by a judicial approach explicitly allowing for competition between the company laws of Member States."\textsuperscript{122}

\textsuperscript{119} Wymeersch, "Company law in the twenty-first century", 2000, ICCLJ 331, 339. To create more competitiveness for their companies Dubovizkaja claims that countries with the seat doctrine should abolish this doctrine, Dubovizkaja, 2003, GmbHR 694, 698. In addition, she argues that in order to prevent frequent problems with companies from non-EU countries, Germany should also not apply the seat doctrine in this context, 697. Spindler/Berner, 2003, RIW 949, 956 referring to two judgements on the federal level, already see such a development of moving away from the seat doctrine (the mentioned judgements are BGH, 2003, RIW 473; BFH, 2003, RIW 627).

\textsuperscript{120} Wymeersch, 2000, ICCLJ 331, 340. Similar expectations found by Spindler/Berner, 2003, RIW 949, 955. For competition between company law makers and the practical problems within the European context, see also Hopt, 1999, ICCLJ 41, 49 et seqq.

\textsuperscript{121} Wymeersch in Ferrarini et al. (2004), 145, 182.

\textsuperscript{122} Winter in Ferrarini et al. (2004), 3, 13.
However, as can be seen with the various commentaries on the ECJ judgements and its implications on German company law, implications for the GmbH are also being discussed.

In this context it is even stated that the Überseering decision will be the "beginning of the end of the German GmbH".\textsuperscript{123}

After the Überseering decision of the ECJ the numbers of new English Limiteds jumped from a two weekly ca. 5,500 to ca. 7,000 incorporations and after the recent Inspire decision are expected to rise again.\textsuperscript{124} Since the end of 2002 nearly 20,000 English private companies limited by shares (Ltd) with central administration in Germany have been founded.\textsuperscript{125}

Accordingly, now the GmbH as a legal structure for business entities not only has to compete with homemade challenges but increasingly also with foreign competitors.

In addition, it will be interesting to see in which way the developments on the European level will have implications for the minimum share capital in the GmbH. However, in this regard it is important to keep in mind that one country’s specific legal instruments are the result of its own developments, be it in each country’s cultural, social, economic and, last but not least, legal environment. So, e.g., for an outside spectator a debate on minimum share capital may seem completely unnecessary and outdated. In the German framework it is, however, important to note that in the context of company law it is clear that minimum capital requirements are a central institution of creditor protection in Germany. Historically interesting to note is that when the GmbH was created, the minimum share capital was 20,000 Goldmark. On quarter, at least 250 Goldmark, of every cash-contribution had to be paid up. Minimum capital provisions were introduced through the legislator "in order to prevent that companies without any seizable

\textsuperscript{123} Hirte, "Wettbewerb der Rechtsordnungen nach 'Inspire Art': Auch das Beurkundungserfordernis für GmbH-Anteilsübertragungen steht zur Disposition", 2003, GmbHR R 421, "Anfang vom Ende der deutschen GmbH".

\textsuperscript{124} Hirte, 2003, GmbHR R 421.

\textsuperscript{125} Schall/Westhoff, "Warum Deutschland eine neue Kapitalgesellschaftsform braucht", 2004, GmbHR R 381.
fortunes step into life and to create a certain guarantee regarding the seriousness of the participation."\textsuperscript{126}

The provisions of German corporate law protecting creditors are fairly strict by international standards and German courts have developed considerable case law, in particular relating to the corporate form of the GmbH, in order to safeguard that the statutory minimum capital of 25,000 Euros actually is paid up and not, at a later stage, repaid.

Therefore in Germany the idea that a company must have a minimal fund as a guarantee of payment and as a compensation for its limited liability is so firmly embedded that it seems difficult to imagine a system which operates without it. This attitude exists even though it is also acknowledged that 25,000 Euros for a private limited company is not more than an indication of seriousness.\textsuperscript{127} In addition the minimum capital cannot be conceived as a guarantee capital, because it is at the same time meant to be the working capital of the company, thus creating a contradiction. Therefore the minimum capital requirement nowadays is seen as being inadequate to assure a satisfaction of the claims of creditors in the company's insolvency.\textsuperscript{128} Taking the developments on the European level as starting point, Kallmeyer criticizes a number of financial provisions for the GmbH, i.a., minimum share capital, and makes suggestions for a reform aiming at an adjustment of financial regulations.\textsuperscript{129}

\begin{minipage}{\textwidth}
\footnotesize
\textsuperscript{126} "Um zu verhüten, dass die Gesellschaften ohne jedes greifbare Vermögen ins Leben treten und um eine gewisse Garantie für die Ernstlichkeit der Betheiligung zu schaffen," Entwurf I, Amtliche Ausgabe, 1891, p. 54, cited according to Thomas/Wachter, "Kapitalaufbringung bei der Bargründung einer GmbH in Europa", 2002, GmbHR 17; Wachter, "Frankreich: Die 'Ein-Euro-GmbH' ab 2004", 2003, GmbHR R 377, 378. The words 'regarding the seriousness of the participation' (Ernstlichkeit der Betheiligung), aim at the activities of the partners involved.


\textsuperscript{128} Wachter, 2004, GmbHR 88, 97.

\textsuperscript{129} Kallmeyer, "Bereinigung der Finanzverfassung der GmbH – Vorschlag für eine GmbH-Reform", 2004, GmbHR 377 et seqq., already suggesting certain changes in specific paragraphs, at 381 et seqq. See also Wachter, 2004 GmbHR 88, 96 et seqq.
\end{minipage}
Heckschen also acknowledges problems with the existing minimum capital regulations. However, he sees the basic idea behind this concept in the well-understood own interest of the incorporator and argues that an entrepreneur, who together with his partners is not capable to raise 12,500 Euros, should consider carefully whether entrepreneurship comes not a little bit too early for him. Therefore this modest financial border-line has got a positive impact on those who might be too fast and too ill-advised with their business idea.\(^{130}\) Schall/Westhoff argue that an existing system of creditor protection cannot easily be put aside. Being in itself a relatively balanced system, selective interventions and abolitions of regulations would cause complications. Therefore they even suggest a new company form.\(^{131}\)

Regardless of the discussed problems, Bayer speaks out explicitly in favour of the existing system of raising and maintaining of capital in the GmbH.\(^{132}\)

Notwithstanding the above-mentioned "pessimistic opinions" voicing the end of the German GmbH, this development is also seen as a historic challenge for the GmbH.\(^{133}\) Subsequently, it is called upon to actively take part in the competition of legal systems caused by the ECJ judgements and react adequately so that the GmbH remains competitive.\(^{134}\) As mentioned, some argue even in favour of a new company form.\(^{135}\)

However, there is also opinion strongly bashing the ongoing debate in which the English limited company is claimed to be superior to the GmbH, arguing that the advantages and disadvantages must be clearly outlined.\(^{136}\) It is argued that in the discussion favouring the English limited company only the advantages are being published, while the disadvantages are not being mentioned.\(^{137}\) Thus, for

\(^{130}\) Heckschen, 2004, GmbHR R 25, 26.
\(^{131}\) Schall/Westhoff, 2004, GmbHR R 381 et seq.
\(^{133}\) Wachter, 2004, GmbHR 88 et seqq.
\(^{134}\) Hirte, 2003, GmbHR R 421. See also Kallmeyer, "Das Eigenkapitalersatzrecht vor dem Hintergrund von Centros und Überseering", 2003, GmbHR R 93 et seq.
\(^{135}\) Schall/Westhoff, 2004, GmbHR R 381.
\(^{137}\) Heckschen, 2004, GmbHR R 25. For a comparison, see also Wachter, 2004, GmbHR 88, 91 et seqq.; Ebert/Levedag, "Die zugezogene private company
example, it is not mentioned that this form of incorporation is frequently sought after
- by entrepreneurs wishing to establish a craft workshop yet neither is qualified as master craftsman nor wishing to employ one,
- companies, to be operated by a director-shareholder, who cannot even make the appropriate declarations according to § 6 GmbHG because of relevant previous convictions,
- companies, which are right from the outset created with a high insolvency risk and which hope to evade the punishment for failing to file an insolvency motion by the stated deadline.138

Taking these constellations into account, Heckschen submits that there is no need to fundamentally question the German GmbH law and it is not foreseeable that the English limited company will take market shares of the GmbH on a noteworthy scale.139

Nevertheless, the possibility is seen that the English company forms, with London being the bridgehead for Americans in Europe, and the Irish company forms (Celtic Tiger) will become the most desirable company forms in the European market. The result of the race to the bottom could be the UK and Ireland being a sort of a European Delaware.140

Nevertheless, it will be interesting to see how these developments will effect the GmbH. In this regard also changes in other countries with a GmbH-history might be instructive.
Spain, e.g., with legislation from 2 April 2003 introduced the Flash-GmbH, a new company,141 which grants GmbH founders the right to be registered in the


141 Sociedad Limitada Nueva Empressa, relying on GmbH features but easing various provisions, aiming at small and medium-sized businesses.
commercial register within 48 hours after setting up the articles in notarial form. The minimum capital must be 3,012 Euros, the share capital is 12,200 Euros.\textsuperscript{142}

The legislator in France also reacted, enacting on 1 August 2003 the French Flash-S.A.R.L.\textsuperscript{143} Through modifications of the existing legislation it is now possible in France to establish a GmbH with only one Euro share capital. In addition, various provisions were eased.\textsuperscript{144} Accordingly, it might also be possible to use the French S.A.R.L. as a substitution for a GmbH.\textsuperscript{145}

Regarding other foreign companies it is, however, also worth mentioning that for the Dutch "Besloten Vennootschap met Beperkte Aansprakelijkheid", as alternative to the GmbH, only minor advantages are seen.\textsuperscript{146}

In this context it is interesting to note developments in South African company law. Following the example of the close corporation, also for the company solvency and liquidity regulations have been implemented in the CA. As stated "the Companies Amendment Act 37 of 1999 radically changed the capital

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maintenance rule and the perceived protection it afforded creditors. As reason for this change they explain that "experience has shown that capital maintenance is not only an imperfect way to protect creditors, but that the rules (mostly English common law) that applied the principle were notoriously imprecise and uncertain."147

Therefore, change is also inevitable in the German GmbH law. Accordingly, the Federal Government proposed a bill on 1 June 2005 on the reform of the GmbH law. Reflecting the above mentioned cultural background, the bill recommends some change in the minimum share regulations, however, only until a certain degree and aims to reduce the minimum capital from 25,000 Euros to 10,000 Euros. In a second step, at a later stage, the liability for managing directors of financially shaken GmbHs will be tightened.148

Looking at the reform process in Company law taking place in many countries with German eyes, it is always especially fascinating and interesting to see how the legal community of former and current Commonwealth countries, given their common heritage, interacts and relies on a wide spectrum of legal opinion and court cases when solving legal problems. Perhaps, on a much smaller scale, some sort of interaction could also happen now, if in changing the German GmbH law,149 the search for solutions would also take into account the above-mentioned developments in the world wide "GmbH-Commonwealth".

However, on the German side, the ECJ decisions force the legislator to think about deregulation of the GmbH law. In the European context, only a slim GmbH

147 Cilliers et al., Entrepreneurial Law (2000), 17.03. See, e.g., the new ss 85 and 90 CA.
148 See http://www.bmj.bund.de/media/archive/950.pdf.
149 Merkt sees a growing pressure on the continental company laws and especially the German regulations, Merk, "Die Pluralisierung des europäischen Gesellschaftsrechts", 2004, RIW 1, 7. Not in connection with these developments are the proposed changes of the legislator to bring in line regulations, i.a., of the GmbHG regarding statutes of limitation, with changes already implemented in the Civil Code, Krämer, "Bundesregierung plant verjährungsrechtliche Änderungen im GmbH-Gesetz", 2004, GmbGR R 361 et seq. For an interesting comparative viewpoint regarding the worldwide quest for an ideal legal form for small businesses, see Rider/Andenas (eds.), Developments in European Company Law – The Quest for an Ideal Legal Form for Small Businesses (1999).
law is competitive, \textit{i.e.}, a modern conception, which on one hand does not lower the substantial safeguarding provisions for creditors and minority members and on the other side eliminates all regulations which are experienced in practice as being too complicated and have possibly lost their original meaning today.\textsuperscript{150}

2.3.1.4.2.3 \textit{High Level Group of Advisors}

Also noteworthy in the European level context is that in September 2001 the European Commission established a High Level Group of Advisors on company law.\textsuperscript{151} This group was charged with making proposals for resolving the then current impasse on developing a Directive on Takeovers, intended to facilitate, \textit{inter alia}, cross-frontier restructuring of European industry in implementation of the Lisbon European Council remit. The Group reported its recommendations in January 2002\textsuperscript{152} and then moved on to consider wider aspects of European company law and corporate governance, issuing a Final Report on those in November 2002.\textsuperscript{153} Matters considered by this Group were, \textit{inter alia},

\textsuperscript{150} Bayer, 2003, BB 2357, 2366.

\textsuperscript{151} Also known as the Winter group, after its Chairman Professor Jaap Winter; see European Commission, \texttt{press release} IP/01/1237 of 4 September 2001, "Company law: Commission creates High Level Group of Experts". See also Rickford (ed.) (2003), 5 \textit{et seq}. The previous Company Law SLIM Working Group (SLIM stands for Simpler Legislation for the Internal Market) had the task to identify simpler legislation for the existing First and Second Company Law Directives; see Dine/Hughes (2004), 1 (64 \textit{et seqq}.). Cf. also Winter in Ferrarini \textit{et al.} (2004), 3 \textit{et seqq.}, also at 14 \textit{et seqq}. See for the various recommendations of the SLIM Working Group published in 1999, \texttt{ZIP} 1944 \textit{et seqq.} with comment from Neye.


recommendations on free movement of companies, which largely anticipated ECJ’s decisions later in 2002, and on the freedom of choice in board structures. The work of the Winter Group took place in the context of a series of corporate scandals in the USA, including, for example, the collapse of Enron Corporation and Worldcom Inc.\textsuperscript{154}

Among its many suggestions and recommendations, The High Level Group of Company Law Experts, \textit{inter alia}, also sees the need for a European Private Company (EPC), focused on small and medium sized businesses, which could be used to facilitate cross-border activities and is based mainly on contractual freedom.

However, the High Level Group also recommends a feasibility study before the Commission decides to submit a formal proposal in this regard.\textsuperscript{155} Winter himself, however, describes it this way, "we expressed strong hesitations to the concept of introducing a Statute for a European Private Company, offering a European legal form particularly suitable for small and medium sized business. Although we acknowledged that the need for such a legal form is expressed widely, in the light of the experience with the creation of the SE Statute we doubted whether Member States could realistically agree on an EPC Statute that would really add value."\textsuperscript{156}

\textsuperscript{154} For an assessment of these proposals on the improvement of social welfare in general and whether they have a desirable effect on companies, see Hertig/McCahery in Ferrarini \textit{et al.} (2004), 21, 29 \textit{et seqq}.

\textsuperscript{155} Press release from 4 November 2002.

Following closely recommendations from the second report of The High Level Group, in May 2003, the European Commission launched an action plan entitled "Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to move Forward". In the meantime, i.a., the proposed feasibility study has been brought on its way by the Commission and is planned to be finished in summer 2005.

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For a critical overview of the European Commission proposals, see Lannoo/Khachaturyan, "Reform of corporate governance in the EU", 2004, EBOR 37 et seqq. Also Hertig/McCahery, "Company and takeover law reforms in Europe: Misguided harmonisation efforts or regulatory competition?", 2003, EBOR 179 et seqq. For criticism regarding the Commissions consultations in the corporate governance context and also a planned forum Becker, "Kritik an der Art der Konsultation hinsichtlich der Corporate Governance", 2004, GmbHR R 317.

2.3.1.4.2.4 Good governance

Following the various corporate scandals of Enron, WorldCom etc. in the United States, which led to the introduction of the Corporate Accountability Act in July 2002 to regulate corporations and corporate governance,\textsuperscript{159} the smooth functioning of corporate governance in European companies was also questioned. Therefore reform initiatives also took place in European countries. In Germany a Government Commission had the task of making suggestions regarding good governance. This led to legislation sanctioning a new "comply or explain" corporate governance code which came into effect in August 2002.\textsuperscript{160}

Even though this discussion is mainly aimed at public (limited) companies, it indirectly influences corporate governance in other business entities such as the GmbH. Therefore corporate governance codices are also brought into discussion for medium-sized businesses.\textsuperscript{161}

The German Code applies to German listed companies. It recommends, however, that non-listed companies observe the German Code as well.\textsuperscript{162}

\textsuperscript{159} In full the Public Company Accounting Reform and Investor Protection Act, 107th US Congress, 2nd Session, HR3763, 30th July 2002. Known also as "Sarbanes/Oxley Act".


\textsuperscript{161} Cf. also Hommelhoff, "Die OECD-Principles on Corporate Governance - ihre Chancen und Risiken aus dem Blickwinkel der deutschen corporate governance-Bewegung", 2001, ZGR 238, 263. For the revised 2004 OECD Principles of Corporate Governance, see http://www.oecd.org/dataoecd/32/18/31557724.pdf.

\textsuperscript{162} Bernhardt, "Corporate governance für den Mittelstand?", 2003, DB 1.

The Code will be reviewed and adjusted yearly as necessary on the basis of national and international developments. The German Code is comprised of the following seven chapters: (1) Foreword; (2) Shareholders and General Meeting; (3) Cooperation between Management Board and Supervisory Board; (4) Management Board; (5) Supervisory Board; (6) Transparency; (7) Reporting and Audit of the Annual Financial Statements.

The regulations of the German Code are divided into three categories: (1) passages that only repeat German law already in force, (2) recommendations for the organs of companies, which are marked in the text by the use of the word "shall," and (3) "soft suggestions" for which the German Code uses the words "should" and "can."163

In connection with such a code and self-regulation it is interesting that a historic explanation is given of why self-regulation developed in common-law countries and not in civil-law countries.164 It is argued that "already decentralized, the English legal system furthered the decentralization of power elsewhere in society and thereby assisted the growth of a market economy, in part by referring the inevitable commercial disputes to persons independent of the sovereign or the bureaucracy under his control. Decentralization in turn made possible private law-making and the growth of self-regulatory bodies. Ultimately, this in turn facilitated the development of market-based institutions, such as

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164 Coffee, "The rise of dispersed ownership: The roles of law and the state in the separation of ownership and control", 2001, 111 Yale L.J. 1 et seqq.
stock exchanges, and enabled them to adapt and to gain the trust of their customers."

Regarding corporate governance, numerous books and articles have been written about advantages and disadvantages of different corporate governance models. Given the scope of this study only a short overview is possible. However, it must be pointed out that there is not just one globally suitable corporate governance model. On the contrary, as mentioned above, every jurisdiction must develop its own structure based on each country's cultural, social, economic and, last but not least, legal environment.

In this context interesting comparisons regarding corporate governance in various countries are being made, especially between the USA and Germany reflecting quite diverse corporate models.

Referring to the corporate scandals, Stamm argues that corporate failures are not endemic to the U.S. or rooted in Delaware corporations law, he sees especially cultural differences. In addition he notes that "large options packages in U.S. corporations entice managers to manipulate the stock price. In

165 Coffee, 2001, 111 Yale L.J. 1 at 61.
166 See, e.g., for a comparative discussion, Cheffins, "Current trends in corporate governance: Going from London to Milan via Toronto", 1999, 10 Duke J. of Comp. & Int’l L. 5 et seqq. Regarding corporate governance from other perspectives, see Singh, "Corporate governance, corporate finance and stock markets in emerging countries", 2003, JCLS 41 et seqq. dealing with various approaches towards the "nascent literature on corporate governance in emerging markets", p. 71. Kim, "Toward the 'best practice' model in a globalizing market: Recent developments in Korean corporate governance", 2002, JCLS 345 et seqq., suggesting that the Korean effort may provide a good model for other emerging economies of an economic and social development toward the establishment of the best practice by global standards, particularly because private sector development programs of international organizations have mandated the new system. See also Hacimahmutoglu, "The system of corporate governance: A Turkish perspective", 2002, ICCLJ 309 et seqq. For the internet influence on corporate governance, see Noack/ Beurskens, "Internet influence on corporate governance", 2002, EBOR 129 et seqq.

Germany, lower executive pay and fewer options give managers less of an incentive to manipulate.  

Furthermore, he states that "the perceived goal of the German corporation is not profit alone." He refers to an interview cited in 'Der Spiegel' (major weekly news magazine) in which the head of a major German company stated that German companies are unlikely to accept "Anglo-Saxon cold capitalism, which exclusively focuses on maximizing profits, [because it] will lead to a crisis in our system and to a decline of acceptance for the pillars of the social free market economy." Stamm foresees that concerning convergence "with regard to certain features, change might be feasible, but rapid change of the entire system is unlikely."

Convergence is also trying to be achieved offensively through the attempt by U.S. institutional investors, specifically the efforts of California Public Employees' Retirement System, the largest American public pension fund, to impose U.S. governance standards on foreign companies. In this regard Andre comments that even though "surprisingly, however, the German reaction to CalPERS' initiatives in Germany appears to have been generally more muted and perhaps somewhat less hostile than the reaction in Britain", but he concludes that "whether CalPERS will be any more than a fringe participant nibbling at the edges of the ongoing reforms seems doubtful".

Butler states that "the differences between German and U.S. corporate structures are significant, and it is not practical or desirable to attempt to conclude which system is the better. Both have their advantages and flaws, and both evolved within their own unique cultural, social, and historical circumstances. Given these differences, it is surprising to witness the current "Americanization" of German corporate governance".

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170 Stamm, ibid.
171 Abbr. CalPERS.
This "Americanization" has been strongly criticized and Bernhardt argues against the unconditionally surrendering to Anglo-American ideas and the current trends on the consulting market, which do not adequately take into account the different traditions and legal systems.\textsuperscript{175}

Different traditions and legal systems play an important part. Referring to research into different corporate government systems Charny states that "each system spawned deviant cases and evolutionary 'mutations,' which thrived in their peculiar economic niches. Further, each system involved complex trade-offs between the competing virtues of a governance system: flexibility vs. stability, innovativeness vs. predictable success."\textsuperscript{176} Regarding prospects for convergence he concludes that "on an optimistic view, then, Germany may build on its institutional strengths to achieve what appears to be the proverbial 'best of both worlds': the resource of strong bank monitors at some firms, with the flexibility and financial advantages of American-style corporate governance at others."\textsuperscript{177}

Interesting also is an approach which examines American and German corporate law norms and considers how a melding of these different legal systems can affect a global corporation.\textsuperscript{178} Even though seeing vast differences between the American and German approaches to corporate governance, and ownership, Chantayan expects that "as a greater amount of global mergers occur, corporate governance in Germany, the United States and other countries will develop to be more uniform. Already Germany is moving toward a more American style of corporate ownership, and management. (....). With each new deal small steps are taken to make cross-boarder corporate governance appear

\textsuperscript{175} Bernhardt, "Corporate governance statt Unternehmensführung", 2004, RIW 401 et seqq.
seamless. In the end there may be less distinctions then there are similarities."\textsuperscript{179}

Regarding convergence, some even proclaim the "end of history for corporate law", stating that "the basic law of corporate governance -indeed, most of corporate law- has achieved a high degree of uniformity across developed market jurisdictions, and continuing convergence toward a single, standard model is likely. (...). Chief among these pressures is the recent dominance of a shareholder-centered ideology of corporate law among the business, government, and legal elites in key commercial jurisdictions. There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value. This emergent consensus has already profoundly affected corporate governance practices throughout the world. It is only a matter of time before its influence is felt in the reform of corporate law as well."\textsuperscript{180} Arguing that there are, "broadly speaking, three ways in which a model of corporate governance can come to be recognized as superior: by force of logic, by force of example, and by force of competition. The emerging consensus in favor of the standard model has, in recent years, been driven with increasing intensity by each of these forces."\textsuperscript{181}

Criticizing this approach, e.g., Njoya, stating that "a degree of caution is necessary in applying Darwinian notions of 'natural selection' and 'survival of the fittest' to the process of market evolution. The assumption that market evolution will weed out inefficient firms has led to the mistaken conclusion that efficiency is a necessary outcome of the evolutionary process."\textsuperscript{182}

Another position does not see competition but rather political forces and path dependency as the main factors in shaping and constraining economic

\textsuperscript{179} Chantayan, 2002, 16 St. John’s J. Legal Comment, 431, 456.
\textsuperscript{181} Hansmann/Kraakman, 2001, 89 Geo. L.J. 439, 449.
\textsuperscript{182} Njoya, "Employee ownership and efficiency: An evolutionary perspective", 2004, 33 Indus. L.J. 211, 212. See also for aspects of employee participation, Kershaw, "No end in sight for the history of corporate law: The case of employee participation in corporate governance", 2002, JCLS 33 et seqq.
evolution. It argues that not only "a high degree of convergence can emerge through corporate migration and stock exchange harmonisation, but that convergence at this level is far more politically feasible than at the level of corporate law reform." 

However, in which direction whatsoever company law will develop, Wymeersch is correct when he assumes that "it seems likely that company law will continue to develop at a high speed" and that "the pace of reform is increasing" and "new techniques of communication will open new frontiers not only to the imagination of businesspersons, but of company lawyers as well." 

2.4 CONCLUSION

Being a unique legal form, since its creation the GmbH so far withstood fundamental reforms. However, developments in supranational law become more and more relevant. Subsequently, for the GmbH especially developments on the European level initiated a discussion in which some even proclaim the end of the GmbH. The wind of change brought about through the ECJ's recent judgements in Centros, Überseering and Inspire Art fuelled a discussion on, i.a., minimum share capital. These discussions already lead to a reform bill. Reflecting a specific cultural background, the bill recommends some change concerning the minimum share capital regulations, however, only until a certain degree and aims to reduce the minimum capital from 25,000 Euros to 10,000 Euros. Influences on the role and shaping of companies and company law also have the findings of the High Level Group of Advisors as well as the discussion

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185 Wymeersch, 2000, ICCLJ 331.
on good governance. Especially interesting here is a comparison between the USA and Germany reflecting quite diverse corporate models.
CHAPTER THREE

3 LEGAL FRAMEWORK OF THE CLOSE CORPORATION

3.1 INTRODUCTION

Like the GmbH, also the close corporation is the subject of its own specific Act. This being the Close Corporations Act 69 of 1984, which came into effect on 1 January 1985.\(^1\)

The following chapter deals with the legal framework surrounding the close corporation. As in case of the GmbH, in the early stages of its introduction some in the business and legal community were raising doubts in connection with this new legal form. However, with the apparent success of the close corporation criticism quickly subsided. The most relevant other forms to conduct business in South Africa are partnerships and the public and private company.

Concerning the close corporation, being seen as the backbone of free enterprise, developments resulting out of a DTI policy paper titled "South African Company Law for the 21\(^{st}\) Century – Guidelines for Corporate Law Reform" also will have implications on this business form. Additional aspects influencing the ongoing reform process in company law are intra-South African factors, in particular the discussion regarding the constitution, its values and its practical relevance. However, to put the reform process in perspective, it is also relevant to sketch some developments elsewhere which might be of importance for the South African discussion. Important to mention at this stage is therefore the reform process in England because of the special relationship between South African and English company law. So the British aim to create a simple and modern framework for their company and partnership law can be of relevance for the South African situation. Accordingly the various reports of, \textit{i.a.}, Law Commissions regarding company and partnership law will be discussed as well as the Limited Liability Partnership as a new form of business entity. Of great

\(^1\) With subsequent amendments; for a detailed overview regarding amendments, see Close Corporations Service, Part 6. Subsequent abbreviation of the Act will be CCA. For a short summary of the history of the Act, see Naudé, 1984, TRW 117; Venter, 1984, TRW 109.
importance, however, is also the role of the close corporation as a legal form commented upon internationally. Especially interesting is a recent discussion on this legal form in the United States of America within the context of reforms in this country. Given this background also discussed will be whether an one-Act approach covering company and close corporation is a wise solution for South Africa.

3.2 CLOSE CORPORATION: FROM 'OFF LIMITS' TO 'NO LIMITS'

As mentioned above, during the beginning stages of the close corporation also doubts were cast on the new legal entity and some urged "legitimate new business ventures" to keep "entirely clear of the close corporation".\(^2\)

As in case of the GmbH, also the close corporation has proved its critics to be wrong. Since its introduction on 1 January 1985, the close corporation’s short history has been a remarkable success. Looking at this legal form from abroad, one was led to expect that the close corporation could serve to function as an example for similar countries looking for a legal form to enhance the development of small business ventures.\(^3\)

However, given the mentioned wind of change in the South African company law through the proposed SA DTI reform proposals, for an overseas spectator it comes as a surprise that in the South African company law reform process the close corporation is not being set as an actor on stage but that its future position is challenged.

3.3 SOUTH AFRICAN BUSINESS FORMS

The South African law also provides for a variety of legal forms for business entrepreneurs. The most commonly used forms of conducting business are a sole proprietorship, a partnership, a company, a business trust and a close

\(^2\) Divaris, "Close corporations of the third kind", 1984, Businessman's Law 83, 84, "whether they are to be big or small, black or white", Divaris *ibid*.

\(^3\) In this context also referring to the critics Henning, Observationes Mercatoriae I", 1986, TRW 97, 98. See also below chapter 3.3.1.4, 'Recent developments'.
corporation. Besides the close corporation, in this context it is sufficient to shortly introduce partnerships and companies.

3.3.1 Distinction between partnerships and corporations

The South African legal system differentiates between partnerships and corporations.

3.3.1.1 Partnerships

The South African law of partnership is not codified, but based on the South African Common Law, which has its roots in both the Roman Law and the Roman Dutch Law.

Different forms of partnerships are available to South African entrepreneurs. It suffices to say that the main classification is made (1) according to the liability of

4 For information on interesting indigenous business forms busy with microlending in the informal sector, the stokvel and mashonisa, see Lukhele, Stokvels in South Africa (1990); Henning, "Stokvels: enkele inleidende opmerkings oor terminologie en omskrwyings", 1996, THRHR 100 et seqq.

the partners, which may be shared by all the partners (ordinary partnerships) or be limited to certain partners (extraordinary partnerships), and (2) to the extent that profit is shared between partners, which may relate to all the income of the partners (universal partnerships) or be limited to the income derived from a specific venture (particular or ad hoc partnerships).

It is, however, noteworthy to mention that the possibility of forming a partnership with limited liability for its members proved to be unpopular. Until 1976, a limited liability partnership, as an enterprise form, was available in South Africa by means of two statutes, namely the Cape Special Partnerships Limited Liability Act 24 of 1861 and the Natal Special Partnerships Limited Liability Law 1 of 1865. Consequently these two statutes were repealed. Hence, a limited liability partnership can no longer be formed.

3.3.1.2 Companies

The traditional corporate form for entrepreneurs has been the company. Different kinds of companies exist in South Africa, namely companies with a share capital and companies without a share capital. The most common used form is the company with a share capital, which is further divided into a public company and a private company.


They were repealed by the Pre-Union Statute Law Revision Act 36 of 1976. See with regard to their insignificance Henning, 1986, TRW 97, 98 referring to Henning/Delport (1984), 257 fn. 9, only ca. 300 were founded in more than one century.

For a brief introduction, see the schematic exposition at Cilliers/Benade (1985), 3.01.

For further reading, see Cilliers/Benade (1985), 3.02 et seqq. with references. Wandrag’s study, The distinction between private and public companies in South
Regarding companies, be it the private or public limited company in South Africa incorporated under the Companies Act 61 of 1973, the facts were that "most commercial enterprises of any significance - even fairly small one-man businesses - tended to seek incorporation under the Companies Act, which from 1979 permitted private companies with one member." Through the introduction of the close corporation, however, this was supposed to change.

3.3.1.3 Close corporation

A recent corporate form is the close corporation. This entity is the result of an intensive legal analysis to find an appropriate legal form for small business. The close corporation was introduced to enable small undertakings to acquire the advantages of incorporation without having to comply with all the complex requirements of the present company law. However, a memorandum prepared for the British Government, is also regarded as inspiration for Naudé, who is generally seen as the "father" or "architect" of the close corporation.

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12 See as an informative introduction Henning/Bleimschein, "Die neue Unternehmensform der 'Close Corporation' in Südafrika", 1990, RIW 627 et seqq.
Noteworthy to mention is also a different approach which, instead of creating a new business form, proposed to give statutory recognition to the "incorporated partnership proper".\(^{16}\)

Nevertheless, as concluded correctly, the close corporation "may be regarded neither as a simplified limited liability company, nor as an 'offene Handelsgesellschaft' (commercial partnership) with own legal personality."\(^{17}\)

To distinguish this new legal form from the existing ones a significant name had to be found. Possible names discussed were "small business corporation", "close company", "partnership company", "corporate partnership" and "small business company".\(^{18}\)

In the end the name "close corporation" was preferred to give effect to the idea of "closeness" of the members, and further because the close corporation is not necessarily small, either in a financial or a structural sense.\(^{19}\)

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\(^{15}\) Henning, 1986, TRW 97, fn. 5; Ramsden, 1988, Businessman's Law 107. The Standing Advisory Committee on Company Law instructed Naudé to prepare a draft Bill, Naudé, 1984, TRW 117.

\(^{16}\) Ribbens proposes instead of creating a new business form to give statutory recognition to the "incorporated partnership proper", "Quo vadis corporate personality and partnership: why not the incorporated partnership proper?", 1982, TSAR 50 et seqq., 128 et seqq., 191 et seqq.; 1983 TSAR 118 et seqq., 201 et seqq. (see in particular 1983 TSAR 201, 209 et seqq.). In a series of five articles he deals in detail with, using his words, the "konseptuele ontwikkeling (...) en die judisiële erkenning (...) en die statutere erkenning van die ingelyfde vennootskap", (conceptional development, judicial recognition, statutory recognition) Ribbens, 1985, SACLJ 49, 50 et seq.

\(^{17}\) Henning/Bleimschein, 1990, RIW 627, "darf weder als eine vereinfachte Kapitalgesellschaft, noch als eine offene Handelsgesellschaft mit eigener Rechtspersönlichkeit angesehen werden.". See, for example, also Ramsden speaking of a "type of statutory limited partnership governed by consensus and mutual trust", in "Close Corporations II – See how they run" 1988, Businessman's Law 141, 143.

\(^{18}\) See Naudé, 1982, MB 5, 6 fn. 7.

\(^{19}\) Venter, 1984, TRW 109 and 111 et seq. Compare also the criticism of Ribbens with regard to the name, Ribbens, 1983, TSAR 118; 1983 TSAR 201, 204 fn. 315; 1985, SACL 49, 53 et seq.
Since its introduction on 1 January 1985, only a few Close Corporations Amendment Acts dealing with a wide variety of matters have been necessary. They deal, also on recommendations by the Standing Advisory Committee on Company Law (SAC), *inter alia*, with technical and procedural questions, clarifications and addressing loopholes.\(^{20}\) Noteworthy is the Close Corporations Amendment Act No. 22 of 2001, making provision, *i.a.*, for the electronic lodging of and access to all documents which have been or are required to be lodged in terms of the CCA.\(^{21}\) A more recent bill is the 2005 Close Corporations Amendment Bill, aiming to alter a number of clauses in the current Act which affect the liabilities of members and further matters taking place after the de-registration of a closed corporation.\(^{22}\) The amendment seeks to bring fairness among all members in their relationships regarding their liabilities when a close corporation has been de-registered and then subsequently re-registered by thus restoring liabilities to the point that they were before de-registration. There is no intention to exempt members from their liabilities at any stage.

In addition, the proposed amendment seeks to allow the appointment of a corporation as accounting officer.

Notwithstanding these changes, of particular importance for the close corporation are the Companies Act,\(^ {23}\) the Insolvency Act (with regard to the winding-up and the event of insolvency) and the Law of Partnership.

However, the context in which the close corporation was created envisaged the following wider perspective.

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\(^{22}\) Available at [http://www.info.gov.za/gazette/bills/2005/b6-05.pdf](http://www.info.gov.za/gazette/bills/2005/b6-05.pdf). The amendment is partly caused through the decision in *Mouton and Another v Boland Bank Ltd*. 2001 (3) *SA* 877 (SLA) and aims to prevent members from being prejudiced under certain circumstances, see the Memorandum on the Objects of the Close Corporations Amendment Bill at no. 2 and 3.

\(^{23}\) S 66 CCA refers.
One aim was the reform of the Companies Act. It was submitted that this Act provides "for the needs of all companies irrespective of size, membership and economic function - from the professionally managed conglomerate giant with listed shares and a complete separation between 'ownership and control', to the small family undertaking or one-man business."\(^{24}\)

Since this was regarded as a highly problematic situation, back at that now-historic stage of reform ideas in South Africa, it was projected that at the end of the reform process the private company would be abolished from the Companies Act, leaving only one company.\(^{25}\)

Its other socio-economic and political aim was even then the policy of promoting small business, which constitute "the backbone of free enterprise"\(^{26}\) and which are seen as "moontlik die vinnigste en beste middel (...) waarmee die vrye markstelsel onder die algemene publiek bevorder kan word."\(^{27}\) This was emphasized especially "in view of the developing informal sector" of the South African economy.\(^{28}\)

\(^{24}\) Naudé, 1982, MB 5, seeing the South African situation like the one in England "but in contrast to all continental European systems", ibid.


\(^{26}\) Naudé, 1982, MB 5, 9 with further reference also with regard to the importance of small industries in South Africa.

\(^{27}\) Venter, 1984, TRW 109, 110 (possibly the quickest and best way through which the free market system can be promoted among the general public).

\(^{28}\) Naudé, 1984, TRW 117, 131. Cf. also cited by Henning, 1986, TRW 97, 98 referring to the mentioned unpublished paper of Naudé in which he demands the professions realize "that we have a third world economy." In the shortened version published in 1986, 3 Med LSO 4.

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Therefore, in connection with its introduction it was submitted that in doing so, "the legal system looked beyond the class interests of the business elite, doing justice to all classes, applying the moral imperative".29

In addition, the policy of privatization of state-owned enterprises, the foundation of the Small Business Development Corporation (February 1981) and the Development Bank of Southern Africa (September 1983) even then should be seen in the context of promoting small businesses.30

3.3.1.4 Recent developments

3.3.1.4.1 Policy paper "South African Company Law for the 21st Century – Guidelines for Corporate Law Reform"

The South African Department of Trade and Industry31 sees an overdue need to review company law in South Africa. To bring the South African company law in line with international trends and to accommodate the changing environment for business, both in South Africa and globally, the SA DTI decided to initiate a review with the aim to modernise the South African company law. Hence it submitted a policy paper "South African Company Law for the 21st Century – Guidelines for Corporate Law Reform" proposing a road for the reform process.32 As this 57-page policy paper also affects the close corporation, in the following it is necessary to address the main implications of this proposed paradigm shift.

29 du Toit, "Applying the Moral Imperative: The Close Corporation", 1984 (November), TRW (The Editor). Even if Larkin challenges such an approach, he also sees the CCA as "a first rate piece of 'black letter' law", in "Companies including close corporations", 1984, Annual Survey of South African Law 322.
31 As mentioned, abbr. SA DTI.
Arguing that the current framework of the South African company law is built on foundations which were put into place in Victorian England in the middle of the nineteenth century, and stating that since the introduction of the 1926 Companies Act only one significant review of company law, which resulted in the Companies Act of 1973, and which still relies on the framework and principles of the English law, has taken place, changes in the commercial environment are a priority need. This is further seen as necessary because of the fundamental changes in South Africa since the last review of its company law; changes which brought the new constitutional framework and political, social and economic environment which has been established post-1994. In addition corporate governance and other legislative developments since the 1990s have further underscored the need for reform.33

Referring to the Government’s vision for the South African economy, which is captured in the Integrated Manufacturing Strategy of the SA DTI, it is stated that "our country needs an economy that can sustainably meet the needs of all our economic citizens – our people and their enterprises.(...) Enterprises of all types and sizes will have to become adaptive, innovative and internationally competitive."34 In its policy paper the SA DTI emphasises that "in realizing this vision, a key role for government is to ensure that the regulatory framework within which enterprises operate promotes growth, employment, innovation, stability, good governance, confidence and international competitiveness. Regulation should be consistent, effective, predictable, transparent, fair and understandable. (...) The regulatory scheme should not create artificial preferences and distortions, where these are unnecessary. And it should attempt, where practically possible, to balance the competing interests of economic actors and society at large."35

In addition, the policy paper submits that "the regulatory policy also needs to recognise the unique South African context and promote equity in a manner consistent with the South African constitution."36 In this context the discussion document of the government "Towards a Ten Year Review" is referred to. There it is stated that "two economies" appear to persist in South Africa. "The first is an

33 See SA DTI policy paper, Foreword by Minister of Trade and Industry Mpahlwa, 4.
34 See SA DTI policy paper, 9.
35 SA DTI policy paper, ibid.
36 SA DTI policy paper, ibid.
advanced, sophisticated economy, based on skilled labour, which is becoming more globally competitive. The second is a mainly informal, marginalised, unskilled economy, populated by the unemployed and those unemployable in the formal sector. Despite the impressive gains made in the first economy, the benefits of growth have yet to reach the second economy, and with the enormity of the challenges arising from the social transition, the second economy risks falling further behind if there is no decisive government intervention."^37

Subsequently, the SA DTI formulates the objectives of the new company law in promoting "the competitiveness and development of the South African economy by:

1. Encouraging entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing costs associated with the formalities of forming a company and maintaining its existence, thereby contributing to the creation of employment opportunities;
2. Promoting innovation and investment in South African markets and companies by providing a predictable and effective regulatory environment and flexibility in the formation and the management of companies;
3. Promoting the efficiency of companies and their management;
4. Encouraging transparency and high standards of corporate governance, recognising the broader role of enterprises;
5. Ensuring compatibility and harmonisation with best practice jurisdictions internationally."^38

According to the SA DTI, the scope of the review and therefore the reform of South African company law will involve an overall review of company law, that is the Companies Act 61 of 1973, the Close Corporations Act 69 of 1984, and the common law relating to these corporate entities. The task will be to develop a legal framework, based on the principles reflected in the Companies Act, the Close Corporations Act, and the common law.40

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^37 SA DTI policy paper, 10.
^38 SA DTI policy paper, ibid.
^39 SA DTI policy paper, ibid.
^40 SA DTI policy paper, ibid.
It is further submitted through the SA DTI that new company law should therefore be consistent not only with the South African Constitution and the principles of equality and fairness that it enshrines, but also with other laws, i.e., the Broad-Based Black Economic Empowerment Act,41 competition law, environmental law and access to information legislation.42

Regarding the CCA, the policy paper sees the requirement of a large number of steps to form and register a business, including among others, the completion of numerous forms, compulsory name reservation and the requirement that all members sign the founding statement and articles of association. The SA DTI argues that a number of the statutory requirements add unnecessary formalities to relatively simple processes and may be of questionable value.43 Furthermore, the CCA is seen as still highly formalistic in nature, making it difficult for unsophisticated entrepreneurs to commence business and ensure their effective management. The SA DTI policy paper also states that the availability of membership only for natural persons precludes certain categories of equity financiers from investing in these business entities. The scope and breadth of liability for corporate debt currently in the Act may easily expose unsophisticated investors to personal liability.44

Regarding the close corporation, another critical point is made by the policy paper stating that the current division between close corporations, private companies and public companies offers limited opportunities for progression from one form of company to another and has resulted in distrust by financiers of close corporations. Therefore the SA DTI sees it as necessary to move away from the largely artificial separation between the different business forms, to recognise only one formal business vehicle and to provide for a simple, easy company formation process.45

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42 SA DTI policy paper, 15.
43 SA DTI policy paper, 16.
44 SA DTI policy paper, 17.
45 SA DTI policy paper, 32.
According to the SA DTI, in connection with insolvency and corporate rescue, it is also to be addressed that for large close corporations no equivalent to s 311 of the Companies Act exists.\(^{46}\)

To comment on this proposed paradigm shift it is at this stage useful to take a step back and look at the recent history of promoting small business in South Africa.

Because it had become clear by the early 1980s, that the incorporation of small businesses under the Companies Act 61 of 1973 was too difficult and complex, reform led to the introduction of the Close Corporation Act 69 of 1984.\(^{47}\) One could also argue that this was in practice a reform of the Companies Act 61 of 1973.

However, as no "coherent South African policy framework on small, medium and micro" enterprises existed,\(^{48}\) South Africa embarked on a national strategy for the promotion of SMMEs. Against the background of the new dispensation and changed priorities, the National Small Business Act of 1996 was introduced.\(^{49}\) Given the dramatic high unemployment rate the SMMEs are seen as being crucial to improving this situation. Their importance is demonstrated in the fact that about "6.5 million or 45 per cent of the members of the economically active population are unemployed or employed outside the formal sector. (...) About 2.6 million are employed by formal SMMEs and 3.5 million people are employed in other informal businesses. It is estimated that SMMEs contribute 46 per cent of the GDP."\(^{50}\)

\(^{46}\) SA DTI policy paper, 43 \textit{et seq.}

\(^{47}\) See previous chapter 3.3.1.3, 'Close corporation'.

\(^{48}\) See Snyman/Henning, "The National Small Business Act, 1996 from white paper to statute: Creating an enabling environment for small, medium and micro enterprises in South Africa", 1998, \textit{JJS} 54 \textit{et seqq}. Hereafter small, medium and micro enterprises will be abbreviated as SMMEs.

\(^{49}\) Which resulted in the enactment of the National Small Business Act No 102 of 1996. For the history of the Act and its grassroots approach, see Snyman/Henning, \textit{ibid.}, 57 \textit{et seqq.}; \textit{cf.} also Snyman/Henning, "A salutory statutory dispensation for small businesses", 1996, \textit{JJS} 132 \textit{et seqq}.

\(^{50}\) Snyman/Henning, 1998, \textit{JJS} 55, referring to other sources.
Besides giving a definition of SMMEs, the Act establishes the National Small Business Council and the Ntsika Enterprise Promotion Agency. These institutions have the task, inter alia, to promote small businesses and recommend to all governmental levels suggestions focusing on hindrances to such businesses. Noteworthy is that another institution has also been established to ease the accessibility of capital, a notorious problem for SMMEs.51

In the process of promoting SMMEs the role of the close corporation is emphasized.52 Given the specific South African economic structure, small businesses play a valuable role by creating new job opportunities, providing stability, eliminating poverty, improving competitiveness, promoting the development of labour skills, and ensuring economic growth.53 According to the SA DTI Investor Handbook, up to 650 applications for registration as a close corporation are received daily at the Registrar's office.54 Given these numbers, just from these objective facts, one gets the impression that the close corporation plays a most important role for quite a large number of entrepreneurs when choosing their preferred form of business. That is why even the SA DTI policy paper comes to the conclusion that the purpose of the Close Corporations Act "to provide a simple, inexpensive business entity (...), has been largely successful."55

Therefore by carefully studying the SA DTI policy paper and the description of the principal areas of company law to which, in the eyes of the SA DTI, careful

54 http://www.dti.gov.za/publications/investorhandbook.htm. As mentioned above, note that the function of the former Registrar of Close Corporations (as well as of the Registrar of Companies) has been taken over by the Companies and Intellectual Property Registration Office (CIPRO).
55 SA DTI policy paper, 13 et seq.
consideration will be given, it must be submitted that they nearly exclusively deal with problems arising out of company law.

However, it is correct that, e.g., good governance must be newly defined. Corporate governance which is generally described as meaning the way in which companies are directed and controlled, like in other countries, plays a vital role in South Africa given its new political dispensation. Therefore besides findings of the King Committee on Corporate Governance in South Africa to improve standards of managerial accountability, already King I dealt with affirmative action in the context of good corporate governance practice. Given the fact that "issues such as affirmative action and black economic empowerment ('BEE'), among others, require urgent attention given the country’s past socio-political and economic situation under apartheid", King II acknowledges that "companies in South Africa must recognise that they co-exist in an environment where many of the country’s citizens disturbingly remain on the fringes of society’s economic benefits." And in acknowledging BEE as a

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56 See, e.g., Mongalo, "The emergence of corporate governance as a fundamental research topic in South Africa", 2003, SALJ 173 et seqq.
58 The King Report on Corporate Governance, Report of a Committee on Corporate Governance headed by Mervyn E King SC, Institute of Directors, Johannesburg (1994) (King I); The King Report on Corporate Governance, Report of a Committee on Corporate Governance headed by Mervyn E King SC, Institute of Directors, Johannesburg (2002) (King II, incl. code). The King Committee issued its first report and a Code of Corporate Practices and Conduct in 1994 and the second in 2002. The King Committee was set up on a private basis, on the initiative of the Institute of Directors in Southern Africa and has the task to review corporate governance on an on-going basis. The Johannesburg Stock Exchange has implemented many of the recommendations, which form part of the Listing Requirements. Cf. also Mongalo, 2003, SALJ 173, 175.
59 King I, chapter 8.
61 King II, introduction, para 36.
good governance practice, the report also states that "in South Africa, where social imbalances have existed for many decades, the need for reform, the need for 'ploughing back' and the need for a greater social and ethical conscience of companies are crucial to their long-term survival. Such actions would also promote the greater well-being of society generally. Increasingly, South African companies are seen as agents of change not only for their own benefit but also for the benefit of their stakeholders."62 In this context, therefore, the question of 'who is a stakeholder' is also under discussion. Mongalo submits that "in a modern company, profit, or the need for it, cannot be the only bottom line in company operation, more especially in the context of South Africa's business environment. The dismantling of apartheid brought with it the realization that companies were not operating in a vacuum. The shibboleths of the exclusive or 'shareholder supremacy at all costs' approach were revealed. The inclusive approach recognises that stakeholders such as the community in which the company operates, its customers, its employees, its suppliers and the environment need to be considered when developing the strategy of a company. Thus, consideration has to be given not only to economic factors but also to social and environmental ones."63 

Thus one sees that socio-economic factors are issues of utmost importance in the South African context, as well as the fear of social unrest, especially when the aims of the BEE are addressed so slowly within society and even more so in the corporate sector. Mongalo cites the Black Economic Empowerment Commission Report,64 where the Commission approves the statement by the

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62 King II, s 4 ch 5 para 1 at 114.
63 Mongalo, 2004, SALJ 93, 114. Cf. also Loubser, "Does the King II report solve anything?", 2002, JBL 135, stating at 140, "in short, the message is clear: good corporate governance is ultimately also good for business"; see also Esser/Coetzee, "Codification of directors’ duties", 2004, JBL 26 et seqq. commenting also on the situation in the UK. For a comparative view also Santow, "The codification of director’s duties: Some observations from an Australian standpoint on the Joint Consultation Paper of September 1988 issued by the Law Commissions of the United Kingdom", 2000, ICCLJ 127 et seqq., dealing, i.a., with problems of not too generalised statutory requirements; Butcher, "Director’s duties in the twenty-first century: A new beginning?", 2000, ICCLJ 197 et seqq.; Directors’ Duties: A new millennium, a new approach? (2000).
64 BEECom report, Report of the government appointed BEE Commission (BEE-Com), chairman Cyril Ramaphosa, Johannesburg (2001). In this 72-page report
Department of Tourism stating, "we run the risk of social unrest that has plagued other countries where previously disadvantaged people have seen no concrete changes in their lives even after independence and the balance of economic power continued to remain in the hands of former oppressors or minority groups. If we do not want to suffer a similar fate as Brazil, Indonesia and Zimbabwe where there have been social upheavals in recent times then transform we must."65

For readers not familiar with the aim of the BEE, it may be helpful to recall that the BEECom proposes, *inter alia*, the following targets to be achieved within a period of ten years as constituting a guide for the Integrated National BEE Strategy:

- Black equity participation in each sector of the economy should be increased to at least 25 per cent, including individuals and collective enterprises. Equity participation refers to ownership measured in terms of economic interest in each sector over the period specified.
- Black people (including businesses and collective enterprises) should hold at least 25 per cent of the shares of companies listed on the JSE.
- At least 40 per cent of non-executive and executive directors of companies listed on the JSE should be black.
- At least 30 per cent of these companies should be black-owned SMEs.
- At least 40 per cent of senior and executive management in private sector companies (with more than 50 employees) should be black.66

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Even though the report and its code directly addresses only companies listed at the JSE Securities Exchange South Africa, a formal approach concerning the application of this specific corporate governance code would not include close corporations. However, given the aforementioned specific South African situation, it is clear that these general ideas have at least an indirect influence on many close corporations. However, when one explanation for requiring a new statutory framework for small and medium sized businesses should be a more intense recognition of good governance and with it of BEE, one could argue with good cause that regarding the close corporation and bearing the constitution and the BEE Act in mind, a new act not necessarily has to be created.

3.3.1.4.1.1 Intra-South African factors influencing the reform process

The policy paper demands that the new company law be consistent, i.a., with the South African Constitution and the principles of equality and fairness that it enshrines. Therefore, the question which also must be answered is, which values of the constitution and other laws will be influencing the interpretation of a new company law? From an overseas perspective, this leads to an interesting and challenging debate in South Africa concerning the contents of its constitution; a

67 In addition also banks, certain financial and insurance entities, as defined in the various legislation regulating South African financial services sector; Public sector enterprises and agencies falling under the Public Management Act and Government departments (excluding courts and judicial officers); see more detailed the definition in para 1.1 of the Code of Corporate Practices and Conduct in King II. Regarding the structure of the companies listed at the JSE, see Mongalo, 2004, SALJ 93, 111, where he submits that due to sanctions in the apartheid era "with little foreign investment and ownership, the biggest South African businesses became nests of complex cross-holdings."

68 SA DTI policy paper, 15.

69 See in this context also the discussion surrounding constitutional rights for juristic persons, chapter 4.3, 'Legal Personality' and constitutional questions in connection with the winding-up of a close corporation, chapter 12.3.2, 'Winding-up'.
constitution which is praised as "the most admirable constitution in the history of the world."70

Subsequently, the question is, where are the "values of an open and democratic society", as mentioned in s 39 of the Constitution, to be found? Regarding its contents it is submitted that concepts "like reconciliation, nation building, ubuntu and African Renaissance suddenly became part of every South African's vocabulary".71 In the search for these values Kroeze looked at the relevant case law. She differentiates between four sources of these values, i.a., the idea of ubuntu.72 The concept of ubuntu "is associated with traditional African societies".73 It was referred to by Mokgoro J in S v Makwanyane and Another 1995 6 BCLR 665 (CC) deciding on the constitutionality of the death sentence.74 It is stated that in using this concept, "she advocates a new attitude to law by injecting ubuntu in the mainstream of South African jurisprudence".75 However, this new attitude into the mainstream has a rather long history; it is claimed to be "a philosophy that is the experience of thirty-five thousand years of living in Africa".76 This concept "permeates and radiates through all facets of our lives, such as religion, politics, economics, etc."77

In this context it is also asked whether Africans have another understanding of democracy as well as of law and subsequently a different perception of the role, e.g., of the state.78 This is being answered negatively, "the question is not whether black judges write different opinions and assume different views and interpretations of democracy and of the Constitution than their white counterparts, but rather that some black and white judges write different

72 See Kroeze, "Doing things with values: The role of constitutional values in constitutional interpretation", 2001, Stell LR 265, 268.
73 See Lemmer/Olivier, 2000, De Jure 138, 143, citing also Smit with the explanation of ubuntu, "n Mens is 'n Mens Deur Ander Mense" Rapport 1998-11-29, 15 (a human is a human through other humans).
74 i.e., at par 131; 224; 300; 308; 313.
75 Lemmer/Olivier, 2000, De Jure 138, 143.
76 See Samkange/Samkange, Hunhuism or Ubuntuism (1980), 34.
77 Samkange/Samkange (1980), at 35 et seqq. and at 103.
opinions and assume different views and interpretations on democracy and the Constitution than some of their other white and black colleagues, based on whether their bottom line position is one of upholding, entrenching and stabilizing the *status quo* in one way or another against the changes and transformations that accompany the establishment and development of the new constitutional order, rather than one of taking part in that process of change and transformation".79 However, that core issues like these are of utmost importance in this discussion on values shows also Strydom debating similar fundamental questions as well as discussing the role of the government, the Janus-faced state and problems of Africanization of higher education in South Africa. 80 Regarding the practical problems, he states, "part of the problem is the absence of a common and internalised legal and moral order at the center of society. The formal trappings of a constitutional democracy are there, but the new constitutional order and its many institutions (some limping along) operate on the periphery of society".81 Therefore it will be interesting to see in which way the discussion regarding the constitution, its values and its practical relevance influences the ongoing reform process in company law.

80 Strydom, in an essay worth reading, "Preface – The unicolour rainbow nation", 1996, TRW i et seqq. See also Scholl-Latour, Afrikanische Totenklage (2003), at 345, stating that apparently for the western media, South Africa is "a holy cow" because it is not reporting brutal reality which also exists in that country. Scholl-Latour is a renowned journalist who travelled throughout Africa in the past 40 years.
81 Strydom at iii.
3.3.1.4.1.2 Reform process in England

In the SA DTI policy paper the reform process in England is also described and commented on. Accordingly, Mongalo submits "that this process can be of assistance to us in South Africa."

Historically, South African company law has closely followed English legislation in this field. With the introduction of the South African Companies Act 61 of 1973, however, this special relationship began to loosen slowly but steadily. It was even stated that the "Companies Act of 1973 effectively cut the umbilical cord between English and South African company law." This development accelerated, caused to a great extent by the ever-increasing EU influence on Member States legislation, in particular, on the field of company law. This introduced and subsequently brought about a wide variety of changes in English company law.

Regarding the current reform process it must be noted that in 1998 the Department of Trade & Industry (UK DTI) initiated a fundamental review of

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82 SA DTI policy paper, 23 et seq.
83 Mongalo, 2004, SALJ 93, 98.
84 See Mongalo, 2004, SALJ 93, 95 at footnote 11, citing Pretorius et al.
85 Cilliers/Benade (1985), 2.06 et seqq.; Cilliers et al. (2000), 8.05 et seqq. See also Wandrag/Henning, "The private company in Britain as influenced by the European Union law", 1996, JJS 1 et seqq. Regarding the diminished importance of the common-law traditions and influence of English common-law heritage for the common-law outside England and the growing importance in England of the European law, Cheffins, "Our common legal heritage: Fragmentation and renewal", 1999, Law Librarian 3, 4 et seqq., citing on p. 7 Judge Lord Denning as characterising the situation by stating EU law is a "tidal wave bringing down sea walls and flowing inland over British fields and houses". In this context see also Williams, "Constitutional issues facing the United Kingdom", 1999, Law Librarian 13 et seqq., i.a., with regard to the constitutional role of the courts, suggesting the establishment of a Supreme Court, p. 18. On 25 February 2004 the Constitutional Reform Bill passed Westminster Parliament and is now under way in the legislative progress, i.a., establishing a Supreme Court, separate from the House of Lords with its own independent appointments system, and its own staff and budget, see http://www. dca.gov.uk/legist/constreform.htm.
British company law with the aim of developing a simple and modern framework. This research was concluded with a Final Report. In that Final Report the Steering Group adopted three core policy proposals as the basis of their recommendations. They describe these principles as "the ‘think small first’ approach to private company regulation and legislative structure; an inclusive, open and flexible regime for company governance; and a flexible and responsive institutional structure for rule-making and enforcement, with an emphasis on transparency and market enforcement.”

During this Steering Group review, inter alia, a special study was published dealing with company law in various countries. In this survey it is submitted that the "South African Close Corporations Act has proved to be one of the most

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For a reader interested in comparative aspects, see the above-mentioned survey prepared by Milman et al. 1999 for the UK DTI.

Also of general interest is the paper 'The Legal Form of Business Entities' by Deakin/Cook, ESRC Centre for Business Research, University of Cambridge (updated version March 2001), available at www.dti.gov.uk/cl/clreview.htm. In estimating how overdue this reform of British company law is, cf. du Plessis, "Enkele internasionale maatskappyegetelike ontwikkelings: moe ons navolg?", 1992, TSAR 561, 563 et seq., 575, referring to various opinions of respected company law scholars showing the deep frustration and rather sarcastic feelings towards their legislature when it comes to company law reform. For similar harsh criticism, see Jordan, 1998, at p. 8 et seqq. citing Sealy, Gower and the Law Society. See also Rider, welcoming the initiative of the DTI cautiously, "albeit not before time", and states that "it remains to be seen what will emerge from the British Government's concern", 1999, ICCLJ 1, 2 and 3.

remarkable innovations in South African company law,” and also as being 
"singularly successful."89
In regard to small companies it can be expected that these are to benefit from 
the advocated reforms as the review "recommends that the current Companies 
Act should be recast to:
- Simplify the statutory requirements for decision-making in private companies.
- Make a range of other simplifications to the law to assist the running of small 
companies.
- Reduce the burden of accounting and audit.
- Make legislation on private companies easier to understand."90

The above-mentioned Final Report by the Company Law Review Steering 
Group presented on 26 July 2001 has been followed by a White Paper entitled 
"Modernising Company Law" issued by the UK DTI.91 In the preface by the 
Secretary of State it is stated that "when British company law was created in the 
nineteenth century, it was a source of advantage. Now it has become a 
competitive disadvantage. The law has become encrusted with amendments 
and case law over generations. It has failed to adapt to meet the changing role 
of small enterprises, IT and international markets".92 In this White Paper the UK 
Government clearly points out that its priority is to address the specific needs of

89 Jordan, 1998, p. 50 at 3.4.3. Here also additional information can be found 
regarding company law developments in New Zealand (at 3.3) and Australia’s 
monolithic Corporations Law, weighting "2.3 kilograms" (at 3.1); regarding the 
latter especially in connection with the enacted but never proclaimed Close 
Corporations Act 1989 and its similarity with the South African original, p. 28 et 
seq. Note that this study for the UK DTI is an updated version and was originally 
prepared as a company law analysis of more than 12 jurisdictions in connection 
with a re-examination of the Hong-Kong companies legislature, 'Review of the 
Hong-Kong Companies Ordinance', Consultancy Report, 1997; see Henning, 
1999, ICCLJ 1 at p. 83, footnote 45 (31). See also the introduction at part 1, p. 1 
of Jordan’s updated version in the DTI-study.
90 Company Law Review Steering Group, Final Report, Separate summary of the 
proposals for small business, "Modernising Company Law: Small Business 
whitepaper.htm. The White Paper consists of Volume 1 with 153 pages and a 
Volume 2 with 118 pages of draft clauses.
92 Modernising Company Law, 3.
small companies by means of a new Companies Act.  

Included in this Act will be also provisions dealing with larger companies. The objective of the proposed Companies Act is to simplify, modernize, and streamline company law in order to support the creation, growth, and competitiveness of companies. Henning submits in this context that this approach of "think small first" corresponds with the European Union ("EU") legislature's proposals of creating flourishing business environment for small enterprises in the EU." The Government has announced that it has the ambition to make the UK the best place in the world to start and grow a business by 2005. Accordingly, it is submitted that the "resulting 'easy-fit' corporate form should appeal to businesses of many types and may even make a good product for the export market."  

Regarding private companies a number of recommendations are being made easing procedures as well as reducing formalistic requirements. New approaches towards capital maintenance and deleting the need for an object's clause, are, for example, also included thus providing them with unlimited capacity.

It is interesting to note that no separate statute has been envisaged to cater for the needs of the smaller entrepreneurs. Even though the Steering Group was  

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93 Modernising Company Law, 3, 8, 15, 111.
94 Id. at 8, 15.
95 Id. 6.1, at 50 and 111.
98 Freedman, "'One size' fits all – Small business and competitive legal forms", 2003, JCLS 123, 148 (Judith Freedman was a member of the Company Law Review Working Group on the needs of small and closely-held companies).
100 Sealy saw it as a strategic question of major importance whether the small business sector should have a free-standing law of its own. He submitted that "there are strong arguments in favour of this, and the successful precedent of South Africa's Close Corporations Act to look to," in "The company of the twenty-
given a mandate to propose whatever changes to the United Kingdom company law were necessary to bring it into line with twenty-first century demands, the approach of the Steering Group is to follow the single Companies Act approach of the past. However, it was envisaged by the Steering Group that this new act must have the specific needs of small companies as a priority and that it will include provisions dealing with larger companies. Accordingly, corporate governance aspects also play an important role.


2. Company Law Review Steering Group, Final Report, e.g., at XII, XV, 18 et seq., 23 et seqq.

3. Company Law Review Steering Group, Final Report, e.g., at 4, 9, 18, 19 et seq., Chapter 3. I.a., the Steering Group proposes a statutory statement of directors' duties, a new form of annual report to shareholders and new institutional arrangements for keeping accounting standards. See, e.g., for some aspects on corporate governance from the UK perspective Parkinson, "Disclosure and corporate social and environmental performance: Competitiveness and enterprise in a broader social frame", 2003, JCLS 3 et seqq. He discusses the merits of civil regulation as a form of social control of business and submits as a departure point, citing on p. 3 Williams, how to "enjoy the obvious benefits of global capitalism while introducing constraints – respect for human rights, protection of individual autonomy, fairness in human relations, and environmental sensitivity – into otherwise 'mindless' capital". See also Ferran, "Corporate law, codes and social norms – finding the right regulatory combination and institutional structure", 2001, JCLS 381 et seqq.; Cheffins "Law, economics and the UK's system of corporate governance: Lessons from history", 2001, JCLS 71 et seqq. comparing the situation to that in the US; Arden, "UK corporate governance after Enron", 2003, JCLS 269 et seqq. Dealing with corporate governance from various angles, i.a., from a historic, capitalistic, feministic, global approach, see Patfield (ed.), Perspectives on Company Law: 2 (1997). See also Roe, Political determinants of corporate governance (2003).
Even though Freedman is critical of the fact that the opportunity was not taken as part of the Company Law Review's exercise to examine the role of limited liability for small firms, and sees this as a fundamental omission, she defends the 'one size fits all' approach in arguing that the creation of artificial and problematic distinctions which could create rather than remove barriers to growth has thus been avoided.\textsuperscript{104}

The Steering Group proclaimed as its objective, that "as a result of the review British law should rank with the best in the world."\textsuperscript{105}

It is noteworthy that the Steering Group "referred to only two prominent examples of free standing limited liability vehicles for use by small firms adopted by overseas jurisdictions as considered suitable for consideration in the context of the review, namely the LLC and the South African Close Corporation."\textsuperscript{106} Regarding the close corporation the Steering Group submitted that one of the advantages of the "free standing approach", which has been followed by the South African Close Corporations Act, is that as a separate statute it is tailored more closely for the needs of enterprises consisting of one or a small group of entrepreneurs.\textsuperscript{107} However, the Steering Group was not in favour of a separate limited liability enterprise act.\textsuperscript{108}

The Steering Group argued, \textit{inter alia}, that such legislation would not cater to the scenario where the enterprise ceased to comply with the criteria posed by the separate act, for instance, where the current entrepreneurs wish to expand and include more entrepreneurs than the membership limit imposed by that act.\textsuperscript{109} Furthermore, entrepreneurs and existing businesses would not use and exploit a new form of business: "The novelty of the free standing approach, taken with the fact that the existing corporate form used by many thousands of small companies would need to continue (compulsory re-registration of such

\begin{itemize}
\item \textsuperscript{104} See Freedman, 2003, \textit{JCLS} 123, 125.
\item \textsuperscript{105} 1999 Strategic Framework, 18.
\item \textsuperscript{106} Snyman/Henning, "The limited liability company in the USA: An innovative organizational option with lessons for South Africa", 2003, \textit{SALJ} 153, 171.
\item \textsuperscript{107} See 1999 Strategic Framework, 62 et seq.
\item \textsuperscript{109} 1999 Strategic Framework, 63.
\end{itemize}
companies under the new regime would be very hard to justify) suggest that the new regime might be unlikely to be used on formation, and even more unlikely to be exploited by existing companies. Professional advisers are likely, even for new companies, to adhere to the tried and tested system they know, and for which they have invested in standard procedures."\textsuperscript{110} Thus, the Steering Group argued that there is a problem of "novelty."\textsuperscript{111} Therefore, according to the Steering Group, there seems "to be a strong case for adapting the existing regime better to meet the needs of small companies."\textsuperscript{112} The White Paper supports this reasoning and approach.\textsuperscript{113}

As mentioned above, Henning substantially challenges the approach of the Steering's Group assumptions regarding the close corporation.\textsuperscript{114} In conclusion, he argues in favour of the adoption of separate legislation in the UK in order to address the needs of small and medium sized businesses.\textsuperscript{115} Indeed, in addition to being misinterpreted through the Steering Group and not fully exploring the legal opportunities of the CCA, it is difficult to understand why entrepreneurs and their advisers should not opt for a new business structure. If the novelty argument were correct, none of the thousands of close corporations in South Africa would have been registered and no company would have been converted into a close corporation.

However, even though the SA DTI policy paper focuses very much on the company law reform in the UK it is also worth briefly mentioning the following developments in the area of partnership law in the UK.

In September 2000 and in November 2001 the Law Commission and Scottish Law Commission released joint consultation papers on the review of the law of

\textsuperscript{110} 1999 Strategic Framework, 64.
\textsuperscript{111} 1999 Strategic Framework, 65.
\textsuperscript{112} 1999 Strategic Framework, 65.
\textsuperscript{113} Henning, "Company law for the next millennium: 'Think small first'", 2003, \textit{Comp. Law}, 353.
\textsuperscript{115} Henning, 2004, \textit{Comp. Law}, 95 \textit{et seq}.
partnership, including the Partnership Act 1890, and reform of the Limited Partnership Act 1907. This has been followed by a Final Report of the Commissions in November 2003.

The Commissions carried out the review of partnership law with particular reference to "independent legal personality; continuity of business irrespective of changes of ownership; simplification of solvent dissolution a model partnership agreement; and to make recommendations." Seeing the need for business vehicles other than a company, and taking into consideration the UK DTI’s company law review programme, the Commissions point out that, "it is clearly important that small businesses should have available to them a business structure which is less formal, less regulated and less cumbersome than the existing form of company. Although there have been suggestions for the introduction of new, simpler forms of companies with limited, 


118 2003 Law Commissions Final Report, 3. In the 2000 Commissions Joint Consultation Paper the Commissions stated at p. 20 "that there are perceived to be three main defects in the existing law, (...). First, partnerships have no legal personality in English law and an insufficiently clear and continuing legal personality in Scots law. (...). Secondly, the existing law often leads unnecessarily to the complete dissolution of partnerships. (...). Thirdly, the rules on winding up the affairs of a dissolved partnership are unsatisfactory, both in theory and in practice." For the recommendations at that stage, see p. 274 et seqq.
or even unlimited, liability for members, so far no such suggestion has borne fruit. Even if a new simpler form of company were to be introduced, it seems likely that there would be a need for ordinary partnerships to continue to be available at the least formal, least regulated end of the scale of business associations."\textsuperscript{119}

Recalling that the last review of partnership law dates back to the year 1837, Henning sees this joint consultation paper as an "occasion of significant historical importance."\textsuperscript{120} He recommends this consultation paper as "compulsory reading for every business and company lawyer". Furthermore, he states that "for partnership lawyers in particular it represents not only the opportunity of a lifetime, but conceivably also the best one for the next millennium."\textsuperscript{121}

After the Final Report was presented in November 2003, the Government sought views on the costs and benefits of the recommendations in the Final Report. Subsequently, the UK DTI opened a consultation, which has already ended.\textsuperscript{122} Further activities are to be expected.

Noteworthy is also that the Limited Liability Partnership Act 2000\textsuperscript{123} introduced the Limited Liability Partnership\textsuperscript{124} in the UK.\textsuperscript{125} As of 6 April 2001 this new form

\textsuperscript{119} 2000 Commissions Joint Consultation Paper, 3. See also 2003 Law Commissions Final Report, 3 et seq.


\textsuperscript{121} Henning, 2004, \textit{Comp. Law.}, 163.


\textsuperscript{123} Further abbreviated as LLPA.

\textsuperscript{124} Further abbreviated as LLP.
of business entity has been added to the list of possible organizational forms for conducting business.\textsuperscript{126}

Originally designed for professional partnerships, but later made available to all businesses and professions, the LLP is a new entity based on an amalgam of company and partnership law. It is a new form of legal business entity with limited liability.\textsuperscript{127} It combines the flexibility of a partnership with limited liability for the members of the LLP, but legally it will be a body corporate and a separate legal entity from its members.

\textsuperscript{125} According to the Act, Schedule, Part 1, s 2 (1) the name of a limited liability partnership must end either with the expression "limited liability partnership" or the abbreviation "llp" or "LLP".

Features of limited liability partnerships are also that they have organisational flexibility and are taxed as partnerships.

In many other respects they are very similar to companies. The LLPA generally allows two or more persons associated for the purpose of carrying on a lawful business with a view to profit to form a limited liability partnership by subscribing to its incorporation document. Every limited liability partnership must have at least two, formally appointed, designated members at all times. If there are fewer than two designated members then every member is deemed to be a designated member. They are responsible for the various duties involved in running the LLP.

Unlike a company it has no share capital, and no rules for meetings or directors, yet it does have the accounting and modified disclosure regimes from company law.

How widely this new form will be used remains to be seen. While some, with its features of partnership and company law and a great flexibility in its structure, see it as a positive new legal form for small businesses. Others comment on it as being a legal form, "which may appear superficially suited to small firms, and which may be taken up by them, but which may actually create costs and difficulties for small firms."

Nevertheless, its similarity with various aspects of the close corporation is noteworthy. This can be explained through the fact that this reform process dates back to a 1992 UK DTI programme, *inter alia*, reviewing the law of private

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128 S 2 LLPA.
129 S 8 (2) LLPA.
130 For the various duties, see especially the Limited Liability Partnership Regulations 2001 (Statutory Instrument 2001 No. 1090).
131 See also Henning, "Forms of business association, new, old and innovative: Limited liability partnerships, limited partnerships and limited liability limited partnerships", 2000, *ICCLJ* III *et seqq*.
133 Freedman, 2003, *JCLS* 123, 140; she also gives an insight in which way the Company Law Review Steering Group dealt with the LLP, which the UK DTI wanted to 'fast-track' and keep it outside the Company Law Review, at 138 *et seq*.
companies. In this research (first through a working group, then through a study of the Law Commission), which led to a consultative document entitled "Company Law Review: The Law Applicable to Private Companies", the concept of the South African close corporation also played a significant role. The Commission did not recommend any particular reform of company law or partnership law. However, regarding its findings, it is submitted that the requirements elaborated in the consultative document "more than adequately describe the South African Close Corporations Act."

However, while the SAC, inter alia, also recommended a new Business Enterprises Act (regulating unincorporated business enterprise, i.a., law of partnership and the law of business trusts), the SA DTI policy paper explicitly states that the scope of the SA company law review will not include partnership law. It is, however, noteworthy that, Mongalo, for example, sees South African partnership law also in a bad state and in need of to being reviewed. Regarding the inclusion of the law of business organizations other than companies, he concludes that "it is therefore clear that the review of companies legislation cannot be done effectively without having regard to the law of other business undertakings. After all, competitiveness is required from all forms of business undertakings, not only companies." Therefore the UK developments in this field could also be of relevance for a possible future South African discussion on the reform of partnership law.

134 See Wandrag/Henning, 1996, JJS 11 et seq.
135 See Wandrag/Henning, ibid.
136 Wandrag/Henning, ibid., 12. See also Henning, "Close corporations and private companies in South and Southern Africa", 1995, Perspectives on company law, 163, 169.
3.3.1.4.1.3 Company law reform as an ongoing process and close corporation as an input commented upon internationally

Turning back to the current discussion on company law reform in South Africa, however, in the SA DTI policy paper one senses a certain sympathy for the approach to be taken in the UK with envisioning one Act. However, regarding the South African company law reform it is to be expected that the experts will also take into account developments in other similar jurisdictions.\(^{140}\) As has been stated in the context of previous company law reform discussions, the developments in the Australian and New Zealand legislations are of interest and the latter is seen as providing "exciting prospects for the South African Company Law".\(^{141}\) Regarding the developments in New Zealand it was in previous company law reform discussions submitted that it is difficult to imagine to ignore the developments there.\(^{142}\)

The question, "moet ons navolg?",\(^{143}\) which has been asked quite some time ago in South Africa also during a debate on a previous company reform process, has lost nothing of its actuality.

On the contrary, given the SA DTI policy paper this question is more relevant than ever. Is the one-Act approach and a new framework the only thinkable solution?

At the forefront of elaborating the various aspects in this regard will be the SAC, with its five standing subcommittees, \textit{inter alia}, also one on the Close

\(^{140}\) See for a short introduction regarding developments in Australia, New Zealand, Singapore and the USA, Henning, 2003, \textit{Comp. Law}, 353 \textit{et seq}.

\(^{141}\) du Plessis, 1992, \textit{TSAR} 561, 578. And through dealing with New Zealand, Canadian company law developments come also into perspective. See also Jordan, 1998. \textit{Cf.} also Wandrag, 28 \textit{Med SOR} (1997), 122 \textit{et seqq}.

\(^{142}\) du Plessis, 1992, \textit{TSAR} 561, 576. Lessing also argued at that time regarding the report no. 9 of the New Zealand Law Commission, entitled 'Company Law: Reform and Restatement', that "there is much wisdom in this Report (…) and it is to be hoped that those in charge of South African company-law reform will have a thorough look at it," Lessing, "Company-law reform in New Zealand", 1990, \textit{SA Merc LJ} 49, 59.

\(^{143}\) "Must we follow", du Plessis, 1992, \textit{TSAR} 561.
Corporations and a Coordinating Research Institute for Corporate Law (CRIC). From a comparative perspective it is interesting to note that these Committees are, unlike in Germany, an *ad-hoc* advisory board, which from case to case may be instituted through the Ministry on varying subjects and with different participants but standing committees.

However, until quite recently, *i.e.*, prior to the SA DTI policy paper, in shaping South Africa’s future regarding the development of entrepreneurial law, the Standing Advisory Committee on Company Law foresaw five principal statutes:

- a redrafted Companies Act (*i.a.*, not including the proposed new Security Act or Bankruptcy Act),
- a new Securities Act,
- a new Bankruptcy Act,
- a new Business Enterprises Act (regulating unincorporated business enterprise, *i.a.*, law of partnership and the law of business trusts), and
- the retaining of the Close Corporations Act 69 of 1984 in its present form.

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144 Cf. s 18 CA. See also Cilliers et al. (2000), 8.16 *et seqq.*

145 Regarding the situation in Germany in this context, one must mention proceedings of the parliament, 'Referentenentwurf' (document prepared by the responsible official of the ministry in charge presented to the interested public; broadly comparable to a Green Paper), 'Regierungsentwurf' (document presented by the government; broadly comparable to a White Paper) and occasionally the institution of commissions on particular matters. In shaping the reform on the Law of Insolvency, the Minister of Justice appointed such a commission ('Insolvenzrechtskommission'), see Scholz-Schmidt, *GmbHG* § 63, note 34 in the 8th edition. Another example is the Commission on Enterprise Law ('Unternehmensrechtskommission') appointed by this ministry ('Bericht über die Verhandlungen der Unternehmensrechtskommission' and published by the Commission in 1980) and the afore-mentioned 'Regierungskommission' Corporate Governance. One should also mention the influence of the 'Deutscher Juristentag' (German Conference of Lawyers) which gives important input into all fields of law and the 'legal machinery' through its commissions.

When the close corporation was introduced the invention was seen as "South Africa spreads its international wings" and that it would give the "development of our law in a comparative context" a new dimension, and would lead to an emancipation of South African company law.

Besides being discussed in the previously mentioned UK reform process, of course the advent of such a legal form created especially for smaller businesses was commented on positively not only within South Africa, but also internationally.

Zimbabwe based its Private Business Corporations Act 15 of 1993 on the South African model.\(^\text{150}\)

However, the concept of the South African Close Corporation reached beyond the neighbouring countries.\(^\text{151}\) Modelled on the South African example, Australia also enacted a Close Corporations Act in 1989, though due to constitutional complications this legislation has not been promulgated.\(^\text{152}\)

When it comes to reform one must also mention developments in the United States of America. In the last years a fundamental reworking of its non-corporate business organizations' legal structures has taken place there. As Vestal describes, "prior to the reformation of our laws, firms could be organized as general partnerships, limited partnerships, or corporations. After the transformation, traditional general partnership law has been reworked: general partnerships have mutated into limited liability partnerships, limited partnerships into limited liability limited partnerships, and a new form, the limited liability company, has been created."\(^\text{153}\)

Regarding the limited liability company\(^\text{154}\) Snyman/Henning state that "the rise from obscurity to its present position as a viable mainstream alternative to the corporation or partnership was met with enormous enthusiasm by the business

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\(^\text{152}\) Henning mentions that another Southern African state may also follow this example, 1995, \textit{THHR} 106.


Abbreviated LLC.
community and the bar. The reason for this is that the LLC is the first statutory business form to offer entrepreneurs limited liability, pass-through tax treatment and a decentralized governance structure among co-ventures which are uniquely flexible."\(^{155}\)

It is interesting to note that during the discussion surrounding the reform process very recently the South African close corporation approach and its legal structure found strong praise in the United States of America. In comparing the approaches towards small entrepreneurs Vestal states that "one might ask whether the American experiment was as justified by sound public policy, or as successful, as the South African experience. The answer on both counts is, I believe, that the South African record is superior to ours."\(^{156}\) Furthermore, it is stated by Callison that "the lessons of the South African experience, particularly its pragmatism and its recognition that business organization law has a robust public dimension, should form a backdrop for the continuing American business


entity law reform process."\textsuperscript{157} And Michael submits that "the South African experience was nonetheless successful by all counts."\textsuperscript{158} Subsequently, in conclusion Vestal states, "it would be a mistake to conclude that American jurisdictions should slavishly follow the South African model of business entity reform. The historic, economic, and political settings for reform are quite different. However, it would be equally erroneous to conclude that we have nothing to learn from our South African friends."\textsuperscript{159}

3.3.1.4.1.4. Close corporation at a crossroad

Regarding harmonisation of the new South African company law, the policy paper explicitly states that "in as far as possible, harmonisation with major trading partners will be pursued. In addition harmonisation with our company law in the SADC area will be pursued."\textsuperscript{160}

Concerning the main trading partners, recent statistics compiled by the SA DTI show that South Africa's main trading bloc is the European Union.\textsuperscript{161} Even when the numbers for the UK are substracted, the result remains the same. Another main trading partner is the USA. In both, the US and the other European countries, different acts are used to cater for the business community. In addition, also on the European Union level in the context of harmonisation different statutes remain or are envisaged. Thus, contrary to quite a number of legislatures, South Africa would only be following the UK-model introducing a 'one size fits all' approach.\textsuperscript{162}

\begin{itemize}
\item \textsuperscript{158} Michael, 2003, \textit{Ky. L.J.}, 849.
\item \textsuperscript{159} Vestal, 2003, \textit{Ky. L.J.}, 829, 836, 837.
\item \textsuperscript{160} SA DTI policy paper, 30.
\item \textsuperscript{162} In the discussion surrounding the creation of the close corporation, Naudé saw the situation in South Africa without a separate statute for smaller businesses like the one in England "but in contrast to all continental European systems". Naudé, 1982, \textit{MB} 5. Through the introduction of the CCA this, however, changed.
\end{itemize}
To achieve greater economic cooperation within the Southern African context, i.e., the Southern African Development Community, it is submitted that "in the same manner as the European Community recognized the necessity of company law harmonisation through the establishment of a Societas Europaea, the need for a Southern African form of business enterprise (...) should be recognized. (...) The same objectives guiding the South African legislature can now guide SADEC: simplicity, accessibility and limited liability. The distinctive features of the close corporation (...) can serve the whole of SADEC well. These objectives echo the needs of the Southern African Development Community for a Societas Africana to complement its African Renaissance." Given the existing reality of the legal form of a close corporation in other African countries already, this Societas Africana would also have the advantage that the process of finding a suitable business form would not have to last more than three decades, as in the case of the Societas Europaea. In addition it would serve as a commendable innovation from a continent which unfortunately too often makes unfavourable headlines. So in that sense the subheading in Henning’s article should add the exclamation mark and read 'A Societas Africana?!'.

As the SA DTI policy paper itself states, "perhaps the most significant departure from the United Kingdom occurred with the adoption in 1984 of the Close Corporations Act." Given the now foreseeable approach of the SA DTI to be attracted by the one-Act approach, it is ironic that now the umbilical cord between English and South African company law seems to be revitalized again.

163 Abbr. SADC.
167 SA DTI policy paper, 13.
In deciding the shape of its company law for the current century, a careful approach should be taken. Even when it is true that regarding South African company law regulations it can be stated, "the result has been a hodgepodge of regulation that is exceedingly complex and badly outdated," the question is how much the necessary reform should include the close corporation and if a one-Act approach is a wise solution.

The aim should be, not only to strike a balance between a new company law which is too interventionistic and thus chases away the necessary foreign investment on one side and South Africa's socio-economic context on the other side, but to regulate only when it is absolutely necessary to regulate. The negative impact of such a reform process on the business community and problems of instability within the business environment can be seen in the fact that even though the reform process is only in its early stages, the SA DTI was forced to clarify rumours that close corporations have to convert to private companies ((Pty) Ltd's) before April 2005 otherwise they will lose their corporate status.

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169 See also Birds, who in the context of the English company law reform discussion regarding the necessity of separate legislation dealing with the needs of smaller companies and the requirements that should be imposed thereon, refers to the "success in some other jurisdictions (e.g. South Africa)" and the fact that separate legislation "has long been the case in respect of the majority of our E.U. partners," 2000, Comp. Law. 39.

170 See Mongalo, 2004, SALJ 93, 97. Regarding the problems South Africa is facing to attract strong and sustained foreign investment, see de Gama, "Foreign direct investment in South Africa", 2003, Codicillus 61 et seqq. In the context of access to skilled workers he points at the fact that South Africa loses thousands of workers every year through emigration and seeing this as very different to other emerging markets such as Malaysia, Singapore, Korea and even Brazil, at 64.

171 "The dti would like to refute these rumours and state categorically that there is no plan to compel CC members to convert their businesses to private companies, nor will CCs lose their corporate status by April 2005 or any time already determined by the dti." SA DTI, media release 1 February 2005, "No compulsion to convert Close Corporations to Companies." Available at http://www.dti.gov.za/article/ articleview.asp?current=1&arttypeid=1&artid=892.
As Mongalo says, "changes should not be merely for the sake of change". So only if, after a detailed consultation, the overwhelming objective facts indeed speak for a one-Act approach, a compromise could be to follow Mongalo's suggestion that "if need be, there should be different statutes for each of the main types of business undertakings in South Africa."172 Regarding the close corporation, it can be submitted that there is no need to reinvent the wheel.

In addition, it would counteract the importance of the necessary reform if the process were compressed into a too ambitious time table.173 It should be kept in mind that the Van Wyk de Vries Commission, whose review was the basis for the Companies Act 61 of 1973, began its work in 1962. The reform process in the UK is also taking its time. The review in the UK started in 1998, the Final Report "Company Law review: Modern company law for a competitive economy" was published on 26 July 2001 and the Government’s response in its White Paper "Modernising Company Law" was published on 16 July 2002. The legislative process for reforming company law is a continuing one. However, so far regulations amended are dealing not with a whole new approach or Companies Act but, e.g., with auditing regulations, increasing company investigators’ powers and the introduction of a community interest company.174 Nevertheless, the reform process has gained new impetus through the publishing of another White Paper in March 2005, which "builds closely on the work of the Company Law Review (CLR), and of the Government’s subsequent White Paper of 2002."175 Subsequently, it, i.a., aims at better regulation, follows the think small

173 In the SA DTI, media release 1 February 2005, "No compulsion to convert Close Corporations to Companies," the DTI states that "the corporate law reform process is still at its embryonic stage (...)" and that "it is envisaged that the Corporate Law reform review will be finalized in 2007."
first approach and has as objective to make it easier to set up and run a company.¹⁷⁶

In the South African context it remains to be seen how the developments in the United Kingdom will find their place in the reform process of South African company law as envisaged in the most recent SA DTI policy paper and how the Coordinating Research Institute for Corporate Law (CRIC) will include them in its own research. However, one should always bear in mind the special significance of company law and its role in the smooth functioning of the economy.

3.4 CONCLUSION

Like the GmbH, also the close corporation so far withstood fundamental reforms and until very recently was set as a relevant player on the stage. However, the DTI policy paper "South African Company Law for the 21st Century – Guidelines for Corporate Law Reform", i.a., explicitly questions the role of the close corporation. Even though it go's without saying that intra-South African aspects play the dominant role, it is also of great relevance for the South African reform process to follow the developments in Britain. Here the aim is clear, the Steering Group proclaimed as its objective that as a result of the review British law should rank with the best in the world. This aim also influences the ongoing reform process of partnership law in the United Kingdom. However, the close corporation has been commented on positively not only within South Africa, but also internationally, i.a., seeing the CCA as an impressive statute and a model worth very serious consideration. The recent discussion in the USA on the close corporation approach and the corporation's legal structure, which found strong praise, is remarkable. Therefore it somehow comes as a surprise that the DTI policy paper moves towards an one-Act approach and it can be doubted whether this is a wise solution.

CHAPTER FOUR

4 CHARACTERISTIC FEATURES

4.1 INTRODUCTION

Both the GmbH and the close corporation aim at providing alternative legal options for small business entities, giving them a simpler and less expensive legal form, which satisfies their needs for flexibility while guaranteeing liability limitations and continuity. In addition, both entities are self-sufficient in that they do not rely on capital markets to fund their operations. With this in mind, the following chapter briefly compares a few characteristic features of each, specifics will be dealt with at a later stage.¹

4.2 LAWFUL PURPOSE, CERTAIN RESTRICTIONS

Both entities can be formed for any lawful purpose in accordance with their respective Acts. This purpose, of course, cannot disregard statutory prohibitions or violate against public bona mores. Certain restrictions, however, which explain themselves by reason of the legal form, do exist. The form of a GmbH cannot be used for a mortgage bank;² a private home savings bank;³ insurance societies and insurance companies in the fields of life-, liability-, fire- and hail insurance;⁴ in the areas of insurance trade;⁵ and pharmacy trade.⁶

¹ For a very informative overview, see Olbrisch/du Plessis, "Some structural differences between the South African Close Corporation and the German GmbH", 1997, TSAR 315 et seqq.
² 'Hypothekenbank', §§ 1, 2 HypBG ('Hypothekenbankgesetz', Mortgage Banks Act).
Regarding the self-employed (‘freie Berufe’), the choice of a GmbH is restricted. It is possible to practice in form of a GmbH for tax advisors and accounting firms and also without codified regulation for architects and engineers. Regarding lawyers and medical doctors wanting to practice in form of a GmbH, the previously strict prohibition has been softened remarkably.

The close corporation may not be used as a trustee for unit trust schemes; no attorney, advocate, chartered accountant or medical doctor may conduct his professional practice in the form of a close corporation. Architects, pharmacists, quantity surveyors, veterinarians and estate agents may carry out their business in the form of a close corporation only if the relevant requirements of their respective Acts have been complied with (Architects Act 35 of 1970, the Pharmacy Act 53 of 1974, the Veterinary and Para-Veterinary Professions Act 19 of 1982 and the Estate Agents Act 112 of 1976). It is noteworthy that in order to cater to the needs of the various professions (e.g., attorneys, stock brokers, quantity surveyors and architects) a special kind of private company with unlimited concurrent joint and several liability of the directors was introduced in 1968 allowing them to be incorporated and thus, i.a., achieve corporate existence and perpetual succession. In this specific case the last word in this company’s name must be "Incorporated".

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5 'Versicherungsgewerbe', § 34b (3) GewO ('Gewerbeordnung', Trade, Commerce and Industry Regulation Act).
6 'Apothekengewerbe', § 8 ApothG ('Apothekengesetz', Pharmacy Act).
7 'Steuerberater', § 49 (1) StBerG ('Steuerberatungsgesetz', Tax Advisory Act).
8 'Wirtschaftsprüfungsgesellschaften', § 27 (1) WPO ('Wirtschaftsprüferordnung', Public Accountants Act).
9 Cf. regarding the lawyers-GmbH, Donath, "Rechtsberatungsgesellschaften", 1992, ZHR (156), 134. Compare for latest changes allowing such choice, chapter 2.3.1.4, 'Recent developments'.
10 Cf. Unit Trusts Control Act 54 of 1981.
12 Cf. s 53 (b); ss 49 (4), 50 (1) CA. See Cilliers/Benade (1985), 3.07.
A commercial objective\textsuperscript{13} is not compulsory even though § 13 (3) GmbHHG declares the GmbH to be a 'Handelsgesellschaft' (commercial company) within the Commercial Code\textsuperscript{14} and s 12(b) CCA speaks of the 'principal business' carried out by the corporation.\textsuperscript{15} Regardless of the fact that most of the entities for the most part are formed for commercial purposes, they, for example, can also be established for scientific, cultural and social aims as well as for sport activities.

4.3 LEGAL PERSONALITY

Both business entities are granted the status of a legal person.\textsuperscript{16} This means, \textit{inter alia}, that they can sue and be sued, acquire rights and incur duties and hold property. It also grants them perpetual existence, entailing that changes in membership do not affect the respective entities existence.\textsuperscript{17}

\textsuperscript{13} Delport-Pretorius (1989), 8, speak of a "profit motive". Cf. also Bleimschein/Henning, "The registrability of a close corporation not for gain", 1989, THRHR 251 \textit{et seqq}. and "Structuring a close corporation not for gain", 1990, THRHR 567 \textit{et seqq}.

\textsuperscript{14} This subjects the GmbH to the rules of the HGB whether its activity is a commercial one or not. Falling under § 6 (2) HGB as a company being a merchant by structure ("Kaufmann im Rechtssinne") - regardless of the nature of its activities ("Formkaufmann") - the GmbH is subject to the HGB rules.

\textsuperscript{15} This wording implies that a corporation may be formed to carry on more than one kind of business, see Henochsberg on the Close Corporations Act s 12, 12.6., 13.2; (further abbr. Henochsberg CCA).

\textsuperscript{16} § 13 (1) GmbHG; s 2 (2) CCA which also explicitly states in sub-section (4) that a corporation has the legal capacity and power of a natural person in so far as a juristic person is capable of having such capacity and exercising such power.

\textsuperscript{17} The principle of a separate legal entity was established in South Africa by the House of Lords in \textit{Salomon v Salomon & Co Ltd} (1897) \textit{AC} 22 (HL), and has since been upheld by South African courts. In the judgement, Lord Halsbury states that "once a company is legally incorporated it must be treated like any other independent person with rights and liabilities appropriate to itself", at p. 30. See also \textit{Dadoo Ltd & others v Krugersdorp Municipal Council} 1920 (AD) 550. In this case the owner of a company owned by Indians bought a stand in an area reserved for ownership of other race groups. The court held that the company was a legal entity separate from that of its members and that the ownership was not prohibited by the law. See also Bourne, for a recent decision of the Supreme Court of Appeal. She sees the independence of the corporate entity from its
In the context of the close corporation, especially from a viewpoint outside South Africa, it is noteworthy to mention the discussion about constitutional rights for juristic persons. Henning/du Toit state, "South Africa has relatively recently entered a constitutional milieu in which the Constitution\textsuperscript{18} enjoys absolute supremacy and in which any law inconsistent with its provisions is null and void. In a constitutional state such as this, the biggest challenge facing company law in the coming millennium is constitutionality."\textsuperscript{19} According to s 8 (4) of the Constitution, juristic persons are entitled to the protection of constitutional rights to the extent required by the nature of the rights and of that juristic person. However, this was challenged in the First Certification Judgement\textsuperscript{20}. As Havenga describes, the objection was raised that the Constitutional Principles only permitted the Constitutional Assembly to confer fundamental rights on natural persons, and that an extension of the rights to juristic persons would diminish the protection they offered to natural persons.\textsuperscript{21} This was rejected by the Constitutional Court, holding that many universally accepted fundamental rights would be fully recognised only if afforded to juristic as well as natural persons. The court pointed out that the Constitution recognises that some rights are not appropriate to benefit juristic persons, and it also permits a court to take the nature of a juristic person into consideration in deciding whether a particular right is available to such person.\textsuperscript{22}

\textsuperscript{18} Constitution of the Republic of South Africa 108 of 1996.
\textsuperscript{19} Henning/du Toit, "South Africa: Constitutionally challenging the Companies Act – the coming millennium", 2000, JFC 181; see also regarding the discussion before enactment of the new constitution and to which extent juristic persons may be protected through it, cf. Larkin, "Company Law (Including Close Corporations)", 1993 Annual Survey of South African Law 425.
\textsuperscript{21} See Ex parte Chairperson of the Constitutional Assembly at 792I–793B.
\textsuperscript{22} See Ex parte Chairperson of the Constitutional Assembly at 793C–D; Havenga, 1999, THRHR 495, 496 et seq. Cf. also AK Entertainment CC v Minister of Safety and Security 1995 1 SA 783 (E) at 790B (s 7(3) corresponds to s 8(3) of the final
Another concern of the objectors in the First Certification Judgement was that affording rights to powerful and wealthy corporations would result in detriment to individual rights, given that powerful corporations have greater resources to enforce their rights through litigation. The court indicated that the same was true of powerful and wealthy individuals, and that the objection wrongly equated juristic persons with powerful and wealthy corporations. It argued that in South Africa there are countless small companies and close corporations that need and deserve the same protection as natural persons do.\textsuperscript{23}

4.4 LIMITED LIABILITY

Since a legal personality is conferred upon these entities, the members\textsuperscript{24} are, generally speaking, not liable for the debts of the GmbH or the close corporation.\textsuperscript{25} The GmbH uses the maintenance of capital concept while the CCA works with a concept based on solvency and liquidity.\textsuperscript{26} Therefore, in case of a liquidation of the entity, the members’ personal estates are not sequestrated.

The GmbH being a 'Kapitalgesellschaft' requires its members to contribute to the 'Stammkapital' (share capital). The minimum share capital requirement is 25,000

\begin{itemize}
  \item \textsuperscript{23} See \textit{Ex parte Chairperson of the Constitutional Assembly, ibid.}
  \item \textsuperscript{24} With regard to the GmbH the expressions "member" and "shareholder" are used interchangeably.
  \item \textsuperscript{25} It is, however, common practice that members and/or the managing director are required by creditors to stand surety or to provide some other form of security for the obligations.
  \item \textsuperscript{26} It is noteworthy that the Companies Act of 1973 has been amended by the Companies Amendment Act 1999, which came into force on 30 June 1999. Through this amendment, a fundamental shift in South African company law took place in that the capital-maintenance concept was replaced with the solvency-liquidity formula as the protection for investors and creditors; see McLennan, "Company dividends: The new Law", 2001, \textit{SALJ} 126 \textit{et seqq.}; Wainer, "The Companies Act changes – Problems and doubts", 2001, \textit{SALJ} 133 \textit{et seqq.}
\end{itemize}
Euros of which an aggregate amount of 12,500 Euros have to be paid at incorporation.\textsuperscript{27} In the GmbH the liability of the members is limited to the amount of their initial contribution to the share capital,\textsuperscript{28} and a joint \textit{pro rata} liability exists for unpaid initial contributions of fellow members.\textsuperscript{29}

The liability of the members in a close corporation is limited to what they have contributed to the close corporation. The corporate entity, as a separate legal person, is liable for its own debts and losses.\textsuperscript{30} However, the members of a close corporation may lose their protection under certain circumstances as set out in the Act.\textsuperscript{31}

4.5 ORGANS, INTERNAL AND EXTERNAL RELATIONS

Both Acts set out non-variable rules with regard to the protection of creditors. As mentioned, the GmbHG uses the maintenance of capital concept while the CCA works with a concept based on solvency and liquidity; both entities are free to arrange their internal relations as they desire, changing the variable rules of their Acts in the articles of association and the association agreement respectively.

Although the GmbH is a 'Kapitalgesellschaft' there is no strict division between the organs involved, namely management and membership,\textsuperscript{32} as is the case in the AG. However, compared to the close corporation, the GmbH is more formally structured and has, as mandatory organs, the managing director and the shareholders' meeting.\textsuperscript{33} Such a strict distinction is not embodied in the CCA; and while the GmbH-members must appoint a managing director to represent

\textsuperscript{27} §§ 5 (1), 7 (2) 1st and 2nd sentence GmbHG. Previously the amounts were 50,000 DM and 25,000 DM. \textit{Cf.} chapter 4.2.2, 'Contribution to the share capital'.

\textsuperscript{28} § 13 (2) GmbHG. Instead of "initial contribution" the expressions "original investment" or "original subscription" are also used in legal literature.

\textsuperscript{29} § 24 GmbHG, in addition to this further contributions may be agreed upon in the articles, §§ 26-28 GmbHG.

\textsuperscript{30} S 2 (3) CCA.

\textsuperscript{31} \textit{Cf.} chapter 9.3.1, 'Different forms of liability'.

\textsuperscript{32} Olbrisch/du Plessis, 1997, \textit{TSAR} 315.

\textsuperscript{33} In the 'Aktiengesellschaft' this meeting is known as the 'Hauptversammlung' or general meeting.
the GmbH, the close corporation uses the partnership principle of *mutua praepositio* (mutual agency). This principle empowers each member to represent the corporation in carrying out its business. Furthermore, each member of the close corporation also has the right to participate in the management of the affairs of the corporation underlining its 'closeness'. As I will later show this difference has a great impact, for example, on external relations and liabilities.

It is important to note that both the doctrine of constructive notice and the doctrine of *ultra vires* do not apply to the close corporation. The doctrine of *ultra vires* is unknown in German company law.

### 4.6 CLOSENESS AND OPENNESS

One of the main differences between the GmbHs and close corporations lie in different 'closeness' or 'openness' respectively with regard to third parties. While the close corporation is limited to only ten members, and membership is limited to natural persons, both natural and juristic persons may become members of a GmbH. Furthermore, the GmbH's membership is not limited to any specific number.

A distinction also exists in connection with publicity procedures. Due to the changes as a result of EC-Directives with regard to accounting and reporting,

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34 § 35 GmbHG.
35 § 54 CCA.
36 See chapters 8, 'External relations' and 9, 'Liability'.
37 Ss 17 and 45 CCA state that no person shall be deemed to have knowledge of any particulars in the founding statement, other documents or an association agreement registered by the Registrar or lodged with him or which is kept at the office of the close corporation. Delport-Pretorius (1989), 43. See chapter 8.3.1, 'Fons and origio'.
38 Delport-Pretorius (1989), 43. See also chapter 8.3.1, 'Fons and origio'.
39 See chapter 8.2.1, 'Managing director and representation'.
40 § 1 GmbHG; s 2 (1) CCA. However, cf. chapter 5.2, 'Rules regarding the number of members in a GmbH and Close Corporation' for further aspects, *i.a.*, in connection with the limitation to ten members.
the GmbH is compelled to 'open its books'\textsuperscript{41} while the close corporation's accounting and publicity are an internal affair and reflect the simplicity of the 'paperwork', as was aimed for in the CCA. Notwithstanding these differences, both entities share their 'closeness' in the fact that even though the "shares"\textsuperscript{42} or respective "interests" are transferable, they cannot be traded at the Stock Exchange and their negotiability is restricted. In the GmbH such a transfer requires a notarial deed, § 15 (3) GmbHG, and very often the articles define further restrictions like, for example, also mentioned in s 33 \textit{et seqq}. CCA.\textsuperscript{43} The service of a notary ('Notar') in Germany is very important for all kind of legal transactions in the every-day life. A notary in Germany is a fully-trained legal professional whose functions include, but are not limited to, the authentication ('Beglaubigung') of signatures. However, notaries have much broader responsibilities, such as the preparation of legal documents and the recording ('Beurkundung') of those legal documents that they have drafted or that have been submitted to them. In addition the notary must provide objective advice to parties who consult him or seek his notarization about the legal significance not only of documents drafted by the notary himself, but also of documents drafted by the parties or their advisors and brought before the notary for recording. Regarding a GmbH a notary becomes relevant, \textit{i.a.}, in connection with its founding, transfer of shares, or change of articles.

4.7 FLEXIBLE STRUCTURE UP TO THE MEMBERS

Besides some common features, one has to keep in mind that the GmbH is a 'Kapitalgesellschaft' which has a certain influence on the entity's set-up and structure.

When regulating the internal relationship, the GmbH rules are much more flexible and not so stringent than those of the AktG. Therefore, it is up to the members to decide how they make use of the flexible provisions with regard to their internal relationship. Thus, they can arrange their internal relationship in a

\textsuperscript{41} See chapter 10.2.1, 'Changes through the Bilanzrichtliniengesetz' for the Directives.

\textsuperscript{42} In the legal terminology regarding the GmbH usually the term "Geschäftsanteile" is translated with "share" but the term "interest" is also used.

\textsuperscript{43} See for further aspects, chapter 5.5.1.2, 'Sale'.
way that the GmbH is moduled very partnership-orientated or arrange it in a way that the internal relationship is much more formalistic and leans more in the direction of the AG.

The same considerations apply to the close corporation’s structure: The members can choose either the structure of a partnership\textsuperscript{44} or that of a private company. It is up to them to decide in which direction they want to arrange the internal structure of their corporation.

4.8 CONCLUSION

With certain restrictions explaining themselves by reason of the legal form, GmbH as well as close corporation can be chosen as business form especially for smaller businesses. A commercial objective, however, is not compulsory for both of them.

The status of a legal person grants them many rights, be it to sue, acquire rights, hold property or achieve perpetual existence. Due to the discussion on the new constitution, in the South African context the Constitutional Court already had to decide on the question whether juristic persons are entitled to the protection of constitutional rights. In the First Certification Judgement the Constitutional Court decided this favourably.

Both entities grant their members limited liability. The GmbH achieves this through the maintenance of capital concept and the close corporation through a concept based on solvency and liquidity. Regarding organs, compared to the close corporation, the GmbH is more formally structured and has, as mandatory organs, the managing director and the shareholders’ meeting. Such a strict distinction is not embodied in the CCA; and while the GmbH-members must appoint a managing director to represent the GmbH, the close corporation uses the partnership principle of \textit{mutua praepositio} (mutual agency). This principle empowers each member to represent the corporation in carrying out its business. Furthermore, each member of the close corporation also has the right to participate in the management of the affairs of the corporation underlining its 'closeness'. While both Acts set out non-variable rules with regard to the

\textsuperscript{44} As mentioned above, the limited partnership is of no relevance in South Africa, chapter 2.4.1.1, 'Partnerships'.


protection of creditors, to a great extent both entities are free to arrange their internal relations as they desire, changing the variable rules of their Acts in the articles of association and the association agreement (if any) respectively.

The doctrine of constructive notice and the doctrine of *ultra vires* do not apply to the close corporation. The doctrine of *ultra vires* is unknown in German company law.
CHAPTER FIVE

5 FOUNDATION

5.1 INTRODUCTION

In order to incorporate their business entities and to achieve the status of a juristic person for the respective entity, members must comply with certain regulations dealing with the entity’s foundation. These regulations share the aim that members must commit themselves to the business entity being established and provide it with the necessary means to start business. They also share the fact that they have to be registered with an official authority, this being the local court for the GmbH and the Registrar of close corporations for the close corporation. In both cases, after registration the public has to be informed. However, differences in this founding process exist reflecting the position of the GmbH as a 'Kapitalgesellschaft'. As the share capital required is meant to protect the creditors, the GmbHG sets out in detail provisions with regard to the members’ contribution and its maintenance. In addition the position of a managing director is compulsory, he has specific tasks in the process of filing the formal application. Even with these differences in mind, it is interesting to compare some aspects of the founding process, i.e., provisions regarding name, domicile, transparency of financial matters, kind of business and amendment of articles of association and founding statement.

5.2 GMBH

The GmbH is entered into a commercial register,¹ which is maintained by the local court in the company's county or district. In order to register such a

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¹ With regard to the importance of the commercial register, see Brox, Handelsrecht und Wertpapierrecht (1993), § 7 note 101 et seqq. with further references. However, due to changes in the Disclosure Directive with the aim to ease and to speed up access, beginning on 1 January 2007 the commercial registers in all Member States, i.a., must be kept electronically and must be ready to be accessed electronically, Directive 2003/58/EC of the European Parliament and of
company the members of the GmbH must observe a number of regulations, as explained in detail below.

The purpose of the commercial register is to provide a record of the names and essential legal relationships of single merchants (‘Einzelkaufleute’), commercial partnerships and incorporated companies like the GmbH. The commercial register consists of two sections (‘Abteilungen’). In section A, i.a., registration relating to single merchants, general commercial partnerships (‘offene Handelsgesellschaften’) and limited commercial partnerships (‘Kommanditgesellschaften’) takes place. Section B is dealing with, i.a., registrations relating to incorporated corporations such as stock corporations (AGs) and GmbHs. The commercial register is kept by the local court. ² There is no single central national commercial register. Instead, one commercial register usually exists in each district of each local court. A GmbH must be entered in the commercial register of the local court where it has its domicile. ³ The court must publish registrations in the commercial register in the Federal Gazette (‘Bundesanzeiger’) of Germany and in at least one newspaper chosen by the local court. ⁴ In addition, registrations in the commercial register are open to inspection by the public and copies can be obtained.

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² § 8 HGB.
³ § 7 (1) HGB.
⁴ § 10 (1) sentence 1 HGB.
5.2.1 Articles of association

Firstly the members have to draw up the articles of association.\(^5\) In essence, this one document contains what would be set forth in two corporate documents under South African company law, namely the memorandum and the articles.

The GmbHG provides that certain minimum stipulations must be contained in the articles of the GmbH. These are the name, the domicile of the company, the purpose of the company, the amount of its share capital as well as the amount of each shareholder’s contribution.\(^6\)

In addition, if the GmbH has been formed for a fixed term or, if apart from the initial contribution to the share capital, further obligations towards the company are imposed on members, provisions to this effect have to be contained in the articles in order to be valid and binding.\(^7\) It is common practice to add additional provisions supplementing, or deviating from, the statutory provisions, which are largely not mandatory, with respect to the structure and operation of the GmbH.

This is due to the fact that the GmbH is based on the concept of freedom of contract, allowing a wide variety of arrangements between the members so long as there is no infringement of the general law or the fundamental principles laid down by the Act.\(^8\) The articles must be in notarial form and must be signed by each member.\(^9\)

5.2.2 Contribution to the share capital

After setting up the articles, further steps have to be taken to achieve registration. Keeping in mind that the GmbH is a 'Kapitalgesellschaft' and that the share capital is meant to protect the creditors, the Act sets out in detail provi-

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\(^5\) In the legal terminology the term "shareholders' agreement" is also used.

\(^6\) As contained in § 3 (1) GmbHG.

\(^7\) § 3 (2) GmbHG.

\(^8\) Oliver (1986), 5.

\(^9\) § 2 (1) 2nd sentence GmbHG; holders of a proxy may only sign if their proxy is either conferred or certified before a notary, § 2 (2) GmbHG. In general this does not apply for separate contracts, an exception, for example, is a contract transferring real estate.
sions with regard to the members' contribution and its maintenance.\textsuperscript{10} The members must subscribe in full to the entire share capital, which must be at least 25,000 Euros.\textsuperscript{11}

With regard to cash-contributions, a minimum of one quarter of each contribution must be paid before the GmbH is registered. Moreover, the total amount of the non-cash contributions made, as well as of the cash contributions paid before the registration, must at least be 12,500 Euros.\textsuperscript{12} The articles may also provide for a combination of cash and non-cash contributions. Regarding non-cash contributions, generally all transferable assets other than cash qualify as non-cash contributions. These could be, e.g., land, buildings, receivables, copyrights, shares in other companies and other tangible, intangible, movable, and immovable property.

The remaining share capital contributions become due for payment as provided for in the articles or, where the articles are silent on the topic, when called for by way of a shareholders' resolution.\textsuperscript{13} With regard to the non-cash contributions, a special report is required explaining the valuation of the non-cash contributions, together with supporting documents.\textsuperscript{14} It is important to note that non-cash contributions must be made in full before registration can take place. If non-cash contributions are made partially, the GmbH must not be registered.

\textsuperscript{10} See § 30 (1) GmbHG stating the general rule regarding payments to the members that these must not reduce the 'Stammkapital' (share capital); § 33 (1) GmbHG regulating that acquiring of shares through the company which are not fully paid up is not allowed.

Compare also the various provisions regarding share capital increase and decrease, § 55 – 58 f GmbHG. The contribution is one of the main duties of members towards the company, see chapter 8.3.2.1.1, 'Obligations with regard to the initial contribution'.

Lutter, 1981, The Journal of Business Law 155, 157 speaks of minimum nominal capital and minimum paid-up capital. The protection of creditors is, however, relative, \textit{ibid}. in fn. 6 Lutter gives an example of a GmbH which reached sales of 200 million DM with the minimum nominal capital of then (before the 1981 reform) only 20,000 DM.

\textsuperscript{11} § 5 (1) GmbHG, (previously 50,000 DM), there is no limit with regard to the share capital. As just mentioned, the amount was increased through the 1981 reform; previously the amount was 20,000 DM.

\textsuperscript{12} § 7 (2) 1st and 2nd sentence, § 7 (3) GmbHG. Special provision has been made for the one-man GmbH, see § 7 (2) 3rd sentence GmbHG.

\textsuperscript{13} § 46 no. 2 GmbHG.

\textsuperscript{14} § 5 (4) 2nd sentence GmbHG.
contributions are made their monetary value must be stated in the articles with regard to the share capital contribution covered by them.\textsuperscript{15}

Following the introduction of the Euro, the Euro Introductory Act was enacted.\textsuperscript{16} This Act sets out the minimum capital for a GmbH at 25,000 Euros, with each shareholder contributing a minimum of 100 Euros.\textsuperscript{17} Companies formed during the transitional period (\textit{i.e.}, up to 31 December 2001) could choose whether to denominate their capital in Euros or 'Deutsche Mark'. Companies formed thereafter must denominate shares only in Euros. Companies formed prior to 31 December 1998 do not have to convert their share capital to Euros, unless they restructure their share capital.\textsuperscript{18} Therefore the 'Deutsche Mark' will remain a feature of company share capital structures for many years to come.

5.2.3 Appointment of managing director

The members must appoint at least one managing director. They can do in this either in the articles or through a separate resolution.\textsuperscript{19}

5.2.4 Filing of formal application

The managing director must file the formal application, which must contain a number of documents as well as be accompanied by statements and specific

\textsuperscript{15} § 7 (3), § 5 (4) 1st sentence GmbHG, introduced through the 1981 reform.
\textsuperscript{16} 'Gesetz zur Einführung des Euro', 9 June 1998, BGBl. I 1242, ('Euro Einführungsgesetz', abbr. EuroEG), in force since 1 January 1999. Based on EU Regulations this is the first of a number of Acts dealing with the introduction of the Euro into national law. For some unsolved questions in the GmbH following the resulting conversion from DM to Euro, see Frank/Wachter, "Ungelöste Folgefragen der Euro-Umstellung bei der GmbH", 2001, GmbHR 898 et seqq.
\textsuperscript{17} See EuroEG dealing with a wide variety of Euro connected changes in company law. Cf. article 3, § 3 regarding the changes concerning the GmbH. The minimum nominal capital of an AG is to be 50,000 Euros with the minimum par value of a share being 1 Euro; Article 3, § 1 and § 2 EuroEG.
\textsuperscript{18} See § 86 GmbHG.
\textsuperscript{19} § 6 (1) and (3) GmbHG; the respective resolution needs a simple majority of the votes cast, § 47 (1) GmbHG.
assurances, with the court of registration. Accordingly, the application includes the articles of association, a list of the members with their personal data and the amount of the share capital contributions subscribed to by each of them, in the case of non-cash contributions corresponding contracts and a special report with supporting facts concerning these non-cash contributions. The application also has to contain the assurance that the contributions in respect of the share capital contributions, as required by § 7 (2) and (3) GmbHG, have been made and that their subject-matter is finally at the free disposal of the managing director. Unless otherwise stated in the articles, the managing director has to (1) give evidence of the managing director's appointment, (2) state the extent of the managing director's authority and (3) lodge his signature for deposit with the court. He also shoulders the obligation to declare that there are no circumstances or facts which preclude his appointment. Where the object of the enterprise requires a government permit, the record of this permit must be submitted.

The Members and the managing director(s) become jointly and severally liable for claims of compensation arising out of untrue statements made for the purpose of forming the GmbH and in case of over-evaluation of non-cash contributions the member concerned is liable to pay the deficit in cash.

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20 For the particulars, see §§ 7 (1), 8 GmbHG; § 78 GmbHG has to be complied with in a prescribed form, see § 12 HGB, §§ 126, 129 BGB; proxy is not possible due to the direct responsibility and liability as expressed in §§ 9, 82 (1) GmbHG.
21 § 8 (1) no. 1 GmbHG.
22 § 8 (1) no. 3 GmbHG.
23 § 8 (1) no. 4 GmbHG.
24 § 8 (2) sentence 1 GmbHG.
25 § 8 (1) no. 2 GmbHG.
26 § 8 (4) GmbHG.
27 § 8 (5) GmbHG.
28 § 8 (3) sentence 1 GmbHG.
29 § 8 (1) no. 6 GmbHG.
30 § 9a (1) GmbHG, see also sub-sections and § 82 (1) GmbHG.
31 § 9 (1) GmbHG, see also § 82 (1) GmbHG.
5.2.5 Court examination following registration application

The court examines both the application as well as the attached documents ensuring that the purpose of the GmbH is legal and not contra bonos public mores. It must further decide if the minimum requirements have been met, particularly, with regard to the subscription of the initial contribution and the minimum payments. If non-cash contributions have been made the court must examine whether an over-evaluation has taken place.

If, for example, the GmbH was not properly formed, the application not properly made, or if non-cash contributions have been overvalued, the court will deny registration. If the application is proven correct, the court will register the GmbH into the commercial register, registering the name and domicile of the company, its objective, the amount of its share capital, the date of the adoption of the articles of association, the name of the managing director as well as his legal capacity.

Through this registration, the GmbH becomes a juristic person. The public is to be informed through announcement of the registered facts in the Government Gazette and another publication (usually a major local newspaper).

5.3 CLOSE CORPORATION

5.3.1 Founding statement

The incorporation of the close corporation is achieved simply. The members must set up a founding statement, which gives the following details as required in s 12 CCA:

32 § 9c GmbHG. See for the details of § 9c GmbHG and the requirements regarding the review of the adjective and substantive law ('formelles und materielles Prüfungsrecht') as well as the amendment of § 9c (2) GmbHG (which was amended to speed up registration and is in force since 1.7.1998), Lutter-Hommelhoff, GmbHG § 9c, note 2 et seqq.
33 § 7 (2) GmbHG.
34 § 9c second sentence GmbHG.
35 § 10 (1) GmbHG. In this context, see also § 15 HGB.
36 § 11 (1) GmbHG.
37 § 10 (3) GmbHG, § 10 (1) HGB.
- full name of the corporation and if required, a literal translation of that name in any one other official language and a shortened form of that name or such translation;
- principal business to be carried out by the corporation;
- postal address of the corporation;
- the office address of the corporation;
- the full name of each member and his identity number or, if he has no such number, the date of his birth, and his residential address;
- the size of the interest of every member in the corporation, expressed as percentage;
- particulars of the contribution of each member to the corporation, be it in the form of money, property (corporeal or incorporeal) or services rendered with and for the purposes of the formation and incorporation of the corporation;
- the name and address of the accounting officer or firm which has consented in writing (which consent must accompany the founding statement on being lodged) to appointment as accounting officer;
- the date of the end of the corporation's financial year.

The founding statement must then be signed by or on behalf of every member.38

5.3.2 Filing of formal application

Before the members hand in their application for incorporation they must obtain the approval and reservation of the name to be used from the Registrar.39 To achieve registration only the founding statement, the form regarding the reserved name of the corporation and the written consent of the accounting officer to his appointment must be submitted to the Registrar of close corporations in Pretoria.40

38 S 12 (1) CCA.
39 S 19 (2) CCA. S 19, as substituted by s 5 of the Close Corporations Amendment Act 16 of 1997, now makes the reservation of name prior to lodging the founding statement or amended founding statement to effect a change of name obligatory. The reservation is valid for two months. See also Close Corporations Service, 2.08.
40 And if applicable, a power of attorney in the case of the founding statement having been signed on behalf of any of its members, see Delport-Pretorius
5.3.3 Registrar examination

If all the requirements have been met, e.g., with regard to the lawfulness of the business of the corporation, the Registrar registers the founding statement and assigns a registration number to the corporation. He also has to certify on the founding statement that the corporation has been incorporated. The notice of incorporation must then be published in the Government Gazette. A copy of its founding statement and any proof of its registration has to be kept at the registered office of the corporation and is open to public inspection.

Through the registration the close corporation becomes a juristic person. Improper references by a person to incorporation in terms of the Act are treated as an offence.

5.4 COMPARISON OF SOME ASPECTS

In the following section it is appropriate to compare some of the following aspects which are required when founding a GmbH or close corporation: Name; domicile; accounting officer; kind of business; amendment of articles of association and founding statement. However, note that differences exist in connection with the business forms coming into legal existence. While the close

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(1989), 11; cf. also Symington, Close corporations in South Africa (1986), referring to other useful aspects, 27, s 12 comment at the end. As already mentioned, the function of the former Registrar of Close Corporations has been taken over by the Companies and Intellectual Property Registration Office (CIPRO).

41 Ss 13 and 14 (1) CCA.
42 S 16 CCA.
43 S 2 (2) CCA.
44 S 22A, s 82 (1)(c) CCA.
corporation comes into existence by registration,\textsuperscript{45} for the GmbH there are two pre-stages: the 'Vorgesellschaft' and 'Vorgründungsgesellschaft'.\textsuperscript{46}

5.4.1 Name

Concerning the name chosen for the business entity, both Acts make specific provisions.

Regarding the situation in Germany the registered name ('Firma') of an enterprise is the name in which all business must be conducted. In the GmbHG, the previous regulation in § 4 required that the name of the GmbH had to be derived either from the object of the business or contain the name of at least one of the members or be a combination of both requirements.\textsuperscript{47} These stringent provisions have been eased fundamentally to give German companies a competitive edge in preparation for the European Common Market. Since the Act on Commercial Law Reform,\textsuperscript{48} pure fantasy business names are possible. A business name merely needs to be suited to designate the merchant and have distinctiveness\textsuperscript{49} without being misleading to persons who might do business with the merchant.\textsuperscript{50} A name no longer need be descriptive of the company's purpose or contain the names of one, several or all of the company's shareholders. Now the company name of a GmbH can include the object of the business (non-personal company name), the name of one or more of the proprietors (personal company name) or freely invented suffixes. Combined versions are also possible.\textsuperscript{51}

\textsuperscript{45} Olbrisch/du Plessis speaking of "uno actu", 1997, TSAR 315, 316.
\textsuperscript{46} Pre-incorporated company and pre-incorporated partnership. Discussed in chapters 9.4.1.1.1, 'Vorgründungsgesellschaft' and 9.4.1.1.2, 'Vorgesellschaft'.
\textsuperscript{47} § 4 (1) GmbHG, § 22 (1) HGB.
\textsuperscript{49} § 18 (1) HGB.
\textsuperscript{50} § 18 (2) HGB.
\textsuperscript{51} Cf. Lutter-Hommelhoff, GmbHG § 4, note 2 et seqq. However, the courts have different opinion regarding the possibility of such names, see, e.g., BayObLG,
Geographic suffixes are basically allowed if the company has a special connection to the named region, for example, its headquarters or base. Whatever the choice, the name must contain "Gesellschaft mit beschränkter Haftung", or abbreviated "GmbH", but not necessarily at the beginning or at the end.

Additional words or descriptions are possible and sometimes necessary to individualize the company. They must, however, not be misleading or confusing to the general public. The name of the firm must not be too similar to an existing one. It must be clear, true, and distinguishable from all other business names previously registered at the local Commercial Register and must indicate the legal structure of the company.

As no national register or clearing system exists, it is the duty of a new company to ensure that it does not violate another company's prior rights and the alertness of the established company to see that no new company uses a similar name. This must, however, not lead to the conclusion that the previously established company is without rights. The opposite is the case, as the established company may institute a claim for omission on the grounds of § 16 UWG, § 24 WZG and § 12 BGB. According to these provisions in the case of confusion it is possible to prohibit the use of a name.


53 § 4 GmbH.

54 § 30 (1) HGB, § 18 (2) HGB. With regard to general principles of the law on firms, see Brox (1993), § 9 note 138 et seqq.; Sudhoff (1992), 152 et seqq.

55 In cases of doubt the relevant Chamber of Industry and Commerce will provide the district court with an opinion on the admissibility of the company name. Therefore it is recommended to contact the relevant Chamber in order to exclude at an early stage any risk of confusion or possible doubts about the company's real status and clarity of purpose.

56 'Gesetz gegen den unlauteren Wettbewerb' (Unfair Competition Act).

57 'Warenzeichengesetz' (Trademark Act).

58 See Lutter-Hommelhoff, GmbH § 4, note 39 for further particulars.
Regarding the close corporation the abbreviation CC if the name is English, BK if the name is Afrikaans, in capital letters, or its equivalent in any other official language, must be subjoined to the name used by the corporation.\textsuperscript{59}

As stated, the members of the close corporation must apply to the Registrar for the reservation of a name prior to submitting the registration form.\textsuperscript{60} This application is be done by completing a special form requiring, \textit{inter alia}, the members to state whether the proposed name is associated with a person, corporation or a company, and if so, the details regarding the association, the reason(s) for, or origin of the proposed name (if there is no association), and the principal business of the corporation.

The Registrar may refuse registration of a corporation if the name is "in the opinion of the Registrar undesirable"\textsuperscript{61} and as submitted "in practice this mainly

\begin{table}[h]
\centering
\begin{tabular}{|l|l|l|}
\hline
Language & Term for close corporation & Abbreviation \\
\hline
Sepedi: Kgwebo e Kgotlangantswego & KK \\
Setswana: Dikoporasi tse di Tswaletsweng & KT \\
siSwati: LiBhizinisi leliValekile & BV \\
Sesotho: Kwebo e Lekanyeditsweng & KL \\
Tshivenda: Dzikoporasi dzo valiwaliwaho & KV \\
Xitsonga: Ntirhisano wa Nhlangano & NH \\
isNdebele: Ikampani yaba-Thileko & KT \\
isXhosa: Inkampani yabamBalwa & KB \\
isZulu: iKhamphani yabamBalwa & KB \\
\hline
\end{tabular}
\caption{Terms for close corporations in various languages.}
\end{table}

\textsuperscript{59} S 22 (1) CCA.
\textsuperscript{60} Chapter 5.3.2, 'Filing of formal application'.
\textsuperscript{61} S 19 (2) CCA.
implies that it may not so closely resemble the name of another close corporation or company or offend against one of the many guidelines formulated by the Registrars of companies and close corporations concerning the acceptability of names.\textsuperscript{62} As in the German system, these provisions try to protect the public from being deceived or misled.

With regard to the use of the name both Acts make provision regulating this aspect. The CCA requires the display of the name and registration number to be on the outside of the corporation’s registered office and in all notices and other official publications (including those in electronic format) as well as on other documents, e.g., bills of exchange, checks and orders for money, goods or services purporting to be signed by or on behalf of the corporation, and also on all letters, delivery notes, invoices, receipts and letters of credit of the corporation.\textsuperscript{63} Failure to do so will make any member or any other person, who on behalf of a corporation signs or issues or authorizes to be signed or issued any of these documents, liable for any payments due, unless the amount is paid by the corporation.\textsuperscript{64}

\textsuperscript{62} Close Corporations Service, 2.08. Cf. "Registrar’s Directive on Names of Companies and Close Corporations", Government Gazette 16665, 15 September 1995, reproduced in Part 7 of Close Corporations Service. See also Ribbens, 1995, \textit{De Rebus} 709 \textit{et seqq}. See also s 20 (1) to (3) CCA for activities of the Registrar and interested persons regarding an order to change the name under which a close corporation has been registered and the offence regulation in case of non-compliance of the corporation with such an order, s 20 (4) and s 82 (1)(c) CCA. In this context s 20 (5) CCA clearly states that the rights of any person deriving from the common law to bring an action against a corporation for passing of a business, goods or services as those of another person are not affected. See also Henochsberg CCA s 20, 20.3 regarding the question of who is an "interested person" and 20.5 regarding the period within such an application must be brought, referring to \textit{Computer Training College BK v Registrar van Beslote Korporasies} 1996 (1) SA 1122 (T).

\textsuperscript{63} Ss 23 (1)(a)(b) CCA. S 23 (2)(a) CCA, the same applies if a member authorizes such signing or issuing. Non-compliance with subsection 23 (1)(a) makes a corporation guilty of an offence, s 23 (3), s 82 (1)(c) CCA.

\textsuperscript{64} With regard to liability, see chapter 10.3.3.3, ‘Non-usage of the name and the registration number’.
Any business letter bearing the registered name of the corporation must also indicate the first name (or the initials) and surname of every member.65

The requirements for the GmbH are the following: As stated in § 35a (1) GmbHG business letters must carry the legal form and the domicile of the company, the court of registration, the registration number and all the directors.66

5.4.2 Domicile

With regard to the domicile, the GmbHG gives the members the choice where to establish the home of the company. Even though this would normally be the place where the company carries on its business and its management, the members are free in their decision to establish the domicile wherever they choose as long as it is within the borders of Germany.67 This is the place to which all communication with the GmbH is directed.

Regarding the domicile, the CCA makes a difference between a postal and an office address of the corporation in the Republic to which all communication and notices to the corporation may be addressed. The latter must be a street address and cannot be a Post Office box number.68 However, this does not "require that every corporation must itself have an office, what is required is that there shall be an office nominated to receive communication and notices."69

65 S 41 (1) CCA. Contravention is declared an offence, s 41 (2), s 82 (1)(d) CCA.
66 But see also for exceptions § 35a (2) GmbHG. If applicable, the name of the chairman of the supervisory board must also appear. The same applies if particulars of the company's capital is given with regard to additional information required in § 35a 2nd sentence GmbHG.
67 The choice of the domicile automatically establishes the place of jurisdiction ('allgemeinen Gerichtstand') according to §§ 12, 17 ZPO ('Zivilprozessordnung', Act on Civil Procedural Law) and the jurisdiction of the registry court, § 7 (1) GmbHG.
68 S 25 (1), s 12(c)(ii) CCA.
69 Symington (1986), 37, s 25 commentary.
5.4.3 Transparency of financial matters

It is noteworthy that the CCA provides for the position of an accounting officer. Even though his position is not equal to that of an auditor, it achieves some kind of control with regard to the financial matters, which are otherwise an internal affair of the corporation.\(^{70}\)

Regarding the GmbH, there is an interesting development worth mentioning. Due to EU influence this business form is also 'forced' to make its financial matters more transparent. Subject to specific conditions, *inter alia*, companies are required to have their financial results audited and approved by a certified public accountant.\(^{71}\)

5.4.4 Kind of business

In the GmbH, the kind of business ('Unternehmensgegenstand') must be specified in the articles\(^{72}\) and is the instrument with which the company's objective ('Gesellschaftszweck')\(^{73}\) is being pursued. As stated, the company's objective can be any lawful purpose. The kind of business is prescribed to inform the public in which field the GmbH plans to carry out its business and also enables the court of registration to check its admissibility.

The CCA does not make a distinction between the kind of business ('Unternehmensgegenstand') and the company's objective ('Gesellschaftszweck'). As stated in the Act, the members have to name only the principal business they intend to carry out, this being as widely or as narrowly stated as they may desire. This means that they may carry out more than one business.\(^{74}\) As with the

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\(^{70}\) See chapters 10.3.2, 'Accounting Officer' and 10.3.3, 'Disclosure'.

\(^{71}\) See chapter 11.2.1, 'Changes through the Bilanzrichtliniengesetz'. However, with exceptions for small and medium sized companies.

\(^{72}\) § 3 (1) no. 2 GmbHG.

\(^{73}\) § 1 GmbHG.

\(^{74}\) Delport-Pretorius give the example of a corporation doing business primarily as an estate agent but with activities in the building industry, here only the estate agent business must be named in the founding statement, (1989), 8.
GmbH, the purpose of a close corporation does not have to be a profit motive but can pursue a non-profit objective and like in the GmbH it is possible that the business of the corporation need not to be of a continuous nature but may be formed to undertake a single venture.\(^{75}\)

5.4.5 Amendment of articles of association and founding statement

If changes occur with regard to the name of the GmbH, the domicile, the object of the company, the amount of the share capital, the amount of the contribution of each share shareholder or the name(s) of the managing director(s) they must be entered into the commercial register and published.\(^{76}\) Compliance with these provisions is achieved through possible sanctions of the court of registration.\(^{77}\)

With regard to changes of shareholders or the contribution an amendment to the GmbHG now requires the managing directors now to inform the commercial register in due course. Non-compliance makes them liable.\(^{78}\) Previously the managing director only had to file an up-dated list with these particulars once a year with the commercial register.

Concerning the close corporation, in connection with amendments of the founding statement, the Act provides that if any change has taken place or occurs in respect to any of the particulars stated in the founding statement, an amended founding statement must be lodged with the Registrar for registration. However, different timetables and procedures are prescribed depending on the change intended.


\(^{76}\) See § 54 GmbHG; the Act makes specific reference to changes which have to be entered into the commercial register: e.g., §§ 39, 57, 58, 65, 67, GmbHG.

\(^{77}\) § 14 HGB in connection with § 132 FGG (‘Gesetz über die Angelegenheiten der freiwilligen Gerichtsbarkeit’, Act Relating to Matters on Non-Contentious Jurisdiction; matters of non-contentious jurisdiction include matters relating to probate, guardianship, various public registers, authentication of signatures etc.).

\(^{78}\) § 40 (1) and (2) GmbHG. Aim of the 1998 amendment (coming into force 1 January 1999) was to increase the protection of creditors, cf. Lutter-Hommelhoff, GmbHG § 40, notes 1, 9.
In case of changes relating to an alteration in the principal business to be carried on, the membership of the corporation, the size of each member's interest in the corporation or the particulars of the contribution of each member, the amended founding statement must be lodged within 28 days of such change and be signed by or on behalf of every member of the corporation and by or on behalf of any person who will become a member on such registration.79

If the name, postal address, registered address or name and postal address of the accounting officer or the end of the financial year of the corporation is changed, the amended founding statement must first be lodged before such a change can take effect, either on date of registration or upon a later date mentioned in the statement.80

Regarding changes in respect to the postal or registered address of the corporation, the accounting officer may sign such a statement on behalf of the members if the corporation has approved of the said change and the accounting officer so certifies in writing.81 The accounting officer may also sign statements in respect to changes in the name or address of the accounting officer on behalf of the members, which change shall take effect upon the date mentioned in the statement.82

5.5 CONCLUSION

Both entities are relatively easy to establish, the close corporation even more so than the GmbH. Given their different background, the GmbH being a 'Kapitalgesellschaft' and the close corporation leaning on partnership ideas, the regulations for the GmbH are more formal than those for the close corporation.

79 S 15 (1) CCA. See Henochsberg CCA s 15, 15.1 regarding the question which court has jurisdiction.
80 S 15 (2) CCA.
81 S 15 (2)(a) CCA.
82 S 15 (2)(b) CCA. See also sub-section (2A) regarding changes caused by an order of court. S (3) CCA provides opportunities for the Registrar to achieve compliance with these provisions, which he may take on his own initiative or on application by any member or creditor. See Hennochsberg, CCA, s 15, 15.13 regarding the initiative of the Registrar.
Subsequently, the GmbHG requires strict compliance with specific obligations regarding the share capital contribution and prescribed organs as, e.g., a managing director. Regarding the name chosen, both systems aim to protect the public from being misled. The close corporation has the advantage of a central register with the Registrar of close corporations in Pretoria, while for the GmbH the local court is the registering authority. Both must show, i.a., the name in their business transactions, the close corporation even display it outside its registered office. Regarding the domicile both are free to establish it within each country’s borders. Important is that a place exists to which all communications can be directed, however, not just a post office box number.

Concerning transparency of financial matters the approach is a different one. The close corporation requires the position of an accounting officer, and through this achieves some kind of control with regard to the financial matters, which are otherwise an internal affair of the corporation. The GmbH is ‘forced’ to make its financial matters more transparent. Subject to specific conditions, i.a., companies are required to have their financial results audited and approved by a certified public accountant.

The kind of business is prescribed to inform the public in which field the GmbH plans to carry out its business and also enables the court of registration to check its admissibility. Regarding the close corporation, the members have to name only the principal business they intend to carry out, this being as widely or as narrowly stated as they may desire. This means that they may carry out more than one business.

When it comes to amending articles of association and founding statement, both Acts require the information to be handed in at their respective registering authority. However, while the managing director of a GmbH can do so in due course, the CCA prescribes different compulsory timetables and procedures depending on the change intended. Compliance with the provisions of the GmbHG and the CCA is achieved through possible sanctions by the registering authority and pending liability.
CHAPTER SIX

6 MEMBERSHIP

6.1 INTRODUCTION

Keeping their different origins in mind, the GmbH being a 'Kapitalgesellschaft' and the close corporation relying on partnership features, it will be interesting to see if this causes differences regarding membership in the respective entities. Modelled as entities for smaller entrepreneurs, the question of restrictions on the number of members and of who may become a member will be of relevance here. To discuss is also how membership is being expressed in the GmbH and the close corporation. Reflecting the closeness of the entities it will be interesting to see if differences exist through which ways membership can be acquired. Also being discussed is, how changes in membership might occur and how membership can be lost. Of relevance in this context is also the question if the entities can assist in the acquisition of members' interests.

6.2 RULES REGARDING THE NUMBER OF MEMBERS IN A GMBH AND CLOSE CORPORATION

Both business entities can be founded by one member, but while this was intended for the close corporation right from the outset, for the GmbH under previous legislation a minimum of two shareholders was required for the formation. The courts had, however, long since acknowledged that once formed, a GmbH could continue to exist with only one shareholder once the shares of all other shareholders were transferred over to him. Accordingly, except for the purely formative stage, the one-man GmbH had long been accepted. A 1980 amendment has made it possible to form a one-man GmbH from the outset.1

1 See chapter 15, 'One-man GmbH'.

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Having this in common, both entities interestingly differ substantially with regard to their maximum number of members. While the maximum number in the GmbH is unlimited, the close corporation is restricted to ten members.²

6.3 RULES REGARDING THE QUESTION OF WHO CAN BECOME A MEMBER OF A GMBH AND CLOSE CORPORATION

Both entities also differ regarding the question of who can become a member.

6.3.1 GmbH

The possibility of becoming a member is extensive in the GmbH. Membership is open to natural³ and juristic persons alike. The commercial partnerships OHG and KG⁴ can also become members of a GmbH. Even though OHG and KG are not legal entities separate from their partners, the HGB gives them some features also found in legal entities. They may, under their firm name, acquire rights and incur obligations, acquire property and other real rights in land, may sue and be sued in the courts.⁵

In the meantime, the 'Bundesgerichtshof' has also declared a civil law partnership⁶ capable of becoming a founder of a GmbH.⁷

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² § 1 GmbHG; s 2 (1) CCA.
³ Minors or persons with a disability must be represented by their guardian, who in the GmbH might need the authorization of a special court ('Vormundschaftsgericht'), §§ 1643, 1822 No.3 BGB. In the GmbH married persons need to be aware of § 1365 BGB (dealing with the disposal of all wealth).
⁴ 'Offene Handelsgesellschaft' (OHG) resembles an unlimited/ general partnership; 'Kommanditgesellschaft' (KG) resembles a limited partnership.
⁵ Cf. §§ 124 (1), 161 (2) HGB.
⁶ 'BGB-Gesellschaft'.
⁷ BGHZ 78, 311. With regard to membership in general, compare Baumbach/Hueck, GmbHG § 1, note 22 et seqq; at note 34 regarding 'nicht-rechtsfähiger Verein'; Scholz-Emmerich, GmbHG § 2, note 40 et seqq.
6.3.2 Close corporation

The 'closeness' of the close corporation does not stop with the maximum number of ten.\(^8\) The close corporation is, generally speaking only open to natural persons. No other juristic person can become a member and neither can a trust or a trustee of a trust _inter vivos_ nor a partnership.\(^9\)

The holding of a member's interest on behalf of a juristic person by means of nominees is expressly forbidden. A person holding membership for the benefit of a trust _inter vivos_ as from before 13 April 1987 may continue to do so subject to certain limitations in terms of s 29 (1A) introduced by the Close Corporations Amendment Act 17 of 1990 and deemed to have come into effect on 13 April 1987.\(^10\)

A natural person will qualify for membership given the following circumstances:
- if he is entitled to a member's interest;\(^11\)

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\(^8\) However, see de Koker and Henning showing the possibility of a close corporation having more than ten members, "Enkele aspekte van die statutêre beheer oor die maksimum ledetal van 'n beslote korporasie", 1990, _THRHR_ 547, dealing with this aspect before the clarification through s 15(c) of the Close Corporations Amendment Act 26 of 1997. In this context it is interesting to note that also the corresponding liability provision in s 63 (c) CCA was deleted to leave no doubt that "close corporations cannot have more than the maximum number of ten members", _Close Corporations Service_, 6.02.

\(^9\) S 29 (1) CCA.


\(^11\) S 29 (2)(a) CCA.
- nomine officii as a trustee of a testamentary trust provided that no juristic person is a beneficiary of such trust;¹²
- nomine officii as a trustee, administrator executor or curator, of an insolvent, deceased or mentally disordered member's estate or his duly appointed representative.¹³

Subsequently it is stated, that "as no other qualification is set for membership of a close corporation it appears that even a minor, an insolvent and other persons under legal disability may become members of a close corporation if they are qualified to hold a member's interest."¹⁴

Under the following restricted circumstances juristic persons qualify for membership:
- nomine officii as a trustee of a testamentary trust provided that such juristic person is not directly or indirectly controlled by a beneficiary of the trust and that no juristic person is a beneficiary of such trust;¹⁵
- nomine officii as trustee, administrator, executor or curator of the estate of an insolvent, deceased, or mentally disordered person or of a person otherwise incapable of managing his own affairs.¹⁶

¹² S 29 (2)(b) CCA.
¹³ S 29 (2)(c) CCA.
¹⁴ Cf. Close Corporations Service, 3.04, arguing that this is borne out by the provisions of s 47 (1)(b)(i) CCA. According to ss 47 and 32 CCA such persons are disqualified from taking part in the management of the close corporation and must be represented in the corporation by their guardians or legal representatives. A married woman has full rights to act as a member of a corporation, ss 32 (2), 47 (1)(a)(i) CCA. With regard to married women note that the marital powers of husbands has been repealed retrospectively, s 29 of the General Law Fourth Amendment Act No. 132 of 1993. Close Corporations Service, 3.04, points out that "the most important exception to the rule that members under legal disability may not participate in the management of the close corporation pertains to a minor who has attained at least the age of 18 years. The guardian of such a minor can lodge a written consent to the effect that the minor may participate in the management of the corporation", s 47 (1)(a)(ii) read with s 32 (1). Regarding 'puppet' members some interesting thoughts are found by Lessing, "'Puppet' members of close corporations", 1989, SA Merc LJ 242 et seqq.
¹⁵ S 29 (2)(b) CCA.
Regarding the exception of s 29 (2)(c) CCA, a recent judgement clearly stated that only an executor of a deceased estate where the deceased was a member of the close corporation in question falls within this exception.\(^{17}\) Therefore the executor of the deceased person’s estate qualifies for membership only if the deceased held that member’s interest at the time of his death.\(^{18}\) However, it has to be clearly pointed out that "subject to the exceptions above, a juristic person is not entitled to hold a member’s interest directly or indirectly or through a nominee."\(^{19}\)

The reason why juristic persons were excluded from membership in a close corporation is explained as "to avoid the creation of complicated inter-group relationships following the conversion of company subsidiaries to close corporations."\(^{20}\) Subsequently, a juristic person or a trustee of a trust *inter vivos*, holding a member’s interest in contravention of any provision of s 29 CCA, will be liable for every debt of the corporation incurred during the time the contravention continues.\(^{21}\) A close corporation, however, may hold shares in a company and may even become a holding company. "It may even enter into partnerships with other companies or close corporations."\(^{22}\) In the case of a close corporation controlling a number of wholly-owned subsidiary companies s 55 CCA applies.\(^{23}\)

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\(^{16}\) S 29 (2)(c) CCA. In terms of s 55 (h) of the Insolvency Act 24 of 1936 a corporate body may not be appointed trustee of an insolvent estate.

\(^{17}\) *Blesovsky NO and Others v Shipper and Another* 2001 (4) SA 1269 at 1271I-J, 1272A-B and F-G.

\(^{18}\) See also commenting on this case Havenga, "Security for costs, membership, and members’ personal liability", 2002, *JBL* 81, 82 *et seq*.

\(^{19}\) *Close Corporations Service*, 3.05. See s 29 (1) CCA.


\(^{21}\) S 63(d) CCA. See also chapter 10.3.2.3, 'Participation'.

\(^{22}\) *Close Corporations Service*, 3.03.

\(^{23}\) See also chapter 13.3.3, 'Group of close corporations'.
6.4 MEMBERSHIP IS EXPRESSED THROUGH SHARES IN THE
GMBH AND MEMBERS' INTERESTS IN THE CLOSE
CORPORATION

6.4.1 GmbH

As shown earlier, the GmbH works with the concept of share capital requiring a
minimum share capital of which an aggregate amount has to be paid up initially.24
With regard to the share capital contributions, the situation is as according to the
GmbHG the following, the amounts of the share capital contributions subscribed
to by various shareholders may be different but each share capital contribution
must be evenly divisible by fifty Euros and may not be less than one hundred Euros.25 Though on formation of the GmbH each member is allowed to
subscribe to only one share capital contribution he can acquire further shares at
a later date.26
As a result § 5 (3) GmbHG provides that the total amount of the share capital
ccontributions must be identical to the amount of the share capital.27 According to
§ 14 GmbHG the share of each member is determined by the amount of his
share capital contribution28 and the share in return is relevant29 for the

24 See chapter 5.2.2, 'Contribution to the share capital'.
25 § 5 (1) and (3) GmbHG; there is no limit with regard to the amount of a share
capital contribution. And as Oliver states: "This single share need not be the same
size as the shares of the other members; the share of each member corresponds
to his entire investment in the company, large or small, and they may thus be
considerable variations in the amounts of the individual shares", (1986), at p. 5.
26 §§ 5 (2), 15 GmbHG.
27 § 5 (3) 3rd sentence GmbHG.
28 As is submitted, "each share relates to one share capital contribution and its
nominal amount must be equal to the 'Deutsche Mark' amount of such share
capital contribution (§ 14 GmbHG). Accordingly, the total amount of the shares of
the GmbH equals the total amount of its share capital (§ 5 (3) 3rd sentence
29 Unless the articles do not provide otherwise.
proportionate distribution of profits, the voting rights and a proportionate distribution of assets, if any, in case of liquidation. However, after incorporation this correlation, mentioned in § 14 GmbHG, is also subject to change, caused, e.g., by sale of parts of a share or an increase or decrease of share capital. Note also that the rights and duties deriving from the share may also be varied in the articles of association.

Thus one can conclude saying that the share is the epitome of rights and obligations of a GmbH-member.

6.4.2 Close corporation

As mentioned earlier, the GmbH requires a minimum share capital, something foreign to the close corporation. Although the possibility of using the company law features of share and share capital was discussed, South African lawmakers decided to use "the analogy of partnership law of expressing members' interest in agreed fractions". Therefore, instead of acquiring shares, a member of a close corporation acquires a member's interest. After explaining the situation in company law Close Corporations Service draws an analogy and describes a member's interest "as a personal right as against the corporation entitling the holder to a pro rata share in the aggregate of members' interests and to participate in a distribution of profits and on liquidation in the remaining assets

30 § 29 (3) GmbHG.
31 § 47 (2) GmbHG.
32 § 72 GmbHG.
33 Lutter-Hommelhoff, GmbHG, § 14 note 1 et seqq. See also the examples by Olbrisch/dup Plessis, 1997, TSAR 318.
34 As this is subject to changeable and not changeable rights or duties, it depends on the respective topic, cf. Lutter-Hommelhoff, GmbHG, § 14 note 1.
35 Cf. regarding the various contents of a share, Scholz-Winter, GmbHG § 14, note 2 et seqq., including further literature; the share, being, i.a., also a personal right which can be pledged, § 1273 (1) BGB. See also Beck GmbH-HB (1995), § 12.
36 § 72 GmbHG. However, naturally also the close corporation "needs funds to do business or to achieve its objectives," Close Corporations Service, 3.31, giving an overview about the corporations own and extrinsic capital, 3.31 et seqq.
37 Naudé, 1982, MB 5, 11.
after all creditors have been paid."\(^{38}\) In this context it is interesting to note that it was decided that the incorporeal rights constituted by a member’s interest was not a movable right referred to in s 68 (1) of the Magistrates’ Courts Act 32 of 1944 for purposes of attachment under process of execution.\(^{39}\) Section 34A CCA now states clear that the provisions of s 34 CCA shall apply *mutatis mutandis* to attachment and sale in execution of a member’s interest in a corporation.\(^{40}\)

It is now expressly mentioned that a member’s interest is moveable property, which shall be transferable in the manner provided by the Act.\(^{41}\) Regarding the nature of a member’s interest it is submitted that this is "a right of action, a *jus in persona*, which is transferred by cession".\(^{42}\)

Every such interest of a member must be a single interest, which is expressed as a percentage of all the interests being held in the corporation.\(^{43}\) The CCA makes provision for the maintenance of the aggregate of the members' interests which must always be 100 per cent.\(^{44}\) When a member's interest is being transferred, an additional member joins, or when the corporation carries out the acquisition, the percentage of each member's interest must be adjusted so that the total interest remains 100 per cent.\(^{45}\)

\(^{38}\) Close Corporations Service, 3.11.

\(^{39}\) See *Jones v Trust Bank of Africa Ltd*. 1993 (4) SA 415 (C).

\(^{40}\) Cf. also Close Corporations Service, 3.11; Henochsberg CCA s 37, at 37.6.

\(^{41}\) S 30 (1) as amended by s 9 of the Close Corporations Amendment Act 26 of 1997.

\(^{42}\) Close Corporations Service, 3.23. See also Close Corporations Service regarding the provision of security by means of members’ interest, discussing the pledge of incorporeals and the out-and-out security cession in the close corporation context, Close Corporations Service, 3.25 et seqq. See also *Badenhorst v Balju, Pretoria Sentraal, en Andere* 1998 (4) SA 123 (T), where it was decided that in case of execution of a members interest through the sheriff as being an incorporeal right some document or similar item representing the right had to be attached, e.g., the certificate issued in s 31 or the founding statement in s 12 CCA.

\(^{43}\) Ss 12(e), 30 (1) CCA.

\(^{44}\) S 38 CCA.

\(^{45}\) Ss 33 (1)(b) and 38 CCA dealing with different possibilities of how the interests may be adjusted.
However, "members can also by agreement change the size of the respective members' interests, for example, when members agree that a particular member's interest is to be increased because of additional contributions made by him to the corporation". Nevertheless, a member's interest does not necessarily have to reflect the percentage which his contribution bears to the total contributions of all members.

Particulars of any increase or reduction of a member's contribution in terms of sub-section 24 (2) CCA must be furnished in an amended founding statement.

Two or more persons cannot be joint holders of the same member's interest in the close corporation and each member can only hold a single interest in the corporation.

Unlike in the GmbH, each member is issued with a certificate showing his current percentage interest. Similar to a share in the GmbH, in the close corporation the member's interest is relevant with regard to the number of votes, proportionate payments and distribution of liquidation assets if any. As in the GmbH, it is not necessarily required "that the size of a member's interest in the corporation be related to the value of his contribution or that the respective contributions be equal in value".

Regarding membership, Delport-Pretorius submit that, "although the Act does not state so explicitly, it is clear from the various provisions dealing with the acquisition of a member's interest that no person can become a member of a corporation unless the existing members agree (directly or by implication) to his introduction into the corporation."

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47 See ss 15 (1), 24 (3), 24 (4)(b), 24 (5) CCA.
48 S 30 (2) CCA.
49 S 31 CCA, which must be signed by or on behalf of every member.
50 Unless an association agreement provides otherwise, s 46 CCA.
51 S 46(d) CCA.
52 S 46(f) CCA.
53 Close Corporations Service, 13.16 referring to s 342 (1) CA.
6.5 ACQUISITION OF AND CHANGE IN MEMBERSHIP

6.5.1 GmbH

6.5.1.1 Acquisition upon formation

Membership in the GmbH can be achieved upon formation of the company through the initial contribution to the share capital.\(^56\)

6.5.1.2 Sale

Subsequent to the formation of a company, a change in membership can be caused by the sale of a share.

However, it is important to note while shares of the GmbH are transferable and inheritable\(^57\) they are not negotiable or as stated "dealing and transferring with its shares is not encouraged by the Law."\(^58\) Notarial form is required for the transfer of shares as well as the agreement imposing on a member an obligation to transfer his share,\(^59\) making the "procedure for transfer (...) formal

\(^{56}\) See chapters 4.2.2, 'Contribution to the share capital' and chapter 8.3.2.1.1, 'Obligations with regard to the initial contribution'.

\(^{57}\) § 15 (1) GmbHG.

\(^{58}\) Mueller et al. (1981), 19, 21 et seqq.; Baumbach/Hueck, GmbHG introduction, note 19; § 15 note 2.

\(^{59}\) § 15 (3), (4) GmbHG. Regarding the importance of the form of this contract in connection with the 'Abstraktionsprinzip' (principle of abstraction), see Scholz-Winter, GmbHG § 15, note 37 et seqq. In dealing with the Civil Code and describing its early concepts, regarding a specific aspect Foster points to the criticism that "the results have become extremely difficult to grasp. The prime example of this is the principle of abstraction (Abstraktionsprinzip)," Foster (1996), 22. Romain, Wörterbuch der Rechts- und Wirtschaftssprache (1994) describing this as "the principle of the abstract nature of rights in rem." See also Olbrisch/du Plessis, 1997, TSAR 318.
and cumbersome and not something which can be done in a hurry."\(^{60}\) Thus, stock exchange dealings in GmbH shares are impossible.\(^{61}\)

Unlike in the close corporation where - as just described - the consent of the members is required,\(^{62}\) the consent of members is not explicitly needed in the GmbHG. However, it is possible to subject the transfer of shares to further restrictions by the articles and, in particular, make it dependent on the approval of the company.\(^{63}\) Therefore, this requirement is commonly used in practice.

Given the possibility of juristic persons being members of a GmbH, a transfer is also possible to a juristic person.

The transfer of shares, however, is not entered into any register. Some kind of control is installed through the information regarding changes of shareholders and contribution which the managing director has to submit to the commercial register.\(^{64}\) Even though this list is available for public inspection, its legal attestation is restricted. As submitted, "the only evidence of ownership of a share is an uninterrupted sequence of notarial documents showing, transfer by transfer, the passing of the share from the initially subscribing (in the course of the formation or of the share capital increase) shareholder to the present owner."\(^{65}\)

\(^{60}\) Oliver (1986), 7.

\(^{61}\) See, however, the recent changes trying to offer an alternative in creating the "small AG", chapter 2.3.1.4, 'Recent developments'.

\(^{62}\) When an association agreement exists, in accordance with it, s 37 CCA.

\(^{63}\) § 15 (5) GmbHG, being the members. For example, if other than family members are to acquire the share. See Lutter-Hommelhoff, GmbHG § 15, note 22 et seq. (note 22a, i.a., deals with one aspect of the 'Abstraktionsprinzip').

\(^{64}\) As mentioned since 1 January 1999 in due course, § 40 GmbHG.

\(^{65}\) Mueller et al. (1981), 23, who also point out that "even an uninterrupted sequence of notarial transfer documents does not constitute fully conclusive evidence", ibid. Scholz-Winter, GmbHG § 16, note 17 et seq. Lutter-Hommelhoff, GmbHG § 16, note 7.
6.5.1.3 Transfer of parts of a share

The transfer of parts of a share may be done only with the approval of the company.\(^{66}\) Here it is also possible to ease or raise the requirements through the articles.\(^{67}\) If several persons own an undivided share jointly, they must also exercise the rights attached thereto jointly.\(^{68}\) The Act does not facilitate the creation of more than one share in the hands of one shareholder. As mentioned, the founder(s) of a GmbH can only subscribe to one share capital contribution each\(^{69}\) and can thus only acquire one single share each. However, shares which a shareholder acquires in addition to his initial share, either by inheritance, transfer, or in the course of a share capital increase, remain separate shares.\(^{70}\)

6.5.1.4 Leaving due to important reason

The GmbH makes no provision regarding a right to leave the company due to important reason. Because of the right to sell the share, a provision in this matter is not necessary. Nevertheless, this aspect can become important. For example, in case the articles require the company to agree, and yet consent is withheld, this could prove to be unreasonable for the member. Therefore, the courts grant a GmbH-member the right of leaving if there are important reasons which make it impossible for a member to remain in the company.\(^{71}\)

\(^{66}\) § 17 (1) GmbHG, for further details § 17 (2) GmbHG.
\(^{67}\) § 17 (3), (4), (5), (6) GmbHG for further details.
\(^{68}\) § 18 (1) GmbHG; with regard to their joint and several liability, see § 17 (2) GmbHG.
\(^{69}\) § 5 (2) GmbHG.
\(^{70}\) § 15 (2), § 55 (3) GmbHG. See Mueller et al. (1981), 22.
\(^{71}\) Another possibility to leave the company would be through the motion of dissolution of the company according to § 61 GmbHG. As this obviously is not adequate, leaving due to an important reason becomes relevant. Cf. Scholz-Winter, GmbH § 15, note 114 with further references.
6.5.1.5 Collection proceedings and abandonment of a share

In this context it is noteworthy that changes in membership might come about due to collection proceedings,\textsuperscript{72} and using the right to abandon the share in case of unlimited supplementary contributions.\textsuperscript{73}

6.5.1.6 Compulsory redemption

Change can be caused through the compulsory redemption of shares.\textsuperscript{74} § 34 GmbHG only allows a redemption of shares if the articles of association provide for doing so. Thus, the articles must contain further details. Subsequently, it is possible for a company to terminate a shareholder's membership in the company.

6.5.1.7 Expulsion of a member

Membership can also be changed through the expulsion of a member. The courts allow such an action by reason of an important cause. Because the GmbHG makes no provision, the §§ 737 BGB, 140 HGB must be utilized analogously. Therefore, a member can be excluded if it cannot be demanded of the company to continue with his membership. If the articles provide that a resolution to this regard is not enough, the expulsion must be achieved through a decision by a court in analogy to § 140 HGB.\textsuperscript{75}

\textsuperscript{72} See chapter 8.3.2.1.1.3, 'Collection proceedings'.
\textsuperscript{73} See chapter 8.3.2.1.2.2, 'Unlimited supplementary contributions'.
\textsuperscript{74} § 34 GmbHG, ('Einziehung des Geschäftsanteils', amortisation of the share).
\textsuperscript{75} See also Mayer/Elfring, "Das zwangsweise Ausscheiden eines Gesellschafters", 2004, \textit{GmbHR} 869 \textit{et seqq.}, suggesting clear regulations in the articles of association.
6.5.1.8 Payment by the company for the acquisition of shares

Acts of the company to purchase its own shares are very restricted and only possible when the share capital is not endangered by doing so.\textsuperscript{76}

6.5.2 CLOSE CORPORATION

6.5.2.1 Acquisition upon formation

Acquisition of membership upon formation of a corporation can be achieved in various ways. Upon formation of a corporation a person becomes a member if his name is mentioned in the founding statement upon registration and a percentage member's interest is allocated to him, if details of his initial contribution are stated in the founding statement, and if he has signed the founding statement.\textsuperscript{77} However, "it is not required for a person to first make his contribution to the corporation in order to obtain membership in the corporation. Membership is obtained whether or not an initial contribution has been made."\textsuperscript{78}

6.5.2.2 Disposal of members' interests

A member of a corporation may dispose of his member's interest in the corporation according to certain restrictions.\textsuperscript{79} Subsequently, a disposal of a member's interest can take place only to the corporation, any other member or any other person qualifying for membership in terms of s 29 CCA. In addition, the corporation may acquire a member's interest only if it has one or more members.

\textsuperscript{76} \S\ 33 GmbHG.
\textsuperscript{77} S 29 (3)(a), s 12 CCA; Delport-Pretorius (1989), 20.
\textsuperscript{78} Delport-Pretorius (1989), 20; see also as to when an initial contribution must be made, chapter 8.3.2.2.1, 'Contribution and enforceability'.
\textsuperscript{79} S 37 CCA.
The disposal of a member's interest must take place in accordance with an association agreement (if any); if such an agreement does not exist (or if the agreement is silent on the matter) disposal can take place only with the consent of any other member of the corporation. In this context it is submitted "that cessions not substantiated by the necessary consent are ineffective."  

6.5.2.3 Sale / acquisition of interest from deceased or insolvent estate

Subsequent to a corporation's formation one can become a member by acquiring a member's interest from an existing member or from his deceased or insolvent estate or by making a contribution to the corporation. The future member becomes a member of an existing close corporation after the amended founding statement has been registered. Specific rules govern the event of the disposal of the interest of an insolvent or a deceased member.  

Concerning the right of a trustee of the estate of an insolvent member or in case of a deceased member, a member's interest can be disposed of notwithstanding

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80 Close Corporations Service, 3.23, arguing with the "intention of the legislature to provide for a corporate form characterised by the close relationship between the members inter se and the fact that section 37 requires the consent of every member for the disposition of an interest or a portion thereof," Close Corporations Service, ibid. Regarding transfer, cf. also Delport, "Transfer of a member's interest in a close corporation", 1992, De Jure 120 et seqq.; Mphalele, "Cession of rights of a member in a close corporation", 1998, TRW 244 et seqq. Cf. regarding a sale of interest subject to a suspensive condition, Ming-Chieh Shen v Meyer 1992 (3) SA 496 (W) referred to in Anonym, "Reg van die dag", 1992, De Rebus 640 et seq. See also supra 5.4.2 concerning the nature of a member's interest.

81 S 33 (1)(a) CCA; non-cash contribution is possible but unlike the initial contribution it may not consist of services, s 33 (2) CCA. The members must lodge an amended founding statement, s 29 (3)(b) CCA, see with regard to the commencement of the membership, s 29 (3)(a) CCA.

82 Ss 15 (1), 29 (3) CCA. To prevent problems which could be encountered by only relying on an amended founding statement, it is suggested to embody the agreement in regard to the sale of the interest into a contract, cf. Close Corporations Service, 3.21 with examples of essential components of such a contract.
any contrary provision in an association or other agreement. The corporation and the members, however, have the right of pre-emption.\textsuperscript{83}

6.5.2.4 Splitting

Given the fact that the close corporation has no share capital and cannot issue shares but gives members a member's interest in the corporation, the CCA has a different approach with regard to splitting (and also redeeming) of a share. The Act regulates that two or more persons shall not be joint holders of the same member's interest.\textsuperscript{84} When a change regarding a member's interest takes place the interests have to be adjusted accordingly, or as the members may decide. Thus, for example, existing interests can be increased. However, regarding the members' interests upon change of membership, one has to keep in mind that the aggregate of the members' interests in a corporation expressed as a percentage must be 100 per cent at all times.

6.5.2.5 Expulsion of a member

It is possible for a court, upon application of any member, to terminate a person's membership of a corporation and thus expel him or her.\textsuperscript{85} This may be the case if a member is permanently incapable of performing his part in the carrying on of the business,\textsuperscript{86} if a member's conduct in the past is likely to have a prejudicial effect on the carrying on of the business,\textsuperscript{87} or it becomes not reasonably practicable for the other member(s) to carry on the business of the corporation with him due to his conduct in matters relating to its business.\textsuperscript{88} In addition, a court can apply the catch-all clause. This is the case

\textsuperscript{83} Ss 34 and 35 CCA. Ramsden, 1988, \textit{Businessman's Law} 141, 143. Cf. Henochsberg CCA s 35, 15.1, submitting that the intention of the legislature in this context is not clear.

\textsuperscript{84} S 30 (2) CCA.

\textsuperscript{85} See Henochsberg CCA s 36, 36.1 with an example not being covered by the Act and regarding the question of which court has jurisdiction.

\textsuperscript{86} Subject to the provisions of an association agreement, if any.

\textsuperscript{87} S 36 (1)(b) CCA. See Henochsberg CCA s 36, 36.4 interpreting this sub-section in the context of activities through a court.

\textsuperscript{88} S 36 (1)(c) CCA.
when circumstances have arisen, which render it just and equitable that such a member should cease to be a member of the corporation.89 When such an order for termination of membership is granted, the court may make further orders regarding the acquisition of the member's interest concerned by the corporation or by other members, the financial (if any) winding-up of the member's interest concerned or any other matters regarding the cessation of membership which the court deems fit.90

6.5.2.6 Other dispositions of members' interests

All other dispositions of the interest of a member, other than those set out in ss 34, 35 or 36 CCA whether in whole or in part, and whether to the corporation, any other member, or any other person qualifying for membership of a corporation,91 must be done in terms of the association agreement, if any,92 or with the consent of every other member of the corporation.93

6.5.2.7 Payment by the corporation for the acquisition of members' interests and financing their purchase by others

The Act contains provisions to facilitate such transfer or disposal enabling the corporation to purchase its members' interests and to finance their purchase by others. It is interesting to note that until 1999 such actions were "either severely restricted or entirely prohibited in company law for fear they would result in an unlawful reduction of capital."94 However, as mentioned above, "the Companies Amendment Act 37 of 1999 radically changed the capital maintenance rule and

89 S 36 (1)(d) CCA. Henochsberg CCA s 36, 36.6 submitting that "greater width of language would be difficult to find" and arguing that through this subss (b) and (c) are becoming superfluous.
90 S 36 (2) CCA.
91 In terms of s 29 CCA.
92 S 37(a) CCA.
93 S 37(b) CCA. To mention is also that membership as such ceases "on the deregistration or liquidation and consequent dissolution of the close corporation," Close Corporations Service, 3.30. See Henochsberg CCA s 37, 37.4 regarding a deficiency in this section.
94 Ramsden, 1988, Businessman's Law 107, 108.
the perceived protection it afforded creditors." So accordingly, the new s 85 of the Companies Act enables companies to purchase their own shares. However, in the GmbH context the pre-1999 South African situation still applies. The capital maintenance concept remains in force and thus acts of the company to purchase its own shares are very restricted and only possible when the share capital is not endangered by doing so.

6.5.2.7.1 Activities of the corporation to purchase its members' interests

The corporation may acquire the interest of a member only if the following requirements, which try to safeguard the creditors' rights, are met. Thus, the previous written consent of every member of the corporation, other than the member whose interest is acquired, authorizing the specific payment must be obtained. In addition, this acquisition is only possible if the corporation's own "financial viability is not thereby diminished". Furthermore it must be kept in mind that no member's interest shall be acquired by the corporation unless there are one or more other members. If a close corporation acquires the whole or any portion of a member's interest, the percentage involved must be added to the interests of the remaining members in proportion to their existing interests or as they may otherwise agree, since, as mentioned earlier, at all times the interest of the members must total 100 per cent.

6.5.2.7.2 Financing the purchase of members' interests by others

The purchase of members' interests by others is possible by granting financial assistance by the corporation in respect to the acquisition of a member's interest. This financial assistance may be given directly or indirectly, by means of a loan, guarantee, the provision of security or otherwise.

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95 Cilliers et al. (2000), 17.03.
96 S 39 (1)(a) CCA; payment in this sub-section includes the delivery or transfer of any property, s 39 (2) CCA. See Henochsberg CCA s 39, 39.1 on practical problems to comply with the provision.
97 Symington (1986), 50 commentary regarding s 40 CCA. Assets to exceed the liabilities after the transaction.
98 S 37 CCA.
99 S 40 CCA.
Both differ significantly regarding the possible number of members and also on the question of who can become a member. While the maximum number in the GmbH is unlimited, the close corporation is restricted to ten members underlying its closeness. The possibility of becoming a member is extensive in the GmbH. Membership is open to natural and juristic persons alike. The close corporation is, generally speaking only open to natural persons. No other juristic person can become a member and neither can a trust or a trustee of a trust *inter vivos* nor a partnership.

Membership as such is expressed through shares in the GmbH and members' interests in the close corporation.

With regard to the share capital contributions in the GmbH, the amounts subscribed to by various shareholders may be different but each share capital contribution must be evenly divisible by fifty Euros and may not be less than one hundred Euros. The total amount of the share capital contributions must be identical to the amount of the share capital. The share of each member is determined by the amount of his share capital contribution and the share in return is relevant for the proportionate distribution of profits, the voting rights and a proportionate distribution of assets, if any, in case of liquidation. However, after incorporation this correlation is also subject to change, caused, e.g., by sale of parts of a share or an increase or decrease of share capital. Note also that the rights and duties deriving from the share may also be varied in the articles of association.

Instead of acquiring shares, a member of a close corporation acquires a member's interest. This is being described as a *personal right as against the corporation entitling the holder to a pro rata share in the aggregate of members' interests and to participate in a distribution of profits and on liquidation in the remaining assets after all creditors have been paid*. The CCA makes provision for the maintenance of the aggregate of the members' interests which must always be 100 per cent. The size of the respective members' interests can be changed, for example, when members agree that a particular member's interest is to be increased because of additional contributions made by him to the corporation.
The transfer of a share and a member's interest is allowed. However, the regulations for transfer and restrictions vary. For the transfer of a GmbH share only notarial form is required for the transfer as well as the agreement imposing on a member an obligation to transfer his share. However, these requirements make the procedure for the transfer of a share formal. Thus, stock exchange dealings in GmbH shares are impossible. This being the only requirement by the GmbHG, one must keep in mind that through the articles of association further requirements can be agreed upon. In the close corporation the consent of the other members is necessary for a transfer of a member's interest. Also every time there is a change in the membership of the close corporation, the names of members of a close corporation must be registered by way of an amended founding statement. Subsequently, fewer restrictions apply to the transfer of a share compared to a member's interest.

The GmbH being a 'Kapitalgesellschaft' needs regulations safeguarding participation and achieving realization of the share capital. Therefore, i.a., collection proceedings and abandonment of a share as well as compulsory redemption are to be mentioned here.

The participation of the entities in the process of purchasing a share and a member's interest differ. Concerning the close corporation the Act contains provisions to facilitate such transfer or disposal enabling the corporation to purchase its members' interests and to finance their purchase by others.

Regarding the situation in company law it is noteworthy that until 1999 such actions were either severely restricted or entirely prohibited in company law for fear they would result in an unlawful reduction of capital. However, through the Companies Amendment Act 37 of 1999 the capital maintenance rule was changed significantly. So accordingly, the new s 85 of the Companies Act enables companies to purchase their own shares. Nevertheless, in the GmbH context the pre-1999 South African situation still applies. The capital maintenance concept remains in force and thus acts of the company to purchase its own shares are very restricted and only possible when the share capital is not endangered by doing so.
CHAPTER SEVEN

7 ORGANS

7.1 INTRODUCTION

Given the fact that both business entities are juristic persons they need organs to act for them. It will be interesting to see if differences between a more formally structured GmbH as a 'Kapitalgesellschaft' and the very closely held organizational form of the close corporation exist. Whether, e.g., members have the opportunity to actively take part in the business of the corporation because of equal management rights or if the organ of a managing director is being prescribed.

7.2 GMBH

7.2.1 Managing director

The GmbH must have at least one managing director, which can be a non-member.1 The members are, however, free to appoint more than one managing director.

7.2.1.1 Personal qualifications

Nobody who has been convicted of particular criminal insolvency offences for a period of five years may become a managing director,2 and persons prohibited by court judgement or administrative order from practising a specific profession or trade are not allowed to become managing director of a GmbH, which is partially or totally involved in the same profession or trade during the period for

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1 § 6 (1), (3) 1st sentence GmbHG.
2 The same applies in case of a judgement of a foreign criminal court covering similar criminal behaviour, OLG Naumburg, 2000, ZIP 622, 624.
which the prohibition lasts.\textsuperscript{3} It is, however, also possible to appoint foreigners, even those living abroad, as long as they are able to enter Germany legally at all times.\textsuperscript{4}

### 7.2.1.2 Appointment and legal position

The appointment of a managing director can take place either in the articles or through a resolution at a shareholders' meeting.\textsuperscript{5} An appointment may be revoked at any time. This revocation may be restricted by the articles to a reason, \textit{e.g.}, important causes, as a particular serious breach of duty with regard to legal capacity or proper management.\textsuperscript{6}

In this context it is sufficient to say that the legal position of the managing director focuses on management and representation of the company. He is responsible for the company's affairs and represents it in and out of court.\textsuperscript{7}

### 7.2.2 Shareholders' meeting

Notwithstanding the fact that in the GmbH the members do not automatically have the right to take part in management affairs or to represent and bind the company, this should not, however, lead to the assumption that they are powerless. The opposite is true. As the members in the close corporation, the shareholders as a whole are the highest decision making organ in the company.\textsuperscript{8}

\begin{itemize}
  \item \textsuperscript{3} § 6 (2) 2nd and 3rd sentence GmbHG.
  \item \textsuperscript{4} OLG Köln, 1999, DB 38.
  \item \textsuperscript{5} § 6 (3) 2nd sentence, § 46 no. 5 GmbHG, as well as through another institution mentioned in the articles of association, \textit{e.g.}, a supervisory board (interpretation derived from § 45 GmbHG).
  \item \textsuperscript{6} § 38 GmbHG. In case he gave no reason the managing director might be able to claim for damages. See also van Venrooy, "Anspruch der GmbH auf sachkundige Geschäftsführung", 2004, GmbHR 237 et seqq.
  \item \textsuperscript{7} §§ 35 (1), 36 GmbHG. For more information regarding the legal position, see chapter 9.2.1, 'Managing director and representation'.
  \item \textsuperscript{8} For further reading, see chapter 8.3.1.1.1, 'Calling of a shareholders' meeting'. The members as a whole constitute an organ of the GmbH. Note, however, that
\end{itemize}
The basically 'universal power' of the members has consequences for the independence of the director's management. With regard to the director, to whom only the power of representation is being assigned to by the Act but not necessarily the management itself, the members have the authority to issue directives. Hereby, the members are in the position to give specific directions for the carrying out or omission of certain management acts. They may also hand out general directives or guidelines to underline their authority on the management of the company. Under certain conditions they also have the right to call for a meeting of shareholders.

7.2.3 Supervisory board

Through its articles the GmbH may provide for a supervisory board. Despite this voluntary installation, a supervisory board may, at times, be compulsory. This is the case for GmbHs, which are subjected to the provisions of the 'Montan-Mitbestimmungsgesetz' extended by the 'Mitbestimmungergänzungsgesetz', the 'Mitbestimmungsgesetz' and the 'Betriebsverfassungsge-setz'.

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9 § 35 (1) GmbHG.
10 § 37 (1) GmbHG.
12 See below chapter 8.3.1.1.1, 'Calling of a shareholders’ meeting'.
13 § 52 GmbHG. With regard to the at times tenable relations between GmbH-Law and Co-determination Law, Scholz-Westermann, GmbHG introduction, note 75. See also regarding Co-determination chapter 2.3.1.3, 'GmbH'.
14 Coal and Steel Co-determination Act of 1951.
15 Supplemental Act to the Coal and Steel Co-determination Act of 1956.
17 Shop Constitution Act of 1952. Applicable for GmbHs with more than 500 employees.
If a supervisory board exists, § 52 GmbHG refers to the provisions of the AktG, which are applicable as long as the Co-determination Acts do not provide otherwise.\(^\text{18}\)

7.2.4 Other organs

The articles may also make provision for other bodies, very often called 'Beiräte'.\(^\text{19}\) Their structure and power is regulated in the articles.

7.3 CLOSE CORPORATION

7.3.1 Management

For the close corporation it is not prescribed in the Act to have a managing director because, according to s 46 CCA, the members as such have equal rights with regard to the management of the close corporation.\(^\text{20}\) The members may, however, choose whomever they please, also a non-member, to manage the affairs of the corporation.\(^\text{21}\) One has to keep in mind that it was one of the declared intentions of the 'creators' of the CCA to "retain as much flexibility as possible in the internal relations between the members themselves and between the members and the corporation".\(^\text{22}\)

\(^{18}\) Mueller et al. (1981), 31; in the case of a voluntary supervisory board "the articles may to a large extent exclude the application of the provisions of the AktG referred to in § 52 GmbHG", Mueller et al. (1981), 31, fn. 26.

\(^{19}\) Advisory board. Cf. Grossfeld-Brondies, "Die Stellung des fakultativen Aufsichtsrates (Beirat) in der GmbH und GmbH & Co. KG", 1987, AG 293 et seqq.

\(^{20}\) S 46 (a) CCA. Unless the association agreement provides otherwise or persons are being disqualified according to s 47 CCA.


\(^{22}\) Venter, 1984, TRW 109, 114.
7.3.1.1 Personal qualifications

Like a corresponding section in the GmbHG, this choice of the members is only restricted by excluding certain persons from taking part in the management of the business of a corporation.\(^{23}\)

These are persons under legal disability\(^{24}\) and those who have been disqualified by the court in terms of the Companies Act from appointment as director.\(^{25}\) Only if authorised by a court can an unrehabilitated insolvent, or persons removed from an office of trust on account of misconduct or persons convicted of certain crimes involving dishonesty or in connection with the formation or management of a company or corporation and who have been sentenced to imprisonment therefore for at least six months take part in the management of a corporation.\(^{26}\)

7.3.2 Members' meeting

For the close corporation a meeting of members is not prescribed in the Act with the exception of the voluntary winding-up of the corporation.\(^{27}\) It is, however, suggested that even though s 58 (3) CCA only requires the annual financial

\(^{23}\) S 47 CCA. See Close Corporations Service, 4.11 fn. 3 for the background that, prior to being amended, s 47 (1) CCA initially disqualified persons from participating in the management of the business of a corporation only when they were members of the corporation. Disqualified persons were therefore able to exercise executive control over a close corporation if they avoided membership of the corporation. See de Koker, Gesamentlike en Afsonderlike aanspreeklikheid as 'n statutêre sanksie in die Maatskappyeerg en Beslote Korporasiereg, 13 Med SOR (1990), 173. This was deemed to be contrary to public policy and the loophole was addressed by s 11 of the Close Corporations Amendment Act 26 of 1997. Disqualification now applies irrespective of membership in the corporation.

\(^{24}\) S 47 (1) CCA. With the exception of minors over the age of 18 years who have obtained the written consent of their guardians, S 47 (1)(a)(ii) CCA.

\(^{25}\) S 47 (1)(c) CCA.

\(^{26}\) S 47 (1)(b) CCA. See Marpro Trawling (Pty) Ltd v Cencelli 1992 (1) SA 407 (C) according to which a sentence of 200 days imprisonment suspended for five years qualifies as such a sentence which does not have the option of a fine.

\(^{27}\) S 67 CCA. See also Delport-Pretorius (1989), 62 et seqq.
statements to be approved and signed by or on behalf of every member, thus not prescribing a meeting, "good business practice would indicate that a formal meeting of members should take place for the approval of the statements."\textsuperscript{28}

However, at this stage it is sufficient to say that as in the GmbH the members of the close corporation as a whole are the highest decision making organ.\textsuperscript{29}

7.3.3 Other Organs

The CCA contains no provision regarding a supervisory board, any member may call a members' meeting, which is in itself an instrument to supervise the other members.

7.4 CONCLUSION

In both entities the members as such are the highest decision making organ, in the GmbH acting through the shareholder's meeting. However, reflecting the close relationship in the close corporation every member has equal rights with regard to the management of the close corporation. The position of a GmbH-member as such does not include such a right. The GmbHG requires different organs. These are a director who is managing the company's affairs, a shareholders' meeting and in certain cases a supervisory board. While it was one of the declared intentions of the 'creators' of the CCA to \textit{retain as much flexibility as possible in the internal relations between the members themselves and between the members and the corporation}, the GmbH's internal affairs and organization in comparison are much more formally structured. There is a clear organizational division between the organs. The CCA on the other side does not require the organ of a director, however, the members may nominate whomever they please to manage the affairs of the corporation. When members in the close corporation decide to appoint one, they are also like in the GmbH free to

\textsuperscript{28} Symington (1986), 69. The annual financial statements have to be approved and signed by or on behalf of every member, s 58 (3) CCA.

\textsuperscript{29} For further details, see chapter 8.3.1.2.1, 'Calling of a members' meeting'.
choose a non-member. Like a corresponding section in the GmbHG, this choice of the members is only restricted by excluding certain persons from taking part in the management of the business of a corporation.
CHAPTER EIGHT

8 INTERNAL RELATIONS

8.1 INTRODUCTION

For both entities closeness is an important feature. Therefore it will be interesting to see how the Acts provide for necessary tools regulating the internal relations between the members.

While for the GmbH articles of association are compulsory and members are free to make provision regarding internal relations, in the close corporation it is up to the members whether they conclude an association agreement or refrain from doing so. However, regarding internal relations it is quite interesting to note that the Acts set out certain minimum requirements from which the members may deviate through articles of association or an association agreement provided that these minimum requirements are not compulsory. So for the GmbH this means that even if the articles of association do not regulate internal relations, these minimum provisions of the GmbHG apply. When internal relations are being regulated in the articles of association or in the association agreement (if any), attention must be given to not come into conflict with minimum requirements of the Act which are compulsory.

Subsequently, one has to distinguish between provisions in the Acts already regulating specific questions of internal relations or those regulations leaving the final decision in this matter up to the members.

The following sets out to explain the standard provisions in the Acts. These deal, inter alia, with the meeting of members as well as with the rights and duties of members.\(^1\)

Next, the focus will be on regulations given by the members themselves, be it in the articles of association or in the association agreement. As in the GmbHG, through the articles of association the CCA also gives the members the possibility to regulate their internal affairs to a great extent through an association agreement. However, if the articles of association make no provision for a GmbH, or for a close corporation, if an association agreement does not exist or

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\(^1\) Cf., for example, § 45 et seqq. GmbHG; s 42 et seqq. CCA.
an existing one makes no provision, the Acts regulate a number of important questions.

8.2 GMBHG AND CCA

8.2.1 Power of members in the GmbH

As mentioned above through their shareholders' meeting the members are the highest decision making organ in the company.2 They decide, for example, about changes of the articles of association,3 in particular, concerning increase and reduction of share capital,4 the dissolution of a company,5 appointment and revocation of liquidators,6 conversion of the company7 or the merger with other companies8 and the calling up of supplementary contributions.9

In addition, § 46 GmbHG lists further areas falling under the regulating powers of the members.10 These areas are:

- the determination of the annual balance sheet and the distribution of the net profits resulting therefrom;
- the making of calls in respect to initial contributions;
- the calling up of supplementary contributions;
- the splitting and the redemption of shares;

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2 Chapter 7.2.2, 'Shareholders' meeting'.
3 § 53 GmbHG.
4 §§ 55, 58 GmbHG.
5 § 60 (1) no. 2 GmbHG.
6 § 66 (1), (3) 2nd sentence GmbHG, in the given circumstances.
7 Previously regulated in § 24 UmwG 1969, (Act Regulating the Conversion of Companies of 1969). However, due to changes now the new 'Umwandlungsgesetz' 1995 is applicable, see chapter 13, 'Merger, Conversions, Groups'.
8 Previously regulated in § 19 et seqq. KapErhG (Act Regulating the Raising of Capital). Due to changes now the new 'Umwandlungsgesetz' 1995 is applicable, see chapter 13, 'Merger, Conversions, Groups'.
9 § 26 (1) GmbHG.
10 § 46 applies if the members do not make provision in the articles of association, see § 45 (2) GmbHG.
- the appointment and revocation of managing directors and their relief;
- the measures applicable to the control and supervision of the management;
- the appointment of 'Prokuristen' and of 'Handlungsbevollmächtigten für den gesamten Geschäftsbetrieb';
- the assertion of the company's claims for compensation arising out of formation or management against the managing directors or members, as well as the representation of the company in litigation with the managing directors.

However, it is up to the members if and in which way they regulate their rights with regard to the affairs of the company in the articles.

It is important to note that in doing so, the members are only restricted by the compulsory regulations of the general law, the compulsory regulations of the GmbHG itself with regard to the protection of the capital contribution and its maintenance, the external authority of the managing director, minority rights, the fiduciary relationship and the equality of rights.

8.2.2 Power of members in the close corporation

Even though the members are very independent in arranging their internal affairs, there are cases where the provisions of the Act cannot be changed. These are provisions dealing with the disposal of the interest of an insolvent member, with persons being disqualified from managing the business of a corporation, the right of a member to call a meeting of members, recording of a

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11 Cf. chapter 9.2.2, 'Special types of authority'.
12 § 45 (1) GmbHG, of course only in so far as they are not contrary to any statutory provisions.
13 E.g., §§ 134, 138 BGB.
14 §§ 19 (2), 21-24, 30 (1), 31 GmbHG.
15 § 35 GmbHG.
16 §§ 50, 51a, 51b, 61, 66 (2) GmbHG.
17 Additional regulations, however, limiting the authority of the members can also be found, for example, in Acts dealing with Co-determination: § 76 et seqq. BetrVerfG, (Shop Constitution Act of 1952), § 1 (1), § 25 (1) and §§ 30, 31 MitbestG, (Co-determination Law of 1976).
18 § 34 CCA.
19 § 47 CCA.
meeting in a minute book and equalization of a resolution passed in writing, signed by all the members and entered into the minute book with one passed in a meeting.\textsuperscript{21}

Besides these regulations there are others, which cannot override the provisions of the Act requiring the written authority or consent of all members.\textsuperscript{22} Provisions in this regard deal with:\textsuperscript{23}

- the original founding statement and any amendment to it;\textsuperscript{24}
- any increase or decrease in the contribution payable by the members;\textsuperscript{25}
- the conversion of the corporation to a company or vice versa;\textsuperscript{26}
- any payment for or financial assistance given towards the acquisition of a member's interest;\textsuperscript{27}
- any association agreement;\textsuperscript{28}
- any loans or furnishing of security to members and certain associates;\textsuperscript{29}
- the ratification of pre-incorporation contracts;\textsuperscript{30}
- breach of a fiduciary duty to the corporation;\textsuperscript{31}

\textsuperscript{20} S 48 (1) CCA. See Delport-Pretorius (1989), 30.
\textsuperscript{21} S 48 (3)(b) CCA.
\textsuperscript{22} As this sometimes is also possible on their behalf, check the applicable section for details.

Thus, where specific consent is required "any provision in an association agreement by which consent to certain types of dealings is purported to be given in advance is null and void", Delport-Pretorius (1989), 30, and "an association agreement - indeed any agreement - cannot override the provisions of the CCA requiring the written consent of all members", Ramsden, 1988, Businessman's Law 142, 143. However, see also Close Corporations Service, 4.10, deeming it risky for the members but possible to grant consent already in an association agreement to the written consent provisions, with the exception of ss 42 and 43 CCA.

\textsuperscript{23} Compare Delport-Pretorius (1989), 30 \textit{et seq.}; Close Corporations Service, 4.09; Ramsden, 1988, Businessman's Law 142, 143.
\textsuperscript{24} Ss 12 and 15(1) CCA.
\textsuperscript{25} S 24 (3) CCA.
\textsuperscript{26} Ss 27 (2)(a) CCA and 29 C(1) of the Companies Act.
\textsuperscript{27} Ss 39 (1)(a) and 40(a) CCA.
\textsuperscript{28} S 44 (1) and (6) CCA.
\textsuperscript{29} S 52 (2) CCA.
\textsuperscript{30} S 5 (2) CCA.
\textsuperscript{31} S 42 (4) CCA.
- loss due to negligence of a member;\(^{32}\)
- the appointment of an accounting officer who is a member or employee of a corporation, or a firm whose partner or employee is a member or employee of a corporation;\(^{33}\)
- the voluntary winding-up of the association.\(^{34}\)

### 8.3 COMPARISON

It is interesting to compare some examples as to how the Acts make provision for a number of questions dealing with rights and duties of members.

#### 8.3.1 Rights of members

Regarding this topic the following statement already made regarding the power of members has to be remembered: Even though in the GmbH a member not automatically has the right to take part in the management or to represent and bind the company, he is far from powerless. As in the close corporation the shareholders as a whole are the highest decision making organ.

It will be interesting to see whether this aspect has an influence on the rights of members.

#### 8.3.1.1 GmbH

**8.3.1.1.1 Calling of a shareholders' meeting**

A shareholders' meeting is called by the managing director.\(^{35}\) Apart from cases when a resolution by the members is expressly required by the Act\(^{36}\) or provided for in the articles of association,\(^{37}\) a meeting has to be called when it is in the interest of the GmbH, particularly when one half of the share capital has been...

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\(^{32}\) S 43 (2) CCA.

\(^{33}\) S 60 (3) CCA.

\(^{34}\) S 67 (1) CCA.

\(^{35}\) § 49 (1) GmbHG.

\(^{36}\) E.g., §§ 26, 46, 50, 53, 60 (1) no. 2, 66 GmbHG.

\(^{37}\) E.g., making provision for regular meetings on fixed dates.
lost.\textsuperscript{38} At least once a year a meeting of members has to be called deciding on the annual financial statements.\textsuperscript{39}

Unlike in the close corporation, where every member has the right to call a meeting,\textsuperscript{40} in the GmbH generally only the managing director has this right.

However, minority shareholders holding at least one-tenth of the share capital also have the right to call for a meeting. This is achieved through a request to the managing director. If this request receives no attention through the managing director or if no addressee for such a request exists, the minority shareholders can take the initiative and call for a meeting.\textsuperscript{41}

If a meeting is to be called, notice must be given to the members at least one week in advance and be sent by registered mail.\textsuperscript{42} Although the members normally pass their resolutions in a meeting they may also pass them in writing.\textsuperscript{43} Accordingly, it is not required to hold a meeting when all the members declare in writing that they agree on the decision to be made or if they agree on the casting of their votes in writing.\textsuperscript{44}

Generally, a report of proceedings at meetings is not prescribed with the exception of resolutions, which must be duly recorded by a notary and those of a

\begin{footnotes}

\item[38] \textsuperscript{38} § 49 (2), (3) GmbHG.

\item[39] \textsuperscript{39} § 46 No. 1 GmbHG. Scholz-Schmidt, GmbHG § 48, note 9. Unless the association agreement transfers this right to another organ.

\item[40] \textsuperscript{40} § 48 (1) CCA.

\item[41] \textsuperscript{41} § 50 GmbHG.

\item[42] \textsuperscript{42} § 51 (1) GmbHG.

\item[43] \textsuperscript{43} § 48 (1), (2) GmbHG. See also Scholz-Schmidt, GmbHG § 48, note 60 \textit{et seq}. In this context 'writing' also includes, \textit{e.g.}, circular letter signed by the members, telegram, telefax, \textit{ibid}. If this is also possible through a circular telephone call ("Rundruf") and a conference via telephone system ("Konferenzschaltung") when the articles so provide, is discussed controversially and depending on the nature of the matter decided upon, see Scholz-Schmidt, note 62, notes 70, 71, 73.

\item[44] \textsuperscript{44} To pass a resolution in writing is not possible, \textit{e.g.}, for resolutions regarding a change of the articles § 53 (1), (2) GmbHG because these decisions have to be officially recorded by a notary.
\end{footnotes}
one-man GmbH.\textsuperscript{45} However, good business practice would indicate such procedure at all meetings.

8.3.1.1.2 Votes

A decision concerning all operational and administrative matters is passed by a simple majority of the votes cast, each fifty Euros share granting one vote.\textsuperscript{46} The vote can be done by a proxy; the appointment must be done in writing.\textsuperscript{47} If the articles are going to be changed, or liquidation or transformation of the company is to be decided upon, the majority must be three-quarters of the votes cast.\textsuperscript{48} The consent of all members is needed when the contribution required from members through the articles shall be increased.\textsuperscript{49}

A member may not participate in a vote in matters involving a potential conflict of interest.\textsuperscript{50} The GmbHG contains no provisions concerning nullity or challenge of decisions by the members. In such a case the provisions of the 'Aktiengesetz' offer help and can be used analogously.\textsuperscript{51}

8.3.1.1.3 Managing rights

In the GmbH, the members take part in the company's affairs as being set out in the articles or, if managing rights are not regulated there, according to the

\textsuperscript{45} Compare with regard to the special features of the one-man GmbH § 48 (3) GmbHG, providing in the interest of legal certainty specific rules.
\textsuperscript{46} § 47 (1) (2) GmbHG. The articles can provide that the voting power regardless of the actual number of shares equals only one vote.
\textsuperscript{47} § 47 (3) GmbHG.
\textsuperscript{48} § 53 (2) 1st sentence GmbHG. This also applies for a vote on the dissolution of the company, § 60 (1) no. 2 GmbHG.
\textsuperscript{49} § 53 (3) GmbHG.
\textsuperscript{50} § 47 (4) GmbHG, for example, if through a resolution a member is released or discharged from liability, a commencement or settlement of an action against him is being decided upon.
\textsuperscript{51} § 241 et seqq. AktG.
provisions of the Act. As a whole, they are the highest decision making organ in the GmbH. However, as mentioned above, regarding external relations it is another organ, the managing director, which represents the company.

8.3.1.1.4 Financial rights

A prominent aspect in this regard is the right to claim the net profits and the amounts (if any) due in the case of a liquidation.

The members decide on the approval of the annual balance sheet and the distribution of the net profits shown therein. The GmbHG gives GmbH-members the right to claim the net profits as shown in the annual balance sheet. The Act regulates the net profits to be distributed in proportion to the shares. However, it is also possible to distribute them in a different way as the members may decide or as set out in the articles. Regarding the distribution of net profits § 29 GmbHG must be mentioned; accordingly, the decision of the majority of members on how to proceed has priority instead of an automatic total distribution.

The Act, nevertheless, makes provision for the protection of the financial well-being of the company. § 30 (1) GmbHG states that assets of the company required for the maintenance of the share capital may not be distributed to the members.

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52 § 45 (2) referring to §§ 46-51 GmbHG.
53 § 29 GmbHG; § 72 GmbHG.
54 §§ 46 no.1, 42a (1) GmbHG compare for further details.
55 § 29 (1) GmbHG; unless the articles provide otherwise. This claim, however, can only be realized if (a) an annual balance sheet showing net profits has been prepared (§ 42 GmbHG in connection with the corresponding provisions in the HGB); (b) the balance sheet has been approved by the members (§ 46 no. 1 GmbHG), or another organ assigned with this duty through the articles.
56 § 29 (2) 1st sentence GmbHG.
57 § 46 no. 1, § 29 (2) 2nd sentence GmbHG; according to BGHZ 14, 264 it is also possible to exclude a distribution at all.
58 § 31 GmbHG makes provision for repayment of money paid in contravention of this provision.
According to § 51a (1) GmbHG the managing director must promptly supply any member on request with information concerning the company's affairs and permit him to inspect the books and documents. These information rights cannot be restricted via the articles. Concerning the procedure to claim them § 51b GmbHG refers to § 132 AktG. However, information and inspection may be refused by a shareholders' resolution when it is feared that the facts will be used for purposes foreign to the company and thereby cause substantial damage to the company or to a connected enterprise.

CLOSE CORPORATION

Calling of a members' meeting

As mentioned, except for the winding-up of the corporation, a meeting of members is not compulsory for the close corporation. Regarding this aspect, at this stage it is sufficient to say that prerequisite for a voluntary liquidation is a decision of the members to proceed with an extrajudicial liquidation carried out by the creditors or themselves. In addition, decisions for a voluntary liquidation have to be signed by the members. A decision of members having more than half of the total votes existing in the corporation is required for a judicial liquidation. As mentioned, concerning a members' meeting it is suggested that "good business practice would indicate that a formal meeting should take place for the approval of the (annual financial ADV) statements."

59 Before the 1980 GmbH-reform these information rights were derived through the analogous application of the information rights in other business entities. See Kretzschmar, "Zur Konkretisierung des Auskunftsrechts nach § 51a GmbHG", 1987, AG 121 et seqq.

60 § 51a (2) GmbHG.

61 Symington (1986), 69. The annual financial statements have to be approved and signed by or on behalf of every member, s 58 (3) CCA. See also above 6.3.2, 'Members' meeting'.
With regard to a meeting the Act itself makes the following provisions:

Unlike in the GmbH every single member of the close corporation has the right to call a meeting for any purpose disclosed in the notice. This right cannot be abolished through an association agreement.

Subject to the provisions of an association agreement, if any, a reasonable date, time and venue must be chosen; three-fourths of the members present in person at a meeting constitutes a quorum and only members present in person at the meeting may vote at the meeting, proxies are not permitted.

Unless an association agreement provides otherwise, a meeting at which a quorum is not present within half an hour after the time appointed for the meeting, shall be adjourned to a day not earlier than seven days and not later than 21 days after the date of that meeting, and if at such an adjourned meeting a quorum is not present within half an hour after the time appointed for the meeting, the members present in person shall constitute a quorum. Where a meeting has been adjourned as described above, the member who adjourned the meeting shall, upon a date not more than three days after the adjournment, send a written notice to each member of the corporation stating:
- the date, time and place at which the meeting has been adjourned;
- the matters before the meeting when it was adjourned; and
- the grounds for the adjournment.

A report of proceedings at meetings shall be recorded in a minute book within 14 days after the meeting. A resolution in writing signed by all the members and entered into the minute book is the same as one which was passed at a meeting of the members.

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62 S 48 (1) CCA.
63 S 48 (2)(a) CCA.
64 S 48 (2)(b) CCA. (Quorum is a fixed number of members that must be present to make proceeding of assembly valid).
65 S 48 (2)(c) CCA, see also s 46(d) CCA with regard to the question of voting.
66 See Delport-Pretorius (1989), 35.
67 S 48 (2A) CCA.
68 S 48 (2B) CCA.
69 S 48 (3)(a) CCA; not changeable.
70 S 48 (3)(b) CCA; not changeable.
8.3.1.2.2 Votes

Unless an association agreement provides otherwise, each member shall have the number of votes that corresponds with the percentage of his interest in the corporation.\(^\text{71}\)

Nevertheless, there are matters which require the written consent of a member or members holding at least 75 per cent of the total members' interests:
- a change in the principal business carried on by the corporation;
- a disposal of the whole, or substantially the whole, of the corporation's undertaking or assets; and
- the acquisition or disposal of any immovable property.\(^\text{72}\)

While in the GmbHG the provision restricting the voting rights of members with conflicting interests is explicit, the CCA restricts these rights indirectly via the duties arising out of the fiduciary position of members towards the corporation.\(^\text{73}\)

8.3.1.2.3 Managing rights

The CCA provides variable rules regarding this aspect which can be found in s 46.\(^\text{74}\) Accordingly, every member is entitled to participate in the carrying on of the business of the corporation\(^\text{75}\) and has equal rights with regard to its...
management and the authority to represent the corporation in the carrying on of its business.

Thus, the members as such have equal rights concerning the management of the close corporation.

8.3.1.2.4 Financial rights

As in the GmbH, the members of the close corporation have the right to claim the net profits and the amounts due in case of a liquidation. Regarding to net profits, the CCA speaks of payments agreed upon by the members, which are payable by a corporation to its members by reason only of their membership. The members of the close corporation must agree on the time when the payments may be made. The Act provides for the payments to be distributed in proportion to their respective interests. However, it is also possible to distribute them in a different way as the members may decide or as set out in the association agreement.

The Act, however, makes provision for the protection of the financial well-being of the corporation. The CCA allows only payments which do not endanger the solvency and liquidity of the corporation.

8.3.1.2.5 Information rights

A corresponding provision can be found in s 56 (4) CCA, which gives a member the right to inspect the accounting records at reasonable times. Regarding the right to inspect other documents than the accounting records it is submitted that this right can be derived from the member's management rights, which must allow him to know about the corporation's situation. As the Act

76 S 46(a) CCA. Except where legally disqualified as set out in s 47 CCA, see chapter 7.3.1.1, 'Personal qualifications'.
77 S 46(b) CCA.
78 Close Corporations Service, 3.11.
79 S 46(f) CCA, this is a variable rule.
80 S 51 (1) CCA. Liability occurs for any payment received in contravention, s 51 (2) CCA.
declares non-compliance to be an offence, it is possible to take legal action where appropriate.81

8.3.2 Duties of members

The different origins of the GmbH (being a 'Kapitalgesellschaft') and the close corporation (relying on partnership features) have direct implications with regard to the priorities of duties. While in the GmbH it is necessary to focus, inter alia, on the duties in connection with contribution, in the close corporation the 'closeness' of the members makes their fiduciary position a topic. The following is, however, only an exemplary list of duties.

8.3.2.1 GmbH

The GmbH as 'Kapitalgesellschaft' must comply with a number of requirements of which only some are familiar to the close corporation. Especially important are provisions regarding duties connected with the contribution.

8.3.2.1.1 Obligations with regard to the initial contribution

8.3.2.1.1.1 Payment

In its aim to protect creditors, the GmbH-regulations for the payment of the initial contribution are strict. Members cannot be released from their obligation to make contributions and no set-off is allowed with regard to the company's claim. Liens in connection with non-cash contributions are restricted and the adequacy of non-cash contributions has to be stated in a report.82

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81 Ss 56 (5), 82 (1)(a) CCA.
82 § 5 (4) GmbHG. See chapter 5.2.2, 'Contribution to the share capital'.

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8.3.2.1.1.2  Payment of interest

If a member fails to pay the amount called up on his initial contribution he has to pay interest on the arrears.\(^{83}\)

8.3.2.1.1.3  Collection proceedings

If a member delays his payment even after being reminded thereof and advised of possible consequences he forfeits his share to the company but remains liable for the amount due.\(^{84}\)

8.3.2.1.1.4  Absence liability

In the case of absence liability the previous and all former holders of the share of the expelled member become liable to the company for the payments due in respect of the initial contribution, which the expelled member has failed to pay.\(^{85}\)

If payment of the amount in arrears cannot be obtained from former holders, the company may cause the share to be sold by public auction.\(^{86}\)

8.3.2.1.1.5  Joint liability to cover

In order to guarantee the share capital, the Act goes even further. If payment of the amount in arrears cannot be obtained through the above-mentioned means, a proportionate liability for the deficit to be shouldered by the other members of the company comes into existence.\(^{87}\)

\(^{83}\) § 20 GmbHG.
\(^{84}\) § 21 GmbHG, 'Kaduzierungsverfahren', also described as forfeiture of shares.
\(^{85}\) § 22 GmbHG, 'Ausfallhaftung' (absence liability).
\(^{86}\) § 23 (1) 1st sentence GmbHG.
\(^{87}\) § 24 GmbHG, 'Kollektive Deckungspflicht' (joint liability to cover).
8.3.2.1.6  Compelling character

To protect the share capital § 25 GmbHG states that the previous §§ 21-25 GmbHG cannot be changed in favour of the members.

8.3.2.1.2  Supplementary contributions

Supplementary contributions to the share capital in addition to the capital already subscribed to by the members can be agreed upon in the articles,\(^{88}\) or by a resolution, which must be passed with the consent of all the members concerned.\(^{89}\)

It must be distinguished between limited and unlimited supplementary contributions. This depends upon if a maximum amount is set for the supplementary contribution.

8.3.2.1.2.1  Limited supplementary contributions

If the contributions asked for are limited, the member's liability remains limited but at a higher figure. Accordingly, the member becomes liable for a supplementary contribution as if it was an outstanding contribution leading to an analogous use of §§ 21-23 GmbHG.\(^{90}\) This means that delayed additional payment leads to the application of the collection proceedings; every legal predecessor becomes bound by absence liability.

A joint liability to cover ('kollektive Deckungspflicht'), however, does not exist. In case the supplementary contributions cannot be collected, the other members will not become liable for the outstanding amount.

\(^{88}\) § 26 GmbHG.
\(^{89}\) § 53 (3) GmbHG.
\(^{90}\) § 28 (1) GmbHG.
In the case of unlimited supplementary contributions being requested, "the company becomes very close to being an unlimited company". However, the liability for a member to pay for unlimited supplementary contributions is not too strict as no collection proceedings or joint liability to cover exists. In addition, he has the right to abandon the share in case of unlimited supplementary contributions. Or as Oliver states, "a member can escape from his precarious position by relinquishing his share to the company. In other words, he must pay or go".

If he chooses to leave the company, he must deliver a corresponding statement to the company. If a member does not make this statement yet fails to pay the contribution, the company itself may declare that it regards the share as having been placed at its disposal. In any case, however, the company must cause the share to be sold in a public auction, any surplus which remains after meeting the expenses of its sale and the outstanding supplementary contributions is due to the member.

8.3.2.1.3 Fiduciary duties

It is quite interesting to note that unlike the CCA in ss 42 and 43, the GmbHG as such does not make provision regarding fiduciary duties of members. However, it has long since been established that fiduciary duties of members exist and a wide selection of these duties originally derived from § 242 and § 705 BGB.

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91 Oliver (1986), 7.
92 § 27 (1) GmbHG, see also (4), 'Abandonrecht' is the abandonment of a share in order to be released from the obligation to pay additional assessments.
93 Oliver (1986), 7.
94 For further details, see § 27 (1) 1st sentence GmbHG.
95 § 27 (1) 2nd sentence GmbHG.
96 § 23 GmbHG. For further details, see § 27 (2) 1st sentence GmbHG. Sale by a different method only allowed with the member's consent, § 27 (2) 2nd sentence GmbHG.
97 § 27 (2) 3rd sentence GmbHG.
98 'Treu und Glauben', principle of good faith.
have been established by courts and in the literature. Generally speaking a duty to act honest and in good faith ('Treuegebot') is the departing point. This 'Treuegebot' requires the member to act as honestly and loyally as can be expected of him in the context of the goal commonly agreed upon in the articles of association.

Fiduciary duties of the members exist in relation to the company as well as between the members inter se.

In relation to the company a member has to protect and further the interests of the members as a whole and the business of the company. In particular, a member has to refrain from harming these interests.

Regarding fiduciary duties between the members inter se, a member in exercising his rights has to take into consideration company relevant interests of other members. This applies, in particular, in the relationship between majority and minority shareholders.

8.3.2.1.4 Legal action

Different opinions exist regarding the rights of GmbH-members to take legal action. When a member takes action it is discussed controversially if he can do this in his own right or if he uses rights derived from the legal powers of the company. In this regard, for example, the actio pro socio is suggested.

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99 Dealing with the 'BGB-Gesellschaft' (civil law partnership).


102 Berger, "Die actio pro socio im GmbH-Recht", 1985, ZHR (149) 599 et seqq. See also the arguments regarding and approval of the actio pro socio by Gerkan,
Further discussed are the contents of claims and under which preconditions a claim for reimbursement, a claim for damages, an application for an injunction and an action for a declaratory judgement can be instituted. The question of who is the party against whom claims may be asserted is also debated: a co-partner, members of an organ or the company itself? However, there are various causes - similar to the ones in the close corporation - in which a member can become active in trying to claim his rights and further the interests of his company.

8.3.2.2 Close corporation

As mentioned, the close corporation relies on partnership features, *inter alia*, through the 'closeness' of the members. However, it is interesting to see how the close corporation deals with aspects of contribution and fiduciary duties.

8.3.2.2.1 Contribution and enforceability

An undertaking by a member to make an initial or additional contribution to a corporation is enforceable by the corporation in legal proceedings. The contribution must be made within 90 days after the registration of the close corporation; the same applies for the delivery and transfer of assets. Failure to do so makes the member jointly liable with the corporation until the contribution

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1988, ZGR 441 at 445. Cf. also in connection with the *actio pro socio*, Scholz-Emmerich, GmbH § 13, note 44 et seqq.


S 24 (5) CCA. When an additional member joins, one must differentiate if the contribution consists of an amount of money, or of any property (whether corporal or incorporeal), S 33 (2) CCA; thus this contribution is to be distinguished from an initial contribution which, in addition, can also consist of services, ss 12(f), 24 (1) CCA.

S 24 (4) CCA. See Henochsberg CCA s 24, 24.1 regarding problems with the language used and his suggestion.
has been made.\textsuperscript{107} Any member may institute such legal proceedings on behalf of the corporation.\textsuperscript{108}

8.3.2.2 Supplementary contributions

It is up to the members to provide for supplementary contributions in an association agreement. However, if the aggregate amount of the initial contribution and loan advance become insufficient to meet the working capital funding requirements of the close corporation and the additional amount required cannot be obtained from some other source, it should be in the members' interest to provide supplementary contributions, assuming the members wish the corporation to continue doing business.

8.3.2.2.3 Fiduciary duties

Regarding the fiduciary position it is submitted that "although members stand in a close relationship towards each other and in this respect are akin to partners, they owe their fiduciary duties to the corporation as a separate legal persona and not to each other as in the case of partners."\textsuperscript{109} Thus, placing members in a position analogous to that of directors in a company, the Act in terms of

\textsuperscript{107} S 63(b) CCA. As Close Corporations Service describes in 6.02 fn. 6 prior to being amended s 63 (b) provided for liability for every debt the corporation incurred from registration to date of actual contribution. The extent of the liability could have been unreasonable where a member failed to deliver an additional contribution long after registration of the corporation. See de Koker, 13 Tran CBL (1990), 145. The Close Corporations Amendment Act 26 of 1997 replaced the reference to the date of registration with a reference to the date of registration of the founding statement containing the particulars of the contribution concerned.

\textsuperscript{108} S 50 (1) CCA. See also s 24 (5) CCA.

\textsuperscript{109} Close Corporations Service, 4.13. See also Viljoen, "Die interne verhoudings tussen die lede \textit{inter se} en tussen die lede en die Beslote Korporasie", 1984, TRW 142 \textit{et seqq}. Cf. also Ribbens, "Close corporators’ fiduciary duties: The significance and impact of the distinction between horizontal and vertical fiduciary relations", 1985, MB 132 \textit{et seqq}. See Henochsberg CCA s 42, 42.1 discussing these views.
s 42 (1) CCA provides that all members stand in a fiduciary relationship to the corporation.

However, it should be possible to state in the association agreement that members also owe fiduciary duties towards each other.\textsuperscript{110} In defining the scope of the fiduciary duties owed by partners \textit{inter se} it is submitted, that "principles of company law and partnership law come into play."\textsuperscript{111}

The fiduciary relationship to the corporation implies that in relation to the close corporation a member must be honest and in good faith. He must exercise such powers as he may have to manage or represent the close corporation in its interests and for its benefit; he must avoid material conflicts of interest between himself and the close corporation. For instance, he is not to derive personal benefits to which he is not entitled to by reason of his membership or service to the close corporation; he is to notify every other member of his interests, which he may have in any contract of the close corporation and must not compete in any way with the close corporation in its business activities.\textsuperscript{112}

Where the member has been in breach of his fiduciary duty he can be held liable to the close corporation for any loss it may have suffered or for any benefit he may have derived.\textsuperscript{113}

However, "where a member fails in his duty to disclose a material interest in any contract of the corporation to every other member, the contract is voidable at the option of the corporation. Where the corporation elects not to be bound by the contract the court may, on application by an interested party, if the court is of the

\textsuperscript{110} Close Corporations Service, 4.13, fn. 1. Cf. also Henochsberg CCA s 42, 42.2; at seqq. discussing the various aspects.

\textsuperscript{111} The principles developed by the courts in this regard must be made applicable, keeping in mind the characteristics of the close corporation; Close Corporations Service, 4.14. Regarding the position in company law, see, e.g., du Plessis, Aspekte van die Regsposisie van besturende direkteure, (1991), 16 Med SOR. Cilliers et al. (2000), 13.81 et seqq. regarding the situation in a company.

\textsuperscript{112} See Brooks, "Ramifications of a member's duty not to compete with his corporation", 1988, MB 46 et seqq.

\textsuperscript{113} S 42 (3)(b) CCA.
opinion that it is equitable in the circumstances, order that the contract be nonetheless binding."

A member who is active in the carrying on of the close corporation's business must act with the degree of care and skill that may reasonably be expected from a person of his knowledge and experience. Failure to do so will make him liable to the close corporation for any loss it may have suffered. Failure to do so will make him liable to the close corporation for any loss it may have suffered.

It is, however, possible as submitted that "breaches may be ratified by the written approval of all the members provided they are fully cognizant of all the material facts."

8.3.2.2.4 Legal action

If disputes between the members cannot be solved internally they have the right to address the court in a number of circumstances. However, a distinction must be drawn between the situation where a member's own rights are affected and where the corporation's own rights are at stake. The former situation is governed by s 49 and the latter by s 50 of the CCA.

Regarding unfair prejudicial conduct, the Act regulates that any member of a corporation who alleges that any particular act or omission of the corporation or of one or more other members is unfairly prejudicial, unjust or inequitable to him, or that the affairs of the corporation are being conducted in a manner unfairly prejudicial, unjust or inequitable to him, or to some members including him, may apply to a court for an order to decide the matter. Subsequently, if the court

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114 Close Corporations Service, 4.15 stating the situation as set out in s 42 (3)(b) CCA. See also chapter 9.3.3, 'Contracts between members and corporation'.

115 S 43 CCA.

116 Close Corporations Service, 4.16 referring to sub-section (2) of s 43 CCA.


118 S 49 (1) CCA. See also Hurter, "Unfairly prejudicial, unjust or inequitable conduct by members in a close corporation", 1997, SA Merc LJ 207, discussing Gatenby v Gatenby & Others 1996 (3) SA 118 (E) as the first reported case in which s 49 CCA has been considered. Cf. regarding the 'influence of women on men', leading to a marriage which is not approved by the son's father, subsequently causing the breakdown of relationship between them and the end of a close corporation being wound up as it was just and equitable under these circumstances (also interesting thoughts on the fair price of a member's interest),
considers it just and equitable, the court may, with a view to settling the dispute, make such order as it thinks fit, whether for regulating the future conduct of the affairs of the corporation or for the purchase of the interest of any member of the corporation by other members thereof or by the corporation itself.  

Proceedings against fellow members on behalf of the corporation can also be instituted. S 50 CCA covers this aspect. It regulates that when a member or a former member of a corporation is liable to the corporation to make an initial contribution or any additional contribution as agreed upon by the members, or on account of the breach of a duty arising from his fiduciary relationship with the corporation, or negligence in carrying on the affairs of the corporation, any other member of the corporation may institute proceedings in respect of any such liability on behalf of the corporation against such a member or former member after notifying all other members of the corporation of his intention to do so.

In a recent decision by the Namibian Supreme Court, after also having been dealt with in a lower court and the High Court of Namibia, the question arose under which circumstances a close corporation has legal standing in proceedings according to s 50 of the Namibian Close Corporation Act 26 of 1997.  

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119 S 49 (2) CCA.
120 S 24 (1),(2)(a) CCA.
121 S 42 CCA.
122 S 43 CCA.
The wording of ss 49 and 50 of the Namibian Act is the same as that of the respective sections in the South African CCA. The full bench of the High Court of Namibia came to the conclusion that s 50 specifically determined that a member of a close corporation could sue 'on behalf of' the corporation, but the action could not be instituted in the name of the close corporation. In the opinion of Sigwadi, the legal position is correctly decided upon and accordingly, South African courts should adopt a similar interpretation of s 50 of the CCA.

For further details regarding prima facie grounds and the court's permission, which is required for a withdrawal of the proceedings or a settlement of the claim, see s 50 (2) and (3) CCA. In this regulation, the Act also enables the court to come to a just decision regarding costs, taking the burden from the member who seeks help having prima facie grounds.

In this context it is worth noting that in terms of s 8 of the CCA, a court may require a plaintiff or applicant close corporation to furnish security for the costs of any legal proceedings "if it appears that there is reason to believe" that the corporation will be unable to pay the defendant’s or respondent’s costs if the latter’s defence is successful. In Vumba Intertrade CC v Geometric Intertrade CC Cloete J confirmed that the phrase "there is reason to believe" places a much lighter burden of proof on an applicant than, say, "the court is satisfied". The "reason to believe" must, however, be supported by facts that give rise to such belief. Therefore a blind belief, or a belief based on such information or hearsay evidence as a reasonable man ought, or could, not give credence to, is not sufficient. Hence, there must be facts before the court on which the court can conclude that there is reason to believe that a plaintiff close corporation will

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123 Sigwadi, 2002, JBL 128 et seqq., referring to Oshuunda CC v Blaauw & Another, High Court of Namibia (case no FA 10/2000, unreported) dealing in detail with this unreported case.


125 Sigwadi, 2002, ibid.

126 An interesting thought can be found at Close Corporations Service, 4.22, "The member institutes the action on behalf of the corporation. Therefore judgement is in favour of the corporation and the corporation is liable for costs and not the member acting on its behalf. There is nothing in the Act prohibiting the corporation itself from instituting the action if the majority is in favour."

127 Vumba Intertrade CC v Geometric Intertrade CC 2001 (2) SA 1068 (W).
be unable to satisfy an adverse costs order.\textsuperscript{128} Cloete J interpreted and applied s 8 CCA in accordance with the principles applicable to s 13 of the Companies Act 61 of 1973 and found no supporting instance where the respondent’s failure to produce its balance sheet, without more, led to an order directing it to provide security for the applicant’s costs.\textsuperscript{129}

8.4 ARTICLES OF ASSOCIATION AND ASSOCIATION AGREEMENT

8.4.1 Introduction

As mentioned above, the members of the respective entities in founding the GmbH and the close corporation must comply with certain minimum requirements, which, for the GmbH, are contained in the articles of association, and for the close corporation in the founding statement.\textsuperscript{130}

Very often, however, the members wish to regulate more than is required in those basic regulations or they want to change or alter provisions of the Acts. The respective Acts give members great flexibility to regulate their particular affairs. The GmbH-members can amplify and thus create their specific articles of association. The members of the close corporation can conclude an association agreement, which then exists in addition to the founding statement. Articles of association and association agreement can be used especially with regard to internal relations, be it between the members \textit{inter se} and/or between the members and their entity. The Acts provide for a number of variable rules subjecting them to change by the members.\textsuperscript{131}

\textsuperscript{128} \textit{Vumba Intertrade CC v Geometric Intertrade CC} supra at 1071E-H.
\textsuperscript{129} \textit{Vumba Intertrade CC v Geometric Intertrade CC} supra at 1070B and 1072B-I. See also Havenga, 2002, \textit{JBL} 81, \textit{et seq}.
\textsuperscript{130} See chapter 5.2.1, 'Articles of association' and 5.3.1, 'Founding statement'.
\textsuperscript{131} With regard to the GmbH generally speaking many of the statutory provisions are not mandatory, thus allowing different or additional provisions to be introduced in the articles. Regarding the close corporation, see Naudé, 1984, \textit{TRW} 117, 126. Venter speaks of "an open door through which members (...) can incorporate various
8.4.2 GmbH

8.4.2.1 Conclude articles of association

For the members of the GmbH it is obligatory to conclude articles of association. This is a difference compared to the close corporation where it is not compulsory and up to the members if they regulate their 'terms of business'.

8.4.2.2 Regulating a wide range of matters

8.4.2.2.1 Mandatory

Notwithstanding the general flexibility with regard to internal relations there are a number of rights of a member, which are non-variable and cannot be changed or altered through the articles. In particular, these are:

- the right to take part in a shareholders' meeting;
- the minority right to call for a shareholders' meeting and the right to demand that topics be announced for the passing of a resolution at the meeting;
- the right of the individual member with regard to information and inspection;
- the right to hand in an application with regard to the appointment and removal of liquidators by the court.
- the right to leave the company due to important cause\textsuperscript{138} or the right to institute the motion of dissolution of the company through a court order respectively;\textsuperscript{139}
- the right to institute a motion with regard to the nullity and impeachment of a resolution of members;\textsuperscript{140}
- the right to abandon the share in the case of unlimited supplementary duties.\textsuperscript{141}

8.4.2.2  Non-mandatory

Distinct from the non-variable rights of the members are those of which the members with their consent can be deprived of or restricted in. Thus, \textit{inter alia}, besides in the case of collection proceedings\textsuperscript{142} and the expulsion due to an important cause,\textsuperscript{143} deprivation of the membership is possible only with the consent of the member concerned.

With the consent of the members concerned it is also possible to dispose of the right to claim the net profits, the amount due in the case of a liquidation, and the voting rights.

In connection with majority rights and minority protection it is worth mentioning that a majority decision dealing with the aforesaid rights can only be blocked by means of the requirement of consent, however, if this majority decision removes these rights as such or infringes on their very nature. In addition, if a shareholders' resolution affects the legal position of members the principles of equal treatment apply, unless the members being treated differently consent to this different treatment.

8.4.2.3  Alter, change or add

\begin{itemize}
\item \textsuperscript{138} Cf. above chapter\textsection6.5.1.4, 'Leaving due to important reason'.
\item \textsuperscript{139} \textsection 61 GmbHG.
\item \textsuperscript{140} The provisions of the AktG are used analogous.
\item \textsuperscript{141} \textsection 27 (1) GmbHG, see also (4). With regard to the 'Abandonrecht', see chapter 8.3.2.1.2.2, 'Unlimited supplementary contributions'.
\item \textsuperscript{142} \textsection 21 et seq. GmbHG. See chapter 8.3.2.1.3, 'Collection proceedings'.
\item \textsuperscript{143} §§ 737 BGB, 140 HGB are used analogous. See chapter 6.5.1.7, 'Expulsion of a member'.
\end{itemize}
The members of the GmbH wishing to alter or change the provisions of the Act, or make provision for matters not dealt with in the Act may do so in the articles of association. In addition to the minimum requirements, they have to comply with when founding a GmbH, they are therefore free to change the non-mandatory statutory provisions as they deem applicable to adjust them for their own or their company's specific purposes and needs. These additional provisions may be regulations which, according to the Act, have to be introduced into the articles of association in order to be legally binding for the company. Regulations which do not need to be mentioned in the articles to be legally binding for the company are those which are de facto part of the articles; worth mentioning here are, in particular, regulations concerning the company's internal affairs, which are decided upon through a members' resolution.

8.4.2.4 Obligations

In addition to the statutory obligations to pay the share capital contribution subscribed to and to pay supplementary contributions authorized in the articles when they are required to be paid, the articles may impose upon members a variety of additional obligations, which are usually referred to as "ancillary obligations" ("Nebenleistungspflichten"). Ancillary obligations may either be created in the articles as obligations that attach to the shares or as personal

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144 §§ 2 (1), 3 GmbHG. Also called 'rechtsnotwendiger Satzungsinhalt', see two footnotes below.

145 These changes must, however, be within the legal framework. As mentioned before, because the GmbHG in general does not state explicitly which provisions may be changed, it is advisable to check in the commentaries to the GmbHG.

146 'Fakultativer Satzungsinhalt' (facultative contents of the articles).

The contents of the articles required by the law ('rechtsnotwendiger Satzungsinhalt') and the facultative contents of the articles ('fakultativer Satzungsinhalt') are called real or substantive contents of the articles ('echte oder materielle Satzungsbestandteile'), they may only be changed through a change of articles according to § 53 GmbHG ('qualifizierte Satzungsänderung', qualified change of articles).

147 § 47 GmbHG, 'einfache Gesellschafterbeschlüsse' (ordinary members' resolutions). They are called formal or unreal contents of articles ('formeller Satzungsinhalt' or 'unechte Satzungsbestandteile'), and may be changed through a members' resolution.
shareholder obligations, whatever the articles may provide. However, provisions to this effect must be contained in the articles.\textsuperscript{148} If an ancillary obligation was not created by the articles when the GmbH was formed, its subsequent creation requires an amendment of the articles. In addition to the three-quarter majority of votes cast generally required for passage of amendments to the articles,\textsuperscript{149} the consent of those who are to be bound under an obligation is required as well.\textsuperscript{150} The same rule applies to any subsequent increase of the scope of an ancillary obligation.\textsuperscript{151}

In principle, the GmbHG contains no limitation on the types of ancillary obligations that may be created by the articles. The wide range of ancillary obligations that may be imposed allows the members a particularly high degree of flexibility in shaping the GmbH and their roles in it according to their interests. Especially in GmbHs with few members or those which are focused on and founded around individuals (‘personenbezogen’), additional obligations are often found and these obligations may appear more important than the obligation to serve the initial contribution. These ancillary obligations may be, for example: management duties or management functions, restraint clauses, fiduciary duties with regard to the company or among the members.\textsuperscript{152} They can also be to provide the GmbH with financial means in addition to the share capital contributions and supplementary contributions, if any. Also imposed as ancillary obligation can be the obligation to make specified assets available to the GmbH, such as real estate, production facilities, patent rights and know-how.\textsuperscript{153}

Obligations, however, can also be the subject of contracts between members or between the company and members. These contracts are not connected with the membership as such. It is, for example, possible to agree on restraint clauses in the articles or in a separate contract. If a member leaves the

\begin{itemize}
\item \textsuperscript{148} § 3 (2) GmbHG.
\item \textsuperscript{149} § 53 (2) sentence 1 GmbHG.
\item \textsuperscript{150} § 53 (3) GmbHG.
\item \textsuperscript{151} § 53 (3) GmbHG.
\item \textsuperscript{152} Dealing at length with fiduciary duties Raiser, 1987, \textit{ZHR} (151) 422 et seqq.
\item \textsuperscript{153} For details on available types, see Scholz-Emmerich, \textit{GmbHG} § 3, note 42 et seq.; also Hachtenburg-Ulmer, \textit{GmbHG} § 3, note 65 et seq.
\end{itemize}
company he remains legally bound only to the separate contract but no longer to the articles.

8.4.3 Close corporation

8.4.3.1 Conclude, alter, change or add

The members as a whole are the ultimate decision making organ in the close corporation.\textsuperscript{154} However, due to the different structure compared with the GmbH, the rules governing the close corporation give the members not only the right to participate in the carrying on of the business of the corporation but also grant them equal rights with regard to the management of the business of the corporation and the power to represent the corporation in the carrying on of its business.\textsuperscript{155}

Although the CCA does not require articles of association, the members are free at any time to enter into a written association agreement.\textsuperscript{156} As with the articles, the association agreement must be signed by or on behalf of each member.\textsuperscript{157} Signing is also prescribed in case of any amendment to, or dissolution of an association agreement; this obligation to sign includes any new

\textsuperscript{154} See chapter 7.3.2, 'Members' meeting' and chapter 8.3.1.2.1, 'Calling of a members' meeting'.

\textsuperscript{155} S 46(a)(b) CCA. In the absence of contrary provisions in the Act or in an association agreement. S 47 CCA, however, names circumstances under which persons are disqualified to participate in the management, see chapter 7.3.1.1, 'Personal qualifications'.

\textsuperscript{156} S 44 (1) CCA. The members are also free at any time to change an existing one, compare sub-section (6). By comparison in the GmbH even the one-man founder must comply with the much more formally structured foundation of a GmbH, \textit{e.g.}, to set up articles of association §§ 1, 2 (1) GmbH. Another difference exists in that only the articles of association need to be in notarial form, § 2 (1) 1st sentence GmbH.

\textsuperscript{157} As mentioned above, § 2 (1) 2nd sentence GmbH; holders of a proxy may only sign if their proxy is either conferred or certified before a notary, § 2 (2) GmbH. S 44 (1) CCA.
member at the time of amendment or dissolution. A new member is bound by an existing association agreement as if he signed it as a party.

Unlike the articles of the GmbH, the association agreement of the close corporation is an internal matter available essentially to members only, which is why it is not entered into a commercial register, nor is it made public in the Government Gazette or other publications. The association agreement is to be kept at the registered office of the corporation and the members may inspect it. Third parties do not have this right, unless the Act provides otherwise and no person dealing with a corporation is deemed to have knowledge of any aspect dealt with in an association agreement.

8.4.3.2 Regulating a wide range of matters

Thus s 44 (1) CCA gives the members the right to enter into a written association agreement at any time (they are free to choose if and when). In the association agreement the members may regulate a wide range of matters as long as the matter regulated is permitted or not inconsistent with the provisions of the Act.

As submitted, an association agreement may, for example, regulate the following matters:
- participation of members in the management;
- settling of differences between members;
- voting at meetings and proxy votes;
- repayment of contributions;
- procedure at meetings;
- sale or transfer of a member's interest by a member;
- disposal of interest of a deceased member;
- financing of the corporation;

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158 S 44 (6) CCA.
159 S 44 (5) CCA.
160 S 45 CCA.
- any other matter which could have been dealt with in a shareholders' agreement in respect of a limited company.\textsuperscript{161}

8.4.3.3 Obligations

As in the GmbH, it is possible for the members to conclude 'other agreements' between themselves and the corporation.\textsuperscript{162} Unless superseded by an association agreement the provisions of s 46 CCA apply. The definition of an association agreement in s 1(ii) CCA does not include 'informal' agreements and therefore it is submitted that in spite of 'informal' agreements the members will still be obliged to adhere to the provisions of s 46 CCA in the absence of a formal association agreement. In the close corporation, these agreements cease to have effect when any party to it ceases to be a member of the corporation.\textsuperscript{163} Therefore, new members or members ceasing to be such are not bound thereby. Furthermore, an 'informal' agreement is subordinate to the formal association agreement in case of inconsistency between the two.\textsuperscript{164} However, it is also submitted that "should all the members act in such a way as to imply that they have agreed to act in a particular manner in certain circumstances, even although this agreement is not embodied in an existing association agreement, the implied consent will be a valid agreement between them provided it does not conflict with the provisions (a), (b) and (c) to subsection 44 (3)."\textsuperscript{165}

\begin{itemize}
\item \textsuperscript{161} Cf. Close Corporations Service, 4.07. As the CCA in general does not state explicitly which provisions may be changed, it is advisable to check in the commentaries. For a draft association agreement, see Close Corporations Service, Part 2; also Hymann, Close Corporation Agreements (1985); see also Symington (1986), 116 \textit{et seq}. and de Beer (managing ed.), Butterworths, Forms and Precedents on Disk, Looseleaf Series, Companies 3, April 1999, 1, 31 \textit{et seq}. for close corporations.
\item \textsuperscript{162} Subject to the condition that these other agreements are not inconsistent with any provision of an association agreement and may not affect any person other than the corporation or a member who is party to it, s 44 (3)(a)(b) CCA. See Henochsberg CCA s 44, 44.4 on the relationship and contents of such an "other agreement".
\item \textsuperscript{163} S 44 (3)(c) CCA; however, it remains valid between the remaining members.
\item \textsuperscript{164} S 44 (3)(a) CCA.
\item \textsuperscript{165} Symington (1986), 53 \textit{et seq}. 
\end{itemize}
8.5 CONCLUSION

Regarding internal relations both Acts have something in common. Both make provision for a number of questions the legislator saw as so important to already regulate them in the respective Acts.

However, the main difference lies in the fact that for the GmbH in addition to the regulations already provided for it is still compulsory to also establish articles of association. In the articles of association it is up to the members if and in which way they regulate their rights with regard to the affairs of the company, of course only in so far as they are not contrary to any statutory provisions, *i.a.*, those on the maintenance of share capital.

For the close corporation an association agreement is not compulsory. When deciding to establish one, the members are relatively free in arranging their internal affairs. However, as in the GmbH there are cases where the provisions of the CCA cannot be changed. In addition there are provisions which may be changed, however, requiring the written authority or consent of all members.

When it comes to a comparison of rights for the GmbH a calling of a shareholders' meeting at least once a year is compulsory, in the close corporation only in case of a winding-up. In the close corporation every single member has the right to call a meeting, while in the GmbH generally only the managing director has this right, unless minority shareholders request one. This difference reflects the close relationship among the members of the close corporation.

Unlike in the close corporation votes in the GmbH can be done by a proxy. Both Acts safeguard crucial provisions through requiring either a certain number of the votes cast in case of the GmbH and the written consent in the case of the close corporation.

Regarding managing rights, the GmbH-members take part in the company's affairs as being set out in the articles or, if managing rights are not regulated there, according to the provisions of the Act. As a whole, they are the highest decision making organ in the GmbH. However, regarding external relations it is another organ, the managing director, which represents the company. In the close corporation, the members as such have equal rights concerning the management of the close corporation.
In the context of financial rights a prominent aspect in this regard is the right to claim the net profits and the amounts (if any) due in the case of a liquidation. The Acts provide for the protection of the financial well-being of the entities. The GmbHG requiring that assets of the company needed for the maintenance of the share capital may not be distributed to the members while the CCA allows only payments which do not endanger the solvency and liquidity of the corporation. Information rights for members are granted extensively in both Acts. The different origins of the GmbH (being a 'Kapitalgesellschaft') and the close corporation (relying on partnership features) have direct implications with regard to the priorities of duties. In the GmbH the focus is on the duties in connection with contribution, in the close corporation the 'closeness' of the members makes their fiduciary position a topic.

Regarding fiduciary duties unlike the CCA, the GmbHG as such does not make provision regarding fiduciary duties of members. However, it has long been established that fiduciary duties of the members exist in relation to the company as well as between the members *inter se*.

The CCA provides that all members stand in a fiduciary relationship to the corporation. However, it should be possible to state in the association agreement that members also owe fiduciary duties towards each other.

Regarding rights of GmbH-members to take legal action it is discussed controversially if a member can do this in his own right or if he uses rights derived from the legal powers of the company. If disputes between the members cannot be solved internally they have the right to address the court in a number of circumstances. However, a distinction must be drawn between the situation where a member’s own rights are affected and where the corporation’s own rights are at stake. The CCA explicitly regulates this situation.

The members of the respective entities in founding the GmbH and the close corporation must comply with certain minimum requirements, which, for the GmbH, are contained in the articles of association, and for the close corporation in the founding statement. Very often, however, the members wish to regulate more than is required in those basic regulations or they want to change or alter provisions of the Acts. The respective Acts give members great flexibility to regulate their particular affairs. The GmbH-members can amplify and thus create their specific articles of association. The members of the close
corporation can conclude an association agreement, which then exists in add-
dition to the founding statement.

Articles of association and association agreement can be used especially with
regard to internal relations, be it between the members inter se and/or between
the members and their entity. The Acts provide for a number of variable rules
subjecting them to change by the members.

Notwithstanding the general flexibility in the GmbH with regard to internal re-
lations there are a number of rights of a member, which are non-variable and
cannot be changed or altered through the articles. Distinct from the non-variable
rights of the members are those of which the members with their consent can be
deprived of or restricted in. In addition the articles may impose upon members a
variety of additional obligations, which are usually referred to as "ancillary
obligations" (‘Nebenleistungspflichten’). Especially in GmbHs with few members
or those which are focused on and founded around individuals (‘personenbe-
zogen’), additional obligations are often found and these obligations may appear
more important than the obligation to serve the initial contribution.

The CCA gives the members the right to enter into a written association
agreement at any time. In the association agreement the members may regulate
a wide range of matters as long as the matter regulated is permitted or not in-
consistent with the provisions of the Act. Unlike the articles of the GmbH, the
association agreement of the close corporation is an internal matter available
essentially to members only, which is why it is not entered into a commercial
register, nor is it made public in the Government Gazette or other publications.
The association agreement is to be kept at the registered office of the corpo-
ration and the members may inspect it. Third parties do not have this right,
unless the Act provides otherwise and no person dealing with a corporation is
deemed to have knowledge of any aspect dealt with in an association agree-
ment.

As in the GmbH, it is possible for the members to conclude 'other agreements'
between themselves and the corporation.
CHAPTER NINE

9 EXTERNAL RELATIONS

9.1 INTRODUCTION

Being juristic persons both entities need to act through organs. Regarding external relations the structures of the GmbH as a 'Kapitalgesellschaft' become apparent. They assign specific functions to each organ of the GmbH. As regulated in the Act, external relations fall into the competence of the managing director. Therefore, the Act itself makes a clear distinction between internal and external relations.

In the close corporation every member has the right to manage and represent the entity. Comparing this situation with the one in the GmbH it is obvious that specific provisions are essential for the close corporation. Therefore, in comparing the two Acts the focus will be on regulations governing the close corporation.

9.2 GmbH

9.2.1 Managing director and representation

As mentioned above, a managing director is responsible for the company's affairs and represents it in and out of court.\(^1\) If there is more than one director and the articles make no provision in this regard then they manage its affairs and represent the GmbH jointly.\(^2\) It is possible that the articles divide the management of the company's affairs into different sections and also give each managing director the right to represent the company alone or together with

\(^1\) §§ 35 (1), 36 GmbHG. Chapter 7.2.1.2, 'Appointment and legal position'.

\(^2\) § 35 (2) 2nd sentence GmbHG.
another managing director, or a 'Prokurist'. However, the commercial register must show the actual situation.

The management covers all areas of the company. The company acquires rights and duties through legal transactions entered into by the director in its name, be it expressly or implied. Given the fact that through the articles it is possible to determine the scope of the management affairs for each director differently, the question arises if this is also possible with regard to representation of the company. Here one has to distinguish between the external and internal relationship. Regarding the external relationship a restriction on the managing director's authority is not possible due to the protection of third parties and to achieve legal certainty.

In this context one has to mention that the doctrine of *ultra vires* does not exist in German company law. Therefore, even transactions "outside the scope of the objects clause in the articles" entered into by the managing director "will bind the company to the third party. If, however, the transaction results in loss or damage to the company, the directors will be liable to it for breach of duty." Also, the company is not bound in case of a fraudulent collusion between the manager and a third party. In this context it is interesting to mention § 181 BGB prohibiting 'Insichgeschäfte'. Accordingly, to prevent conflicting interests such 'Insichgeschäfte' are not permitted unless the members consent, or an exclusion clause is contained in the articles.

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3 'Prokurist' (procuration holder) being the holder of a special statutory authority, see chapter 9.2.2, 'Special types of authority'.
4 § 10 (1) 2nd sentence, § 39 GmbH.
5 § 36 GmbH. See also chapter 9.2, 'GmbH'.
6 § 37 (2) GmbH. Thus restrictions have no effect on third parties. The German law of agency makes a strong distinction between the external relationship (power of representation) and internal relationship (power to manage the business).
7 Oliver (1986), 8.
8 This can be translated as 'doing business with oneself', 'self-dealing'. The regulation describes situations where somebody is acting as principal and agent and as such concludes transactions with himself as representative of another. Therefore it is not possible for the same person to act on both sides of the transaction unless this is expressly permitted.
Nevertheless, internally (between the GmbH and the managing director) his authority may be limited by the articles or a shareholders' resolution.\(^9\)

A violation thereof may constitute a breach of the service contract with the GmbH and may give rise to claim for damages.\(^10\)

The managing director must show the "diligence of an orderly businessman"\(^11\) with regard to the affairs of the company. Failure to do so makes him or them jointly and severally liable to the company for the damages caused.\(^12\)

### 9.2.2 Special types of authority

In this context to mention are two special types of authority which can be granted. These authorities for a 'Prokurist',\(^13\) being a holder of a special statutory authority, and 'Handlungsbevollmächtigter für den gesamten Geschäftsbetrieb',\(^14\) are types of authority based in the commercial law.\(^15\) The authority's scope is unrestricted regarding external transactions with *bona fide* third parties. Internally, however, liability may arise.

It is also possible to grant authority for acts within the GmbH (e.g., regarding management) if the articles of association so provide or a shareholders' meeting so decides. However, it is not possible to transfer the functions of a GmbH organ as such, e.g., granting all the powers of a managing director to such a person and letting him manage the affairs of a company instead of a managing director.\(^16\)

\(^9\) § 37 (1) GmbHG.
\(^10\) May also lead to termination of his position as managing director.
\(^11\) § 43 (1) GmbHG.
\(^12\) § 43 (2), (3) GmbHG, this applies especially if in contravention of § 30 GmbHG payments are made out of the assets of the company which are required to maintain the share capital or if the company acquires its own shares and thus contravenes § 33 GmbHG.
\(^13\) As mentioned, translated as procuration holder.
\(^14\) Describing an officer/agent having authority for all business affairs.
\(^15\) With regard to the requirements, see § 48 et seqq., § 54 HGB, § 164 et seqq. BGB for the principal and agent provisions under civil law. Cf. Scholz-Schneider, GmbHG § 35, note 16 et seqq.
\(^16\) Scholz-Schneider, GmbHG § 35, note 17.
9.3 CLOSE CORPORATION

Regarding the close corporation, the provision dealing with the power of members to bind the corporation in the context of external relations, has been replaced in toto by the Close Corporations Amendment Act 1997.¹⁷ This revision aimed at a simplification of the existing regulation and providing greater protection to bona fide third parties.¹⁸

9.3.1 Fons and origio

Comparing the situation in the GmbH with that of the close corporation - where every member represents the entity - it is obvious that for the close corporation specific provisions are essential.

The relationship between the close corporation and outsiders has to be seen against the background of the declared intention to use the partnership law and the abolition of the ultra vires doctrine,¹⁹ as well as of the doctrine of constructive notice.²⁰

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¹⁷ S 13 Close Corporations Amendment Act 1997. The previous s 54 regulated in several sub-sections the circumstances under which acts of members dealing with non-members had binding character for the close corporation. They covered the areas of express or implied authority or subsequent ratification, transactions 'for the carrying on, in the usual way', of the corporation's business, transactions falling outside the 'ordinary course' of the business of the corporation.

¹⁸ Cf. Henning, 1994, JJS 106, 125-126, mentioning problems of interpretation regarding the previous s 54 "partly due to its origins in the law of partnership".

¹⁹ S 2 (4) CCA gives the corporation the capacity and powers of a natural person of full capacity in so far as a juristic person is capable of having such capacity or of exercising such powers. This gives the corporation "unlimited capacity to take part in commercial activities." Delport-Pretorius (1989), 43.

²⁰ Ss 17 and 45 CCA state that no person shall be deemed to have knowledge of any particulars in the founding statement, other documents or an association agreement registered by the Registrar or lodged with him or which is kept at the office of the close corporation. The non-application of constructive notice gives additional protection to an outsider dealing with the corporation. Cf. also Close Corporations Service, 5.18.
In his proposal, Naudé sees the obvious answer for management, control and representation in "a codification of the relevant partnership law."21 In another article he states "(…) the traditional ultra vires doctrine will be irrelevant to the question whether a close corporation is bound by a contract."22 Notwithstanding the 1997 amendment the concept underlying this approach is also shown in an interesting comparison, between the previous s 54 CCA and provision 57 of the Close Corporation Draft to rules laid down in Ghana's Incorporated Private Partnership Bill and Act of 1962 respectively, the English Partnership Act of 1890 and the American Uniform Partnership Act.23

9.3.2 Rules set out in the Act

Like the GmbH, as a juristic person the close corporation acts through organs. Thus, the general rule expressed in s 54 (1) CCA is that in relation to bona fide third parties, any member is an agent of the corporation.24 The corporation is bound by the act of its member with such parties whether or not the member performed the act for the carrying on of the business of the

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21 Naudé, 1982, MB 5, 11, see also for internal relations of members, 7. For a detailed comparison between the regulations in s 46(b) and the mutua praeposition (mutual mandate/agency) in partnership law, see Henning, "Die Aanspreeklikheid van 'n Beslote Korporasie vir die Handelinge van 'n Lid en enkele ander aspekte van Eksterne Verhoudings", 1984, TRW 155, 166 et seq. See also his general comparison between close corporation and partnership concerning representation, ibid. 167; "Kommersielle reg - Aspekte van die verteenwoordiging van 'n beslote korporasie (deel 2)", 1986, De Rebus 73 et seq.; "Handelinge van 'n lid en die beoogde aanspreeklikheid van 'n beslote korporasie", 1983, TRW 230 et seqq. Compare also Naudé, 1984, TRW 117, 130. As in partnership law this is a variable rule, thus it may be varied by an association agreement.

22 Naudé, 1984, TRW 117, 129. See also Henning, 1984, TRW 155, 156 et seqq.


24 Regarding the previous dispensation, see Close Corporations Service, 5.22a et seqq.
corporation. Even if the member has in fact no power to represent the corporation, the corporation is bound unless the outsider has, or ought reasonably to have, knowledge of the fact that the member has no power to act for the corporation in the particular matter.

The Close Corporations Service mentions the similar situation in partnership law where a bona fide outsider who does not know of internal restrictions of power is in principle not affected by it. However, it is pointed out that "in contradistinction to the position under partnership law, a corporation may be bound to a contract falling outside its scope of business even if it was not actually or ostensibly authorised or ratified by the corporation." This is on the condition that the outsider did not have, or ought reasonably to have had, knowledge of the member's lack of authority.

Regarding the doctrine of estoppel it is submitted that "section 54 should not be interpreted so as to exclude the operation of the doctrine of estoppel."

If a member has no authority or exceeds his power to represent the close corporation, concerning internal consequences the proceedings are as follows: In cases where the close corporation is bound to a contract, notwithstanding the lack of a member's authority or internal restrictions on his part, the member concerned might be personally liable to the close corporation for any loss suffered by the corporation as a result of his acts. His liability arises out of his fiduciary relationship to the close corporation. This implies, inter alia, that he has to "act honestly and in good faith" which includes, in particular, to exercise his

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25 S 54 (2) CCA.
26 S 54 (2) read with s 46 CCA. Be the power to act be restricted, limited or excluded by law or through an association agreement. Compare also s 46(b) CCA which gives members, subject to the provisions of s 47 CCA, equal rights in regard to the management of the close corporation and to represent the corporation in the carrying on of its business.
27 Close Corporations Service, 5.16. See also Ramsden, 1988, Businessman's Law 141.
28 S 54 (2) CCA.
29 Close Corporations Service, 5.17, for further literature concerning the previous dispensation, see 5.22c. Regarding estoppel, see also Henochsberg CCA s 54, 54.1 sharing this view.
powers "to manage or represent the close corporation in the interest and for the benefit of the close corporation." He "shall not act without or exceed" these powers.30 Consequently, it is stated that "accordingly, a member is in breach of his fiduciary duty to the close corporation if he concludes a contract on behalf of the close corporation without in fact having the authority to do so."31 Thus, becoming liable to the close corporation for any loss suffered as a result thereof and any economic benefit derived by reason thereof.32

In dealing with s 54 CCA it has to be kept in mind that this provision covers only aspects regarding "the power of a member to bind the corporation in relation to a person who is not a member of the corporation and who is dealing with the corporation."33 Therefore s 54 CCA does not cover circumstances where the person dealing with the corporation is not an outsider but a member, or where a non-member acts as agent of the corporation.34

9.3.3 Contracts between members and corporation

As s 54 CCA is not applicable the general principles of representation come into force.35 Concerning contracts, which are concluded between a member and 'his' close corporation it is submitted "that such contract will be binding on the close corporation provided conclusion thereof was expressly or impliedly authorized by the close corporation or the agreement is ratified by the close corporation."36

30 S 42 (1), (2)(a) CCA.
31 Delport-Pretorius (1989), 47. See also Naudé, 1984, TRW 117, 130.
32 S 42 (3)(a) CCA. And as submitted, "moreover, in appropriate circumstances any other member may approach the court for relief under s 49", Delport-Pretorius (1989), 47. In contrast, the director in a GmbH is only liable to the damages caused to the company, § 43 (2) GmbHG.
33 Close Corporations Service, 5.21.
34 Close Corporations Service, 5.22, also with other examples. See Henning, 1986, De Rebus, 73-75.
35 But as Close Corporations Service at 5.26 reminds us, "it should be kept in mind that a member will normally be fully conversant with internal limitations on and requirements for authority."
Due to the existing fiduciary relationship of the member towards the close corporation, he has to notify the other members about any direct or indirect interest in the contract he may have.\(^{37}\) In the case of non-compliance the close corporation has the option to declare the contract void. It is possible, however, for a court to order that such a contract may be binding to the parties.\(^{38}\) Also to note is that s 52 CCA states that without the prior written consent of all the members loans and the provision of security by a close corporation to its members or to juristic persons controlled by them are prohibited and invalid.\(^{39}\)

9.3.4 Power of non-members to bind the corporation

Concerning the special types of authority mentioned in the GmbH the CCA makes no provision in this respect. However, regarding the authority of non-members to bind the corporation, the common law position is applicable.\(^{40}\) Therefore a corporation may authorise a person who is not a member to act as its agent, either generally or in a particular matter. Accordingly, the corporation will be bound if the non-member had the express or implied authorisation to conclude the contract. It will also be bound if the corporation ratifies the contract after its conclusion, then the corporation is estopped from denying that the person acting on its behalf had the authority to do so.\(^{41}\)

\(^{37}\) S 42 (2)(b)(ii) CCA.

\(^{38}\) S 42 (3)(b) 2nd sentence CCA. See also chapter 8.3.2.2.3, 'Fiduciary duties'.

\(^{39}\) S 52 CCA.

\(^{40}\) In this case the rules of agency come into operation. See Delport-Pretorius (1989), 47. See also McLennan, 1985, SALJ 322, 326 who expresses his reservations with regard to the failure of the Act to, i.e., deal with "acts of other representatives of close corporations such as employees, officers (as defined in s 1) and outside agents." He submits an alternative statutory suggestion, ibid. 326 et seq.

\(^{41}\) See Inter-Continental Finance v Stands 56 and 57 Industria 1979 3 SA 740 (W).
9.4 CONCLUSION

Regarding the GmbH a managing director is responsible for the company’s affairs and represents it in and out of court. One has to distinguish between the external and internal relationship. Regarding the external relationship a restriction on the managing director's authority is not possible due to the protection of third parties and to achieve legal certainty. Nevertheless, internally (between the GmbH and the managing director) his authority may be limited by the articles or a shareholders' resolution.

The doctrine of *ultra vires* does not exist in German company law. Therefore, even transactions outside the scope of the objects clause in the articles entered into by the managing director will bind the company to the third party. If, however, the transaction results in loss or damage to the company, the directors will be liable to it for breach of duty. Also, the company is not bound in case of a fraudulent collusion between the manager and a third party. To prevent conflicting interests 'Insichgeschäfte' (‘doing business with oneself’) are not permitted unless the members consent or an exclusion clause is contained in the articles.

Regarding authority to mention are two special types which can be granted, 'Prokurist' (procuration holder) and 'Handlungsbevollmächtigter für den gesamten Geschäftsbetrieb' (officer/agent having authority for all business affairs) are types of authority based in the commercial law.

Concerning the close corporation, the provision dealing with the power of members to bind the corporation in the context of external relations, has been replaced *in toto* by the Close Corporations Amendment Act 1997.

The relationship between the close corporation and outsiders has to be seen against the background of the declared intention to use the partnership law and the abolition of the *ultra vires* doctrine, as well as of the doctrine of constructive notice.

Acting through organs the CCA regulates as a general rule that in relation to *bona fide* third parties, any member is an agent of the corporation.

The corporation is bound by the act of its member with such parties whether or not the member performed the act for the carrying on of the business of the
corporation. Even if the member has in fact no power to represent the corporation, the corporation is bound unless the outsider has, or ought reasonably to have, knowledge of the fact that the member has no power to act for the corporation in the particular matter.

Regarding contracts between members and their corporation the general principles of representation come into force. Concerning contracts, which are concluded between a member and 'his' close corporation such contract will be binding on the close corporation provided conclusion thereof was expressly or impliedly authorized by the close corporation or the agreement is ratified by the close corporation.

Concerning the authority of non-members to bind the corporation, the common law position is applicable. Therefore a corporation may authorise a person who is not a member to act as its agent, either generally or in a particular matter. Accordingly, the corporation will be bound if the non-member had the express or implied authorisation to conclude the contract. It will also be bound if the corporation ratifies the contract after its conclusion, then the corporation is estopped from denying that the person acting on its behalf had the authority to do so.
CHAPTER TEN

10 LIABILITY

10.1 INTRODUCTION

The liability of members can take on various forms. It can be one of joint and several liability, personal liability, liability for repayments and criminal liability. Given the fact that the GmbH and the close corporation are legal entities apart from their members, this has implications for the extent of their personal liability and subsequently the protection of creditors. Generally, in the GmbH as well as in the close corporation only the assets of the entities alone are available to creditors in discharge of liabilities of the entities. Nevertheless, the Acts also try to protect the creditors. But they use a different approach.

10.2 GMBH

10.2.1 Approach share capital

The GmbH approaches to protect creditors through the compulsory establishment of share capital to which every member must give a contribution. According to § 13 GmbHG only the assets of the company alone may be utilized in case of its liabilities. Contribution, raising of capital and maintenance are strictly regulated and enforced through the Act given the fact that normally members' private assets are not liable for debts of the GmbH.¹

¹ See Scholz-Westermann, GmbHG introduction, note 19 et seqq. with further literature. Seeing the resemblance to South African company law in this regard, Olbrisch/du Plessis, 1997, TSAR 316 submit that "the most essential structural difference between the GmbH and the close corporation pertains to share capital."
Members cannot be released from their obligation to make contributions and no set-off is allowed with regard to the company's claim.\textsuperscript{2} Liens in connection with non-cash contributions are restricted\textsuperscript{3} and the adequacy of non-cash contributions has to be stated in a report.\textsuperscript{4}

In rare cases of the piercing of the corporate veil (so-called 'Durchgriffshaftung'), however, the strict distinction between company assets and members' private assets receives no attention with the result that a member becomes personally liable for debts of the GmbH.\textsuperscript{5} This arises also especially in connection with the one-man GmbH, where the economic identity is very apparent although formally different legal personalities exist.

Piercing of the corporate veil may arise if the legal form of the juristic personality is misused, or if a distinction between GmbH and one-man member leads to results incompatible with the principles of good faith.\textsuperscript{6} It must be noted, however, that piercing of the corporate veil can only take place if no other claims against the members exist.

10.2.2 Subsidiary liability

To protect creditors as far as possible the GmbHG installs a system of subsidiary liability.

Here the above-mentioned obligations regarding the initial contribution have to be referred to. They describe through which procedures (collection proceedings, absence liability, joint liability to cover) the system of subsidiary liability tries to protect creditors.\textsuperscript{7} It has to be kept in mind that these regulations have a compelling character and cannot be changed through the articles of association.

\begin{flushright}
\footnotesize\begin{itemize}
\item[2] § 19 (2) 1st and 2nd sentence GmbHG.
\item[3] § 19 (2) 3rd sentence GmbHG.
\item[4] § 5 (4) GmbHG.
\item[5] For further literature regarding this complex subject, see Scholz-Westermann, GmbHG introduction, note 10 et seqq.; Scholz-Emmerich, GmbHG § 13, before note 55; note 76 et seqq.
\item[6] 'Treu und Glauben', § 242 BGB (principle of good faith).
\item[7] See in chapter 8.3.2.1.1, 'Obligations with regard to the initial contribution' the corresponding sections.
\end{itemize}
\end{flushright}
10.2.3 Articles of association / resolution

Further liability may occur if the members made provision in the articles of association,\(^8\) or pass a unanimous resolution\(^9\) to authorize supplementary contributions to the share capital in addition to the capital already subscribed to by the members.\(^{10}\)

10.2.4 Loans, guarantees

No loan may be made out of the assets of the company to any director or representative, which is required for the maintenance of the share capital. A loan made in contravention of this regulation must be repaid forthwith.\(^{11}\) Loans to members are possible as long as the maintenance of the required share capital is not being violated. In the case of contravention, however, the loans must be refunded.\(^{12}\)

10.2.5 Criminal liability

Provisions regarding criminal offences are to be found in §§ 82, 84 and 85 GmbHG. They define and describe the cases of criminal misconduct of shareholders, managing director(s), members of a supervisory board and liquidators. These provisions apply besides the rules of the Criminal Act.

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\(^8\) § 26 GmbHG, the members have to pass a resolution accordingly.
\(^9\) § 53 (3) GmbHG.
\(^{10}\) A member then, however, has the right to abandon his share, see chapter 8.3.2.1.2.2, ‘Unlimited supplementary contributions’.
\(^{11}\) § 43a 2nd sentence GmbHG. With regard to the possibility in the close corporation of getting financial assistance for the acquisition of a member’s interest, see chapter 6.5.2.7.2, ‘Financing the purchase of member’s interests by others’.
\(^{12}\) §§ 30 (1), 31 (1) GmbHG. Regarding loans of members to the GmbH, cf. §§ 32a, 32b GmbHG.
10.3 CLOSE CORPORATION

10.3.1 Different forms of liability

The approach of the close corporation regarding liability is different to the GmbH and explains itself by its special structure. Emphasis is laid on self enforcement. Members can become jointly and severally liable with the close corporation for the debts of the corporation. In addition, it is also possible for a member to become personally liable to the corporation for any loss suffered by the corporation. Accordingly, a member may lose his protection against personal liability should he fail to observe certain fundamental principles. In doing so the Act tries to protect creditors and achieve compliance with "requirements and duties which serve a purpose" by relying on self enforcement.

Thus, the general rule, as expressed in s 2 (3) CCA, which provides that members shall not merely by reason of their membership be liable for the liabilities or obligations of the close corporation, is also subject to certain

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13 This joint and several liability means, "that each member individually becomes directly liable and may be sued individually for all the corporation's debts. The corporation's creditors may sue the corporation, or any of the members, or all the members", van Dorsten, *South African Business Entities* (1990), 45. For an interesting comparison between the situation in company law and close corporation law, see de Koker, 13 Med SOR (1990), 124-206.

provisions of the Act. "These circumstances, in general terms, concern the fact that the requirements of the Close Corporations Act have not been properly observed. In such case it is, again speaking generally, only members who are knowingly parties to the non-compliance who are liable together with the Close Corporation."\textsuperscript{15}

10.3.2 Joint and several liability for the debts of the close corporation

Provisions with regard to joint and several liability for the debts of the close corporation deal with:
- the use of the corporation's name without the addition of the abbreviation CC or its equivalent in any other official language;
- problems with the contribution (delay);
- prohibited participation of members;
- contravention of liquidity and solvency requirements in connection with the acquiring of a member's interest by the corporation and with the financial assistance to a member acquiring his interest;
- contravention of the disqualification from taking part in the management; and
- vacancy of the post of the accounting officer.

This joint and several liability is also used when the close corporation still has outstanding liabilities while it is deregistered.

At this stage it is suitable to give a short survey of the provisions mentioned above.

10.3.2.1 Use of CC or its equivalent in any other official language respectively

With regard to the abbreviation CC or its equivalent in any other official language respectively, the CCA makes provisions for dealing with its use. If the

\textsuperscript{15} Anonym (Editorial), "Close Corporations", 1985, \textit{The Taxpayer} 141, 147. And as Urquhart submits, "this liability arises either by order of Court, or simply by operation of law.", in "The Close Corporation", 1984, \textit{SACLJ} 41, 61.
name of the corporation is used in transactions without the abbreviation, liability of the responsible member may arise in case the third party was not aware that he was dealing with a close corporation.\textsuperscript{16}

10.3.2.2 Contribution

A delay in making the initial or additional contribution leaves a member jointly liable with the corporation for a specified period. It is noteworthy that such an undertaking by a member to a corporation is enforceable by the corporation in legal proceedings.\textsuperscript{17}

10.3.2.3 Participation

With regard to the prohibited participation of a juristic person or a trustee of a trust \textit{inter vivos}, non-compliance faces liability for the period where a member's interest was held.\textsuperscript{18}

10.3.2.4 Liquidity and solvency requirements in connection with the acquisition of a member's interest

The following is important regarding the contravention of liquidity and solvency requirements in connection with the acquisition of a member's interest by the corporation and in connection with the financial assistance to a member acquiring his interest. The Act contains provisions to facilitate such transfers or disposals enabling the corporation to purchase its members' interests and to finance their purchase by others, "actions either severely restricted or entirely prohibited in company law for fear they would result in an unlawful reduction of capital."\textsuperscript{19}

\begin{footnotes}
\item\textsuperscript{16} Ss 22 (1), 63(a) CCA.
\item\textsuperscript{17} Ss 24 (4), 63(b) CCA. S 24 (5) and s 50 (1) CCA, see chapter 8.3.2.2.1, 'Contribution and enforceability'.
\item\textsuperscript{18} Ss 29, 63(d) CCA. However, keeping in mind the special circumstances s 29 CCA also makes provision for.
\item\textsuperscript{19} Ramsden, 1988, \textit{Businessman's Law} 107, 108.
\end{footnotes}
Regarding payment by the corporation for the acquisition of a member's interest the corporation may acquire the interest of a member only if requirements, which try to safeguard the rights of creditors are met.\textsuperscript{20} If the requirements of the Act are not met, each member and (as the case may be), each former member will be liable for all the debts of the corporation before the payment was made.\textsuperscript{21}

Regarding the granting of financial assistance by the corporation in respect to the acquisition of a member's interest the following is to be observed: Financial assistance may be given directly or indirectly, by means of a loan, guarantee, the provision of security or otherwise.\textsuperscript{22} This assistance is only possible if the corporation's own "financial viability is not thereby diminished".\textsuperscript{23} If the provisions of the Act are not met, liability of members and the person who received such assistance will arise for all the debts of the corporation incurred before the assistance was given.\textsuperscript{24}

10.3.2.5 Disqualification

Regarding disqualification from taking part in the management s 47 CCA regulates the exclusion of certain persons from taking part in the management of a corporation. Liability arises in case of non-compliance.\textsuperscript{25}

10.3.2.6 Accounting officer

If the position of the accounting officer is vacant for a period of six months or more, liability may arise for all the debts of the corporation incurred while the vacancy existed.\textsuperscript{26}

\textsuperscript{20} See chapter 6.5.2.7.1, 'Activities of the corporation to purchase its members' interests'.
\textsuperscript{21} Ss 39, 63(e) CCA.
\textsuperscript{22} S 40 CCA.
\textsuperscript{23} Symington (1986), 50 commentary regarding s 40 CCA. Assets have to exceed the liabilities after the transaction.
\textsuperscript{24} Ss 40, 63(f) CCA.
\textsuperscript{25} S 63(g) CCA. Note that non-compliance with certain provisions of s 47 CCA is treated as an offence, s 47 (2) read with s 82 (1)(c) CCA.
\textsuperscript{26} S 63(h) CCA.
Concerning deregistration and outstanding liabilities provision is made that in case the registration is erased even though liabilities still exist, all members are jointly and severally liable.\(^{27}\) The liability incurred under s 26 (5) CCA, and the effect on such liability of the corporation’s reregistration, were the main issue under consideration in *Mouton v Boland Bank Ltd.*\(^{28}\) Both the trial court and the Supreme Court of Appeal confirmed that if members allow their corporation to be deregistered in circumstances where it has assets and liabilities, personal liability for the debts of the corporation arises under s 26 (5) CCA.\(^{29}\) In addition both courts considered the effect of s 26 (7) CCA on the member’s liability under s 26 (5) CCA. Schutz JA agreed with Rose Innes J that reregistration under s 26 (7) CCA did not terminate the member’s liability.\(^{30}\) Therefore, this interpretation is seen as a warning to members of a close corporation who fail to liquidate the corporation where it cannot meet its liabilities. Should such a corporation be deregistered, its creditors may look to its former members for payment of debts.\(^{31}\) However, s 26 (5) CCA is seen as a welcome innovation in the South African law and it is submitted by Matlala that the Companies Act requires a similar provision.\(^{32}\)

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27 S 26 (5) CCA. Before the 1986 amendment unlimited personal liability of former members existed. The amendment is retroactive with effect to the date of commencement of the CCA.

28 *Mouton v Boland Bank Ltd* 2001 (3) SA 877 (SCA). See also *Boland Bank Ltd v Mouton & Another* 1997 4 All SA 67 (C).

29 *Mouton v Boland Bank Ltd* 2001 at 881G. See also *Boland Bank Ltd v Mouton & Another* 1997 supra at 75f.


32 See Matlala, 2001, *SA Merc LJ* 429, 437. As mentioned above, a 2005 Close Corporations Amendment Bill aims to alter, *i.e.*, the relevant section in the current Act which affects the liabilities of members taking place after the de-registration of a closed corporation. For the Amendment Bill see http://www.info.gov.za/gazette/bills/2005/b6-05.pdf. The amendment is partly caused through the
It is noteworthy that the interpretation of Rose Innes J in *Boland Bank Ltd v Mouton and Another*\(^{33}\) was applied in *Commissioner, South African Revenue Services v Mendes & Another*.\(^{34}\) There Ludorf J stated that he is in agreement with this judgement, save that in his view, it is not necessary to postulate an underlying notion of an intended penalty. In his judgement it is enough that the legislation simply does not provide either expressly or by implication that members’ liability be extinguished, once it had arisen by virtue of this provision, *i.e.*, s 26 (5) CCA.\(^{35}\)

10.3.3 Personal liability for losses of the close corporation

Personal liability for losses of the close corporation may arise with regard to the violation of fiduciary duties and care and skill requirements.\(^{36}\) It may also arise in connection with reckless or fraudulent carrying-on of the corporation's business, abuse of the separate juristic personality, non-usage of the name and registration number and the granting of loans to members and others. In addition, criminal liability may arise.

10.3.3.1 Reckless or fraudulent carrying-on of business of the close corporation

As all members may take part in the management it is appropriate to look, in particular, at the liability for reckless or fraudulent carrying-on of the business of a close corporation according to s 64 CCA.

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\(^{33}\) See above.

\(^{34}\) *Commissioner, South African Revenue Services v Mendes & Another* 2001 (4) SA 934 (SE).

\(^{35}\) *Commissioner, South African Revenue Services v Mendes & Another* at 937J – 938A.

\(^{36}\) S 42 (3)(b) CCA. See also chapter 8.3.2.2.3, 'Fiduciary duties'.
The Act deals with situations where it appears that any business of the close corporation was or is being carried on recklessly, with gross negligence, or intended to defraud any person, or for any fraudulent purpose. On application, a court can declare that any person who was knowingly a party to the carrying-on of the business in that manner, is personally liable for all or any of the debts or other liabilities of the close corporation. The court has wide powers to give effect to the declaration and enforcing liability.37

However, to answer the problems of proving a member’s reckless or fraudulent conduct of a close corporation’s business and subsequently decide upon his personal liability under s 64 CCA is not as simple as it seems. On the contrary, quite recently these questions caused diverging judgements.38 Noteworthy is, however, that given the similarity of provisions of s 64 CCA to the wording of s 424 of the Companies Act 61 of 1973, judicial interpretation of s 424 was applied.39

*Harri & Others NNO v On-Line Management CC* dealt with the personal liability for debts of a close corporation in terms of s 64 CCA, where the business of the close corporation was carried on recklessly. The court had to answer the question whether liability in terms of this section is limited to instances where a close corporation is unable to meet its financial obligations. The court held that

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37 S 64 (1) CCA. S 64 CCA provides that reckless or fraudulent conduct of business constitutes an offence and can give rise to a court order that those responsible are personally liable for the corporation's debts. S 64 (2) read with s 82 (1)(a) CCA declares such conduct (without prejudice to any other criminal liability incurred) an offence punishable with a maximum fine of R 2000 or maximum imprisonment of two years, or both. See also Naudé, 1984, *TRW* 117, 128. Cf. McLennan, "Reckless or fraudulent conduct of corporate businesses", 1998, *SALJ* 596, discussing *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO en 'n Ander* 1998 (1) *SA* 971 (O). See also *Du Plessis NO v Oosthuizen en 'n Ander* 1999 (2) *SA* 191 (O). Cf. regarding a decision that a magistrate’s court has jurisdiction to make orders contemplated in ss 64 or 65 of the CCA, *Johnson v A Blaikie & Co (Pty) Ltds t/a FT Building Supplies Manaba* 1998 (3) *SA* 251 (N).

38 *Harri & Others NNO v On-Line Management CC* 2001 (4) *SA* 1097 (T), also reported in 2002 1 All SA 95; *L & Plant Hire BK en Andere v Bosch en Andere* 2002 (2) *SA* 662 (SCA).

39 *Harri v On-Line Management* supra at 1099C-G; *L & Plant Hire BK v Bosch* supra at 677F – 678E.
this provision did not indicate that the people who conducted a close corporation’s business recklessly or fraudulently could be liable only if the corporation could not pay the resultant liability.40

The Supreme Court of Appeal (SCA) had an opportunity to decide this same issue in *L & Plant Hire BK v Bosch*. The court restricted the scope of s 64 CCA stating that s 64 has, as far as creditors are concerned, to be interpreted restrictively to apply exclusively to the "reckless" or "grossly negligent" conduct of the business of a close corporation which has a negative effect on the creditor’s claim against that corporation. It held that where the corporation could discharge its liability one could not sue members in terms of s 64 CCA.41

It is noteworthy that this decision was reached without referring to *Harri v On-Line Management* and the case-law mentioned in that decision respectively. However, it is concluded that these other decisions have effectively been overruled.42 And it is submitted that the correct legal position is contrary to what is actually said in these decisions.43 The decision in *Harri v On-Line Management* has also been reviewed by other authors. The judgement was seen as, in its implications, being bad for members of close corporations and other people who involve themselves in managing the business of close corporations. This occurred because once the managers had crossed the threshold of gross negligence, the liability of the corporation would have been replaced by the joint and several liability of the corporation and those who conducted its business. Therefore it was stated that this judgement erodes the

40 *Harri v On-Line Management* supra at 1099E-F.
41 *L & Plant Hire BK v Bosch* supra at 678B. See the translation in the headnote at 664C-E.
42 Matlala, "Note on personal liability for the debts of a close corporation which is able to pay", 2004, *Stell LR* 295, 303; referring also to Body Corporate of Greenwood Scheme v 75/2 Sandown (Pty) Ltd 1999 (3) *SA* 480 (W). This decision was the one Bertelsmann J relied upon in his judgement, *Harri v On-Line Management* supra at 1099C-G.
43 Matlala, 2004, *Stell LR* 295, 301; discussing at 297 also the decision Body Corporate of Greenwood Scheme v 75/2 Sandown (Pty) Ltd 1999 (3) *SA* 480 (W). This decision was the one Bertelsmann J relyed upon in *Harri v On-Line Management* supra at 1099C-G.
protection of limited liability. Also in another case the question was discussed, whether under s 64 (1) CCA the main member should be held personally liable for having conducted the corporation's business recklessly or fraudulently. After referring to the relevant case law under inclusion of the interpretation of s 424 of the Companies Act 61 of 1973, Davis J in detail discussed the interpretation of s 64 in the given circumstances. In the end, however, he used the discretion enjoyed by the court under this section to dismiss the claim. In conclusion of this judgement, Smith submits that it indicates that the court is not inclined to extend the net of potential liability under s 64 (1) of the CCA.

10.3.3.2 Abuse of the separate juristic personality of the close corporation

The Act deals with the gross abuse of the corporation's juristic personality. A court has the power to lift the corporation's corporate veil if it finds the incorporation of a close corporation, any act by or on behalf of or any use of a close corporation to constitute a gross abuse of its juristic personality. It may declare that the close corporation is deemed not to be a juristic person in respect of such rights, obligations or liabilities of the close corporation or of any of

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45 M A Vleisagentskap CC and Another v Shaw NO 2003 (6) SA 714 (C).

46 M A Vleisagentskap CC v Shaw supra at 723G.

47 Smith, "It's not as simple as it seems", 2004, JBL 48, 53.

its members or of any person named in such a declaration. As in s 64 CCA, the
court has the right to give further orders to give effect to its declaration.49

10.3.3.3 Non-usage of the name and the registration number

Non-usage of the name and registration number on financial documents and
other forms will make any member or any other person who on behalf of a
corporation signs or issues or authorizes to be signed or issued any of these
documents liable for any payments due, unless the amount is paid by the corpo-
ration.50 So accordingly, it was held in Bouwer v Andrews 1988 that failure to
insert the number on the cheque renders the signatory personally liable,
however, only if the corporation fails to pay.51 Also in a recent case it was held
that to avoid personal liability, a member must ensure that when signing a close
corporation’s cheque, the corporation’s name and its registration number are
properly mentioned theron.52

10.3.3.4 Prohibition of granting of loans and furnishing security to members
and others

The prohibition of granting of loans and furnishing security to members and
others is regulated in s 52 of the Act.53 This prohibition is not enforced under

49 S 65 CCA.
50 S 23 (2) CCA.
51 Bouwer v Andrews 1988 (4) SA 337 (E). Note that in case of a company such a
failure causes no such personal liability, s 50 (3) (b) CA. See, e.g., Koker
criticizing this situation, 1994, SA Merc LJ 205, 211. Cf. also, e.g., Stafford t/a
Natal Agricultural Co v Lions River Saw Mills (PTY) LTD 1999 (2) SA 1077 (N) for
the problems of legal fact finding in connection with the use of order forms,
coming here to a common law solution of undisclosed principal and agent.
52 Durity Omega (Pty) Ltd v Gauteng Civils CC and Others 2000 (1) SA 165 (T), see
the headnote at 165I. Also Smith, "A corporation’s name and number", 2000, JBL
15 et seq.
53 For a description of loan, security and control, see s 52 (4) CCA. With regard to
the situation within a group of companies controlled by a corporation, see s 55
CCA. Compare with regard to the application of ss 37 and 226 Companies Act
1973, Henning, 1984, TRW 155, 172 et seq.; application of s 226 Companies Act
and s 55 CCA, "Observationes Mercatoriae II - Beslote korporasies en die
special circumstances. However, unless the prior specific consent in writing of all its members is given, a close corporation may not make a loan whether directly or indirectly,
- to any of its members;
- to any other close corporation in which one or more of its members together hold more than a 50 per cent interest; or
- to any company or other juristic person (except a close corporation) controlled by one or more members of the close corporation.

Furthermore, it may not provide any security to any persons in connection with any obligation of any such member, or other close corporation, company or other juristic person.

With regard to details concerning the particulars of the required previous written consent compare Symington.\textsuperscript{54}

In the case of non-compliance, the members concerned are liable to indemnify the close corporation and any other person (without actual knowledge of the contravention) against any loss suffered directly resulting from the invalidity of such loan or security.\textsuperscript{55}

10.3.3.5 Repayments

10.3.3.5.1 Improper distribution of income

In this context it is submitted that "a corporation may distribute net income to its members only if it is solvent and sufficiently liquid. A distribution in breach of

\begin{itemize}
\item Symington (1986), 61 \textit{et seq}.
\item S 52 (3) CCA. Any member guilty of an offence is in danger of getting the highest penalty possible imposed by the Act (R 2000 or/and imprisonment up to two years, s 82 (1)(a) CCA).
\end{itemize}
these requirements may be recovered from members."\textsuperscript{56} However, this excludes any payment to a member in his capacity as a creditor of the close corporation, a payment as remuneration for services rendered as an employee or officer of a close corporation, a repayment of a loan or of interest thereon, or a payment of rental.\textsuperscript{57}

10.3.3.5.2 Payments and salaries received before winding-up

Ss 70 and 71 CCA regulate the repayment of amounts received in the event of the corporation being wound-up within two years of such payment. If the provisions of the Act are not complied with, the members concerned must repay all payments made to them in this period.\textsuperscript{58}

10.3.3.6 Criminal liability

Concerning the criminal liability of its members, s 332 (1) of the Criminal Act 1977 is applicable. This sub-section deals with the liability of a juristic person for unlawful acts committed by its directors or servants in the performance of their duties or while furthering the interests of that corporate body. Under certain instances members (and employees) can be charged for crimes committed by other members or employees of the corporation.\textsuperscript{59}

\textsuperscript{56} \textit{Close Corporations Service}, 6.05. S 51 (1), (2) CCA.
\textsuperscript{57} S 51 (3)(ii) CCA; 'payment' includes the delivery or transfer of any property, s 51 (3)(b) CCA.
\textsuperscript{58} See also ss 73 (1) and 81 CCA.
10.4 LIABILITY OF FOUNDERS

10.4.1 GmbH

With its registration into the commercial register the GmbH becomes existent as a legal entity. As in the case with other legal entities, the registration is also here constitutive.

10.4.1.1 Liability of founders before registration

Very often the future shareholders or managing directors enter into commitments and obligations before the registration occurs. Certain commitments, such as the raising of the capital and payment of costs and fees, may be unavoidable. According to § 11 (2) GmbHG, those acting on behalf of the future company are personally liable for such pre-incorporation contracts. Upon registration the question arises whether and to what extent the liability of the persons originally responsible for such pre-incorporation contracts will be replaced by that of the company.

A distinction must be made between the entity prior to the official recording of the articles by a notary ('Vorgründungsgesellschaft') \(^{60}\) and the entity after the official recording of the articles by a notary but before registration ('Vorgesellschaft'). \(^{61}\)

\(^{60}\) Civil-law partnership the object of which is to prepare the means necessary for the activities of a capital company yet to be formed.

\(^{61}\) Pre-incorporation limited company/pre-incorporated company. For the specific responsibilities of a notary in this regard, see Robrecht, "Aussenhaftung der Gesellschafter nach Scheitern der GmbH-Gründung", 2003, GmbHR 1121, 1122. Regarding both phases, see Mohr, "Praxisrelevante Probleme und Gestaltungshinweise bei der GmbH-Gründung", 2003, GmbHR 347. For a comparison, \(i.a\), of liability questions between a GmbH and a small AG in the founding phase, see Heidinger, "Die Haftung und die Vertretung in der Gründungsphase der GmbH im Vergleich zur (kleinen)Aktiengesellschaft", 2003, GmbHR 189, calling for precautions in the case of the small AG, 197 et seq.
Regarding the question of liability, solutions for the 'Vorgründungsgesellschaft' were found relatively easily while the discussion concerning the 'Vorgesellschaft' was more controversial. Therefore, in the following passages the focus lies on the 'Vorgesellschaft'.

10.4.1.1.1 'Vorgründungsgesellschaft'

Until a company becomes a legal entity through registration it has the status of a 'Vorgründungsgesellschaft'. A 'Vorgründungsgesellschaft' comes into existence prior to the official recording of the articles by a notary through informal arrangements. Depending on the transactions it is regarded as an OHG or a BGB-Gesellschaft and is liable accordingly.

10.4.1.1.2 'Vorgesellschaft'

By means of the official recording of the articles by a notary the so-called 'Vorgesellschaft' comes into existence. The 'Vorgesellschaft' is a necessary transit stage in the process of forming a GmbH.

The legal nature of the 'Vorgesellschaft' was discussed quite controversially. At one stage the 'Vorgesellschaft' was seen as a 'BGB-Gesellschaft' or as a society ('Verein') having no legal personality.

Nowadays, the dominant opinion considers the 'Vorgesellschaft' to be a community in its initial stages on its way to become the organizational form projected. At this stage it is regarded as an association sui generis having no corporate existence on which, nevertheless, the regulations of the projected legal entity have to be applied insofar as these regulations do not necessarily require as a prerequisite the legal personality of a company.

Due to the fact that the 'Vorgesellschaft' has no legal personality, according to §§ 427, 431, 840 BGB the founders are normally jointly and severally liable for

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62 Also called 'Gründungsgesellschaft', GmbH i.G.
63 So especially the 'Reichsgericht', compare RGZ 151, 86, 91.
64 Cf. BGHZ 21, 242, 246; 51, 30, 32; 80, 212, 214. With regard to co-operatives, see BGHZ 17, 385, 389; 20, 281, 285, 286. A landmark decision with regard to the 'Vorgesellschaft' is BGHZ 80, 129.
liabilities of the 'Vorgesellschaft' arising from the law or from contracts concluded in the name of the 'Vorgesellschaft'.\textsuperscript{65} The liability of the founders is limited to the assets of the 'Vorgesellschaft'.\textsuperscript{66}

Besides and independent from this liability of the founders, a joint and several liability of the persons acting in the name of the future legal personality arises ('HandelIndenhaftung').\textsuperscript{67} According to the courts, this liability only applies to such persons acting as or similar to managing directors.\textsuperscript{68}

With the registration into the commercial register the legal entity comes into existence.\textsuperscript{69} So the above-mentioned crucial question is asked whether and to what extent the rights and duties of the founders (of the 'Vorgesellschaft') are being transferred to the legal entity. The BGH has now made clear with regard to the GmbH that all assets and liabilities ('Aktiva' and 'Passiva') of the 'Vorgesellschaft' are transferred to the company.\textsuperscript{70}

In addition, the question arises as to what happens to the pre-registration liability of the founders and regarding the 'HandelIndenhaftung'. According to the BGH through registration the until then existing liability of the founders\textsuperscript{71} as well as the 'HandelIndenhaftung'\textsuperscript{72} ceases.

\textsuperscript{65} This liability of the founders is discussed controversially, for further reading see, e.g., from a historical point Wiedemann, "Das Rätsel Vorgesellschaft", 1970, JurA 446, 454 et seqq.; Schmidt, "Zur Haftung der Gründer in einer GmbH für Verbindlichkeiten der Vorgesellschaft", 1976, NJW 421; for more recent information and literature Scholz-Schmidt, GmbHG § 11, notes 1 and 6; Lutter-Hommelhoff, GmbHG § 11, note 9 et seqq.

\textsuperscript{66} See BGHZ 65, 378, 381 et seq.; 72, 45, 49 et seq.; 80, 129, 142 et seqq.

\textsuperscript{67} § 11 (2) GmbHG.

\textsuperscript{68} See BGHZ 47, 25; 65, 378; with regard to exceptions, cf. BGHZ 72, 45, 47, 'HandelIndenhaftung' does not arise in case the contract is concluded in the name of the 'Vorgesellschaft' only.

\textsuperscript{69} § 11 (1) GmbHG.

\textsuperscript{70} BGHZ 80, 129, 140.

\textsuperscript{71} BGHZ 80, 129, 138; but see also ibid., page 142 with regard to exceptions.

\textsuperscript{72} BGHZ 80, 182, 185.
10.4.2 Close corporation

10.4.2.1 Pre-incorporation contracts

As in the case of the GmbH the need may arise for contracts to be "entered into on behalf of or for the benefit of a close corporation yet to be formed."\(^{73}\) S 53 CCA therefore gives the close corporation the opportunity to ratify or adopt written contracts entered into by a person professing to act as an agent or a trustee for a close corporation not yet formed after its incorporation.\(^{74}\) The ratification or adoption has to be in form of written consent of all the members within the time specified in the contract or, if no time is mentioned, within reasonable time after incorporation.\(^{75}\) If the close corporation decides not to adopt or ratify such a contract "an agent or trustee acting for a close corporation yet to be formed incurs no personal liability under the contract."\(^{76}\) Nevertheless, third parties entering into such pre-incorporation contracts obviously seek security. So in practice "it is usually provided in the pre-incorporation contract that the agent or trustee assumes liability in his personal capacity" in case of the corporation not being formed "or, if formed, does not ratify the contract".\(^{77}\) Additional security is achieved by

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\(^{73}\) Delport-Pretorius (1989), 40.

\(^{74}\) Thus Ramsden states that "the contract operates retrospectively to the date on which it was entered into on behalf of the close corporation", 1988, Businessman's Law 141, see also his remarks in fn. 5, ibid.; cf. also Henning, 1984, TRW 155, 172. As "at common law a contract cannot be entered into by an agent acting for a juristic person yet to be formed", Delport-Pretorius (1989), 41, this constitutes an exception to the common law principle, see Close Corporations Service, 5.01.

\(^{75}\) See Henochsberg CCA s 53, 53.1 regarding a suggested amendment caused through problems in regard with the words in the Act of "within a reasonable time after incorporation."

\(^{76}\) Delport-Pretorius (1989), 42.

\(^{77}\) Delport-Pretorius (1989), ibid. See also Build-a-Brick BK v ESKOM 1996 (1) SA 115 (O); Michael v Caroline's Frozen Yoghurt Parlour (PTY) LTD at 1999 (1) SA 624 (W).
making the agent or trustee to stand surety "for the due fulfillment of the corporation's obligations in terms of the contract."\textsuperscript{78}

Since s 53 CCA is permissive and not peremptory, various other arrangements to accept a pre-incorporation contract may be made,\textsuperscript{79} as, for example, "common law devices, such as the \textit{stipulatio alteri} (contract for the benefit of a third party) or cession and assignment".\textsuperscript{80} Mention is also made of the possibility "to conclude a contract on the basis that a party is allowed to nominate someone else to take over his rights and obligations under the contract."\textsuperscript{81} Thus, somebody can enter into a contract personally and then form a close corporation, which he then names as his nominee.

\section*{10.5 CONCLUSION}

The GmbH tries to protect creditors through the compulsory establishment of share capital to which every member must give a contribution. Only the assets of the company alone may be utilized in case of its liabilities. Contribution, raising of capital and maintenance are strictly regulated and enforced through the Act given the fact that normally members' private assets are not liable for debts of the GmbH. The strict capital maintenance regulations are aimed at protecting creditors. To protect them as far as possible the GmbHG installs a system of subsidiary liability. No loan may be made out of the assets of the company to any director or representative, which is required for the maintenance of the share capital.

Provisions regarding criminal offences are also to be found in the GmbHG. They define and describe the cases of criminal misconduct of shareholders, managing director(s), members of a supervisory board and liquidators. These provisions apply besides the provisions of the Criminal Act.

The approach of the close corporation regarding liability is different to the GmbH and explains itself by its special structure. Emphasis is laid on self enforcement. Liability is imposed on members as a sanction in order to to achieve compliance

\textsuperscript{78} Delport-Pretorius (1989), \textit{ibid}.
\textsuperscript{79} Henning, 1984, TRW 155.
\textsuperscript{80} Ramsden, 1988, \textit{Businessman's Law} 141. See also Delport-Pretorius (1989), at 41 explaining \textit{stipulatio alteri} in the close corporation context.
\textsuperscript{81} Delport-Pretorius (1989), 40.
with a specific number of compulsory regulations. Members can become jointly and severally liable with the close corporation for the debts of the corporation. In addition, it is also possible for a member to become personally liable to the corporation for any loss suffered by the corporation. Accordingly, a member may lose his protection against personal liability should he fail to observe certain fundamental principles. In doing so the Act tries to protect creditors and achieve compliance with requirements and duties which serve a purpose by relying on self enforcement.

This joint and several liability is also used when the close corporation still has outstanding liabilities while it is deregistered.

Regarding the GmbH specific regulations concerning the liability of founders are to be found relating to pre-incorporation contracts. Very often the future shareholders or managing directors enter into commitments and obligations before the registration occurs. Certain commitments, such as the raising of the capital and payment of costs and fees, may be unavoidable. According to the GmbHG, those acting on behalf of the future company are personally liable for such pre-incorporation contracts. Upon registration the question arises whether and to what extent the liability of the persons originally responsible for such pre-incorporation contracts will be replaced by that of the company. A distinction must be made between the entity prior to the official recording of the articles by a notary ('Vorgründungsgesellschaft') and the entity after the official recording of the articles by a notary but before registration ('Vorgesellschaft').

As in the case of the GmbH the need may arise for contracts to be entered into on behalf of or for the benefit of a close corporation yet to be formed. The CCA therefore gives the close corporation the opportunity to ratify or adopt written contracts entered into by a person professing to act as an agent or a trustee for a close corporation not yet formed after its incorporation. The ratification or adoption has to be in form of written consent of all the members within the time specified in the contract or, if no time is mentioned, within reasonable time after incorporation.
CHAPTER ELEVEN

11 ACCOUNTING, DISCLOSURE

11.1 INTRODUCTION

It will be interesting to see if the different approaches regarding the number of members and liability regulations as well as the prescribed organ of a managing director in the GmbH play a role in this regard. Unlike for the GmbH the provisions regulating financial statements of the close corporation are relatively few.

Regarding the GmbH one has to keep in mind that the number of members is not restricted through the Act. Accordingly one aim of the annual financial statements in the GmbH is to present substantiated information to the members who may be not so close to the actual day-to-day business. Through the annual financial statements they can obtain the relevant information they need, e.g., in connection with their decisions regarding the distribution of profits. Another aim is the protection of creditors. Given the capital of maintenance approach through the annual financial statements they can obtain the necessary information regarding the capital fund of the company.

11.2 GMBH

11.2.1 Changes through the 'Bilanzrichtliniengesetz'

The implementation of the 'Bilanzrichtliniengesetz' (Accounting and Reporting Act) caused substantial changes for all companies, and especially for the GmbH with regard to preparation, accounting principles, mandatory audits and publication of the financial results of the business.¹

¹ The Act came into force on 1 January 1986 implementing the Fourth, Seventh and Eighth EEC Company Law Directives (also known as the Accounting Directives) concerning Preparation and Publication of Corporate Financial Results. See for the particulars chapter 2.3.1.3, 'GmbH', at the end. Cf. also Lutter-Hommelhoff, GmbHG before § 41, note 1 et seqq.
The 'Bilanzrichtliniengesetz' distinguishes not according to the company form but between small, medium-sized and large companies.²

Under the Fourth and Seventh Company Law Directives, Member States have the option of granting SMEs exemptions from certain financial reporting and disclosure requirements usually imposed on limited liability companies.


Quite interesting to note is that Germany tried vehemently to exclude the GmbH & Co. KG (limited partnership <KG> with a limited liability company <GmbH> as general <personally liable> partner) from these accounting requirements. It needed a conviction through the European Court of Justice to enact, i.a., the corresponding provisions into German law, cf. Lutter-Hommelhoff, GmbHG introduction, note 19 and before § 41. The 'Kapitalgesellschaften-& Co Richtlinien-Gesetz' (Act on Partnerships with a Limited Company as General Partner) has now been inforce since 9 March 2000, see BGBl. I 2000, 154. Abbr. KapCo-RiLiG. Besides making general regulations through this Act, the GmbH & Co KGs lose their exemption from the auditing and disclosure requirements. As result of the introduction, i.a., higher costs for such businesses can be expected. See Zimmer/Eckhold, "Das Kapitalgesellschaften & Co.-Richtlinie-Gesetz", 2000, NJW 1361 et seqq. In a way this situation is similar to the one in Great Britain, where, contrary to the Fourth Directive (dealing with the publication of accounts) this regulation was made applicable only to private companies; cf. Wandrag/Henning, 1996, JJS 1, 4. See also Wandrag/Henning, "Types of companies and financial disclosure in the European Union", 1997, JJS 181 et seqq. For some modifications regarding the disclosure obligations, see Hoffmann/Lüdenbach, "Bilanzrechtsreformgesetz – Seine Bedeutung für den Einzel- und Konzernabschluss der GmbH", 2004, GmbHR 145 et seqq. Also Theile, "Neuerungen bei der GmbH durch das Transparenz- und Publizitätsgesetz - TransPuG", 2002, GmbHR 231 et seqq.

² Cf. § 267 HGB.
Accordingly, only large companies are subject to all of the provisions of the 'Bilanzrichtliniengesetz'. Exceptions are being granted for small companies in particular, but also for medium-sized ones. They are subjected to more lenient requirements concerning the contents of their financial results as well as regarding auditing and publishing; in some cases the small companies are even excluded from these provisions. For example, a small company is not required to publish its profit and loss statement and the report on its business and economic situation, nor is it obliged to have its accounts audited.

This process of easing the provisions for small and medium-sized enterprises had already brought about further corrections in the past. Due to amendments to the Fourth and Seventh EEC-Directives, even more exceptions had been granted to small and medium-sized companies. Provisions dealing with the preparation of the annual accounts, particularly of small GmbHs, which do not have to prepare a report on the economic position were also eased.

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4 See, i.a., §§ 264 (1) 3rd sentence, 266 (1) 3rd sentence, 276, 288, 316 (1), 326, 327 HGB.

5 § 326 1st sentence HGB.

6 §§ 316 (1), 267 (1) HGB.


8 See AG 1990, R 303.

The definitions of SMEs in the Fourth Company Law Directive and the thresholds therein are for accounting purposes only. To qualify under the Directive as either a "small" company or a "medium-sized" one, three criteria are being used, of which companies must meet at least two. They must not have more than a certain number of employees and their balance sheet total (the value of the company's main assets defined as the total of subscribed capital unpaid, formation expenses, fixed assets, current assets prepayments and accrued income) and net turnover (income from sales after deduction of rebates, value added tax and other turnover taxes) must be below certain figures.

Under EU law, these thresholds are revised every five years to take account of economic and monetary trends. On the basis of these trends since the last revision, the new Directive, which follows a Commission proposal in January 2003, increases the thresholds for balance sheet total and net turnover again.\(^\text{10}\)

Subsequently, a most recent correction changed the relevant figures describing small and medium-sized companies again. Now small enterprises are those fulfilling any two of these requirements: an aggregate balance sheet amount not exceeding 4,015 million Euros (previously 3,438 million Euros), turnover not exceeding 8,030 million Euros (previously 6,875 million Euros), no more than 50 employees. Medium-sized ones are those that fulfill any two of these requirements: an aggregate balance sheet amount not exceeding 16,060 million Euros (previously 13,750 million Euros), turnover not exceeding 32,120 million Euros (previously 27,500 million Euros), no more than 250 employees.\(^\text{11}\)

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\(^{11}\) § 267 HGB adapted through the 'Bilanzrechtsreformgesetz'.
However, notwithstanding these changes one must mention that one aim of the annual financial statements in the GmbH is to present substantiated information to the members who may be not so close to the actual day-to-day business. Through the annual financial statements they can obtain the relevant information they need, e.g., in connection with their decisions regarding the distribution of profits. Another aim is the protection of creditors. Through the annual financial statements they can obtain the necessary information regarding the capital fund of the company.

11.2.1.1 Annual balance sheet

As before, the introduction of the 'Bilanzrichtliniengesetz', the managing director has the duty to provide for the keeping of proper books of account and is also responsible for drawing up a balance sheet together with a profit and loss account. But due to the changes, he must also prepare an appendix, which gives further information. These three parts (balance sheet, profit and loss account, appendix) form a unit and constitute the annual accounts. Furthermore, a report on the company's business situation must also be prepared.

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13 See Scholz-Crezelius, GmbHG appendix § 42a, note 37 et seqq.
14 § 242 HGB. In the case of a company's start he has to draw up an opening balance sheet, § 242 (1) HGB ('Eröffnungsbilanz').
15 § 264 (1) 1st sentence, § 264 (2) 2nd sentence HGB; particulars regulated in §§ 284-288 HGB. Notes ('Anhang') take the place of the business report ('Geschäftsbericht') according to § 160 AktG, Grossfeld, "Bilanzrecht für Juristen - Das Bilanzrichtlinien-Gesetz vom 19.12.1985", 1986, NJW 955, 959. Through the mentioned 'Bilanzrechtsreformgesetz', i.a., the scope of information which has to be given, has been widened, §§ 285 and 289 HGB.
16 § 264 (1) 2nd sentence HGB.
17 § 264 (1) 1st sentence HGB. Until the change even small companies had to prepare a report on the economic situation ('Lagebericht', particulars were to be found in § 289 HGB). This has been changed through the mentioned Act to amend the Deutsche-Mark Balance Act and other provisions of Commercial Law of 25 July 1994.
11.2.1.2 Public accountant

Since the enactment of the 'Bilanzrichtliniengesetz' on 1 January 1986 it is required\(^{18}\) for large and medium-sized companies that the financial results must be audited and approved by a certified public accountant.\(^{19}\)

11.2.1.3 Disclosure

Another change introduced through the 'Bilanzrichtliniengesetz' was that all GmbHs must publish their financial results, which are then available in the commercial register.\(^{20}\)

\(^{18}\) Before the members could, however, decide to have the balance sheet of their GmbH audited.

\(^{19}\) Cf. § 316 et seqq. HGB, also with regard to the appointment of an accountant and the importance of the approval of the financial results by him.

\(^{20}\) Or even published in the Government Gazette ('Bundesanzeiger') depending on the size of the company, § 325 et seqq. HGB, with regard to the duty of the court, see also § 329 HGB. Before, only GmbHs which fulfilled two of the following three requirements according to the 'Publizitätsgesetz' (Disclosure Act) were required to publish their results: If their (a) total balance sheet volume exceeded DM 125 million, (b) annual sales exceeded DM 250 million and (c) average number of employees during the year exceeded 5000. Notwithstanding these previous provisions, however, the members could decide to publish the results of their GmbH. Concerning non-compliance, see § 335 1st sentence, no. 6 HGB. Until abolished in 1994, also § 2 (1) 2nd sentence 'Gesetz über die Auflösung und Löschung von Gesellschaften und Genossenschaften' (abbr. LöschG, Act concerning the Dissolution and Deleting of Corporations and Co-operatives) was applicable. Provision was made there that a company had to be struck off the commercial register ex officio in case it had not been fulfilling its publicity duties for three succeeding years and was not able to substantiate that it still had assets. This regulation has been abolished through the 'Einführungsgesetz zur Insolvenzordnung' (abbr. EGLInsO, Introduction Act to the Insolvency Act), BGBI. I 1994, 2911).
11.3 CLOSE CORPORATION

11.3.1 Annual balance sheet, accounting

Like the GmbH the close corporation is also obliged to keep accounting records and prepare annual financial statements, which consist of a balance sheet with notes and an income statement or any similar financial statement and the report of the accounting officer. The accounting officer does not carry out an audit of the books, records and financial statements. Rather, his task is to determine whether the annual financial statements are in agreement with the accounting records of the corporation and to determine the accounting policies applied in preparation of the annual financial statements. However, as decided

21 For further details concerning, i.a., their contents and keeping, see ss 56 CCA; the penalty in case of an offence of this section is the highest penalty imposed by the Act, ss 82 (1)(a) CCA, fine not exceeding R 2000 or imprisonment for a period up to two years. See also Joubert/ Rademeyer, "Finansiele en Rekeningkundige Aspekte van Beslote Korporasies", 1984, TRW 182 et seqq. Note that in ss 8 CCA proceedings regarding the documents to be placed before the court, the same situation applies as for a company, (balance sheet, profit and loss account or any similar document), Henry v R E Designs CC 1998 (2) SA 502 (C).

22 S 58 (2) CCA; as Symington describes it "income statement corresponds with the term 'profit and loss account'", (1986), 69. See ss 58 CCA for further details. In addition, note that a cash flow statement is also required, especially "where the close corporation has several members and conducts a reasonably large business", Close Corporations Service, ibid., referring to generally accepted accounting practice. See Close Corporations Service, 8.25 et seqq. for an example of the annual financial statements of a close corporation.

23 Unless he is appointed by the close corporation to do so. As the CCA does not require an auditor's report like the CA, the report may only "in a very limited sense be regarded as fulfilling the function of the auditor's report", Close Corporations Service, 8.04 fn. 2.

24 S 62 (1)(a) CCA.

25 S 62 (1)(b) CCA. Symington (1986), 75 submits that this term indicates that he is "expected to report if he feels, they have not been prepared in accordance with generally accepted accounting practice appropriate to the business." See also s 62 (2), (3) CCA. Cf. also Pretorius, "Anspreklikheid van rekeningkundige beamptes teenoor derdes op grond van wanvoorstelling in die finansiele jaarstate van 'n beslote korporasie", 1986, MB, 142 et seqq. Compare Close Corporations
in *Maccelari & others v Help U Build Project Management CC* members are advised to pay attention to the report on the corporation’s financial statements. When they have signed them according to s 58 (3) CCA, the statements will be relied upon by the financial community. In the mentioned case decided upon, the members apparently did not pay much attention to the accounting officer’s report. In his report the accounting officer had, in view of the financial position, without discussing it with the members, subordinated the loan accounts of the members to claims of other creditors of the corporation. The court concluded that it was not really relevant whether the accounting officer had discussed the issue of subordination with the members and whether such an agreement existed. The members had created the impression that there was a subordination agreement and were not allowed blandly to deny its existence.

Regarding the annual financial statements, the members must ensure that annual financial statements are prepared within nine months after the end of every financial year of the close corporation.

11.3.2 Accounting officer

The Act emphasizes the importance of an accounting officer. He must be appointed right from the inception of the close corporation and the position of an

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28 Non-compliance with s 58 makes any member guilty of an offence, see ss 58 (4)(a), 82 (1)(b) CCA. Compare Close Corporations Amendment Act No. 17 of 1990 regarding changes in s 57 CCA concerning the financial year of the corporation.

29 S 59 CCA. Regarding qualifications, see s 60 CCA, see also the requirement of the written consent of all members with regard to a direct or indirect involvement with the close corporation, s 60 (3) CCA. Note that through Act No. 81 of 1992 sub-sections 1 and 4 have been changed. It is made clear now that the officer must be a member of an appropriate profession at all times he is performing this
accounting officer should never be vacant for longer than 28 days. As stated in the Act, the appointment of the first accounting officer of a corporation referred to in the founding statement takes effect on the date of registration of the corporation. If a vacancy occurs in the office of an accounting officer, whether as a result of removal, resignation or otherwise, the corporation must appoint another accounting officer and comply with the provision in regard to the registration of an amended founding statement within 28 days.  

11.3.3 Disclosure

The Act makes no provision concerning publicity of the corporation's financial statements. Given the fact that the report of the accounting officer is not an audit and that the creators of the close corporation intended a closely held membership, Symington sees "a very limited distribution of the financial statements and hence very little use or reliance thereon by persons others than
the members themselves."\textsuperscript{31} Information must only be disclosed in case of crucial aspects of the corporation’s financial well-being. In such a case the accounting officer must inform the Registrar.\textsuperscript{32}

\section*{11.4 CONCLUSION}

In case of the GmbH the aim is to present substantiated information to the members and creditors. The implementation of the 'Bilanzrichtliniengesetz' (Accounting and Reporting Act) caused substantial changes for all companies, and especially for the GmbH with regard to preparation, accounting principles, mandatory audits and publication of the financial results of the business. The Act distinguishes not according to the company form but between small, medium-sized and large companies. Accordingly, only large companies are subject to all of the provisions. Exceptions are being granted for small companies in particular, but also for medium-sized ones. They are subjected to more lenient requirements concerning the contents of their financial results as well as regarding auditing and publishing; in some cases the small companies are even excluded from these provisions. Since the enactment of the 'Bilanzrichtliniengesetz' it is required for large and medium-sized companies that the financial results must be audited and approved by a certified public accountant. Another change introduced through this Act was that all GmbHs must publish their financial results, which are then available in the commercial register. The managing director is responsible, \textit{i.a.}, to provide for the keeping of proper books of account and drawing up a balance sheet with a profit and loss account.

Like the GmbH the close corporation is also obliged to keep accounting records and prepare annual financial statements, which consist of a balance sheet with notes and an income statement or any similar financial statement and the report of the accounting officer. The accounting officer does not carry out an audit of

\begin{itemize}
\item \textsuperscript{31} Symington (1986), 70. He also suggests that "his report should include the statement that he expresses no opinion on the accuracy of the financial position or results disclosed in the annual financial statement," \textit{ibid.} 75. This is in contrast to the audit according to GmbHG, compare § 322 HGB; regarding the liability of accountants, see Brandner, "Berufshaftung und Versicherung der Wirtschaftsprüfer", 1985, \textit{JZ} 757 et seqq.
\item \textsuperscript{32} S 62 (3) CCA.
\end{itemize}
the books, records and financial statements. Rather, his task is to determine whether the annual financial statements are in agreement with the accounting records of the corporation and to determine the accounting policies applied in preparation of the annual financial statements. The Act emphasizes the importance of an accounting officer. He must be appointed right from the inception of the close corporation and the position of an accounting officer should never be vacant for longer than 28 days. 

The Act makes no provision concerning publicity of the corporation's financial statements. Given the fact that the report of the accounting officer is not an audit and that the creators of the close corporation intended a closely held membership, the distribution of the financial statements is generally limited to the members. Information must only be disclosed in case of crucial aspects of the corporation's financial well-being. In such a case the accounting officer must inform the Registrar. In addition, the financial statements do not have the importance as in the GmbH for members not involved in the daily business of the corporation or for creditors, because their interests are safeguarded by the provisions in the CCA pertaining to the personal liability of members.
CHAPTER TWELVE

12 TERMINATION

12.1 INTRODUCTION

There are different ways through which an entity may be terminated. Invalidity, dissolution, liquidation, insolvency proceedings and composition are each the result of certain developments. Specific provisions deal with these developments. Both entities being juristic persons, it will be interesting to see if the procedures are similar.

12.2 GMBH

12.2.1 Invalidity

Due to specific defects of its articles relating to its share capital or its purpose, a company may be declared invalid. The company may be declared invalid by the court upon an action brought by a shareholder, a managing director or a member of the supervisory board.\footnote{§§ 75 - 77 GmbHG, dealing with the 'Nichtigkeitsklage’ (action for annulment) brought by any of the GmbH's organs; see, however, regarding their minimal practical relevance, Lutter-Hommelhoff, \textit{GmbHG} § 75, note 1.} As soon as the invalidity declared by the court has been registered in the commercial register, the provisions relating to the dissolution also apply to the winding-up of the company declared invalid.\footnote{§ 77 (1) GmbHG.} However, this does not affect the validity of transactions made with third parties by the company.\footnote{§ 77 (2) GmbHG.} According to § 77 (3) GmbHG, the shareholders are also obliged to make the contributions promised as far as required to discharge the company's liabilities.
12.2.2 Dissolution

A GmbH is dissolved in the following circumstances:\(^4\)
- expiration of the period stated in the articles;\(^5\)
- resolution by the members with a majority of three-quarters of the votes cast;\(^6\)
- by court order upon an action brought by members owning at least ten per cent of the shares asking for a dissolution due to an important cause;\(^7\)
- by court order declaring the opening of insolvency proceedings;\(^8\)
- by court order declaring the opening of insolvency proceedings impossible due to lack of assets;\(^9\)
- by force of an order of the court of registration establishing a defect in the articles according to §§ 144a, 144b FGG or the non-compliance with the obligations set forth in § 19 (4) 1st sentence GmbHG;\(^10\)
- striking off the commercial register due to lack of assets according to § 141a FGG.\(^11\)

The elimination of a GmbH must be seen as a process generally following different stages:

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\(^4\) Additional circumstances can be stated in the association agreement, § 60 (2) GmbHG.

\(^5\) § 60 (1) no. 1 GmbHG.

\(^6\) § 60 (1) no. 2 GmbHG, the members may change the required votes cast in the articles.

\(^7\) § 60 (1) no. 3; § 61 (2) GmbHG, see § 61 (1) giving the catch-all clause. The reference in § 62 (2) GmbHG for the dissolution by the administrative authority is obsolete. The competence lies now with the administrative courts and the applicable procedure is determined by the Administrative Court Procedure Code (‘Verwaltungsgerichtsordnung’).

\(^8\) § 60 (1) no. 4 GmbHG. See also § 64 GmbHG with regard to the duty of managing directors to apply for the institution of insolvency proceedings and their possible liability; with regard to criminal sanctions, see § 84 (1) no. 2 and (2) GmbHG. See chapter 12.2.4, ‘Insolvency’.

\(^9\) § 60 (1) no. 5 GmbHG.

\(^10\) § 60 (1) no. 6 GmbHG.

\(^11\) § 60 (1) no. 7 GmbHG.
Dissolution (requiring the circumstances mentioned), liquidation being the subsequent consequence (as long as insolvency proceedings are not applicable) and striking of the GmbH from the records and thus the cessation of its juristic personality.\(^\text{12}\)

With the dissolution the GmbH enters - except in the case of insolvency proceedings - the liquidation stage. The company becomes a company in liquidation made public to third parties with the addition i.L. ('in Liquidation') and remains as such as long as divisible assets exist and only ceases to exist with the payment of the last assets.

12.2.3 Liquidation

Concerning the winding-up of a company in liquidation the procedure is as follows:

The notice of dissolution must be given for entry in the commercial register\(^\text{13}\) and public notice of the dissolution must be given by the liquidators.\(^\text{14}\)

The company becomes an 'Abwicklungsgesellschaft' or 'Liquidationsgesellschaft'.\(^\text{15}\) The 'Abwicklung' is completed by the liquidator according to the non-variable rules of § 66 et seqq. GmbHG. With the exception of insolvency proceedings, the managing directors are acting as liquidators unless the articles or the members through a resolution appoint other persons.\(^\text{16}\) Minority rights are protected in the way that through an application of members holding not less than one-tenth of the share capital, the appointment of liquidators may be made by the court due to substantial grounds.\(^\text{17}\)

\(^{12}\) See Lutter-Hommelhoff, GmbHG § 60, note 1 also for particulars and exceptions.

\(^{13}\) § 65 1st sentence GmbHG; see also 2nd sentence, in these cases the court must make an official entry of the dissolution and its ground, 3rd sentence.

\(^{14}\) See § 65 (2) GmbHG for details regarding the information of the public and creditors.

\(^{15}\) These terms describe the fact of a winding-up of a company in liquidation. As mentioned above, this is shown through the affix to the company's name 'i.L.' ('in Liquidation'), see §§ 68 (2), 71 (5) 1st sentence GmbHG for particulars.

\(^{16}\) § 66 (1) GmbHG. Opinion in the legal literature also allows legal persons to act as liquidator, see Lutter-Hommelhoff, GmbHG § 66, note 1.

\(^{17}\) § 66 (2) GmbHG, the same conditions apply for their revocation, § 66 (3) GmbHG.
Otherwise, liquidation follows the normal procedure, giving liquidators the task of terminating current business transactions, fulfilling the obligations of the dissolved company, collecting its book debts and converting its assets into cash.\textsuperscript{18}

At the commencement of the liquidation and in each succeeding year the liquidator must draw up a balance sheet.\textsuperscript{19} If he signs for the company it must be stated that the company is in liquidation.\textsuperscript{20} The distribution of company assets, if any, is done in proportion to the shares\textsuperscript{21} but only after at least one year after the last public information has been given.\textsuperscript{22} If all the assets have been distributed the GmbH is striked of the commercial register,\textsuperscript{23} and the GmbH ceases to exist. The public is to be informed through an announcement in the Government Gazette and another publication.\textsuperscript{24}

In case it is discovered that assets to be liquidated still exist after the GmbH has been striked off the commercial register, the striking itself is to be reversed. A supplementary winding-up has to take place for which again liquidators have to be assigned to by the court.\textsuperscript{25}

\textbf{12.2.4 Insolvency}

Regarding bankruptcy and composition proceedings, the 'Insolvenzordnung' replaced the previous regulations as of 1 January 1999. Under the unified 'Insolvenzordnung' new procedures are specified and creditor rights remodelled.

\textsuperscript{18} § 70, see also § 66 et seqq. GmbHG.
\textsuperscript{19} § 71 (1) GmbHG.
\textsuperscript{20} As mentioned, § 71 (5) GmbHG, 'GmbH i.L.'
\textsuperscript{21} § 72 GmbHG, unless the articles provide otherwise. Obviously the distribution, if any, may only be completed when all the debts of the company have been discharged.
\textsuperscript{22} For other details as, for example, time restrictions etc., see §§ 65 (2), 66 et seqq., 72, 73 GmbHG.
\textsuperscript{23} § 31 (2) 1st sentence HGB, this has only a declaratory meaning as the legal existence ceases when no more assets of the company exist.
\textsuperscript{24} § 10 (1) HGB.
\textsuperscript{25} § 273 (4) AktG is deemed to be used analogously.
The reorganisation procedures contain a debtor in possession feature and thus reflect American influence.\textsuperscript{26}

The insolvency procedure may lead to either the reorganisation or the liquidation of an insolvent enterprise.\textsuperscript{27}

The central element of the new 'Insolvenzordnung' is the insolvency plan and the possible waiver of any residual debts for an entrepreneur and his business.\textsuperscript{28}

Concerning the commencement of insolvency proceedings the following is to note. In the case of the GmbH, the insolvency proceedings are initiated upon a request from a creditor.\textsuperscript{29} A managing director can also file such a petition.\textsuperscript{30} He is, in particular, obliged to file a petition in the case of insolvency or excessive

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\textsuperscript{26} Insolvency Act, 'Insolvenzordnung' being abbr. InsO; BGBl. I 1994, 2866. These being the Bankruptcy and Composition Codes in the former West Germany and the Act on Collective Enforcement ('Gesamtvollstreckungsordnung') in the former East Germany. The changes effected through the new Act and its Introductory Act ('Einführungsgesetz'), BGBl. I 1994, 2911, also included, \textit{i.a.}, the striking of the Act Concerning the Dissolution and Deleting of Corporations and Co-operatives ('Gesetz über die Auflösung und Löschung von Gesellschaften und Genossenschaften').

Regarding the discussion and process which subjected the practicability of the two-tier law on bankruptcy and settlements to a critical examination and which led to this reform, \textit{cf.} Scholz-Schmidt, \textit{GmbHG} § 63, note 120, in the 8th edition; see also for further literature Lutter-Hommelhoff, \textit{GmbHG} § 64. The main criticism brought against these statutes was their inability to facilitate the rescue of viable businesses. For the first time in the history of Germany's insolvency laws, a statutory rescue procedure has been enacted, see also Seagon/Althen, "The New German 'Insolvenzordnung' (Insolvency Act) – Critical Aspects", 1994, \textit{Insolvency Law & Practice}, 167.

\textsuperscript{27} If the debtor is a natural person, he may be discharged from his remaining obligations on the basis of a special procedure to discharge the residual debt; this kind of discharge from residual debt was previously unknown under German law.

\textsuperscript{28} §§ 1 InsO, 11 InsO.

\textsuperscript{29} § 14 (1) InsO.

\textsuperscript{30} § 15 InsO.
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indebtedness.\textsuperscript{31} He is liable to prosecution if such a petition is not filed within three weeks.\textsuperscript{32} Failure to observe the time limit means that the director is personally liable to the creditors for any new claims or any further deterioration of the assets of the insolvent enterprise.\textsuperscript{33} A petition can even be filed voluntarily when insolvency is imminent.\textsuperscript{34}

The Insolvency Court (County Court)\textsuperscript{35} can appoint an interim insolvency administrator and instruct him to produce an expert assessment of the insolvent enterprise.\textsuperscript{36}

The insolvency proceedings will begin if the interim insolvency administrator concludes that enough assets are available to justify the insolvency proceedings \textit{(i.e.,} the insolvent enterprise can cover the court fees and the costs of the receiver). Otherwise the opening of insolvency proceedings will be rejected due to insufficient assets.\textsuperscript{37}

A definitive insolvency administrator is appointed as soon as the insolvency proceedings are established,\textsuperscript{38} subsequently the administration of the insolvent enterprise is transferred to him.\textsuperscript{39} He can conclude current or day-to-day transactions or refuse to meet the conditions of contracts.\textsuperscript{40}

\textsuperscript{31} §§ 64 (1), 71 (3) GmbHG, §§ 17, 19 InsO.
\textsuperscript{32} § 64 (1) GmbHG.
\textsuperscript{33} § 64 (1) GmbHG.
\textsuperscript{34} § 18 InsO.
\textsuperscript{35} § 2 InsO.
\textsuperscript{36} § 21 (2) no. 1, § 22 InsO.
\textsuperscript{37} § 22 (1) no. 3 InsO.
\textsuperscript{38} § 27 InsO.
\textsuperscript{39} §§ 56 (1), 80 (1) InsO, his tasks are, \textit{i.a.}, those mentioned in §§ 148, 150 \textit{et seqq.} InsO. However, the court may also leave the power of disposal with the debtor, who is then placed under the supervision of a creditors’ trustee, §§ 270, 274 InsO.
\textsuperscript{40} For example, contracts of employment are not automatically invalidated with the establishment of insolvency proceedings but must be terminated with notice, § 113 InsO. Any loss of salary suffered by employees due to the insolvency can be compensated with a maximum of three months salary from the substitute insolvency pay (previously, substitute bankruptcy pay). The employees, just like
The insolvency administrator must, as one of his foremost tasks, pay particular attention to securing the assets of the enterprise, the collection of outstanding debts and the decision as to whether to continue the business based upon an economic evaluation of the enterprise and the reasons for the insolvency.\textsuperscript{41} Three months after proceedings have been initiated at the latest, the creditors' meeting decides on the basis of a report prepared by the insolvency administrator whether the enterprise is to be liquidated or continued for the purpose of reorganisation.\textsuperscript{42}

If the insolvency administrator does not continue with the enterprise, the assets of the business are realised and the proceeds paid to the creditors in an order of priority laid down in the 'Insolvenzordnung'.\textsuperscript{43} After the proceeds have been distributed, the enterprise is dissolved and the residual claims of the creditors are of practically no value.\textsuperscript{44}

An insolvency plan is drawn up if the economic evaluation of the enterprise leads to the conclusion that the reasons for insolvency are not based on structural weakness and that it can be restored to financial soundness.\textsuperscript{45}

It is possible for the entrepreneur or director or executive board to submit an insolvency plan already together with the petition at the Insolvency Court.\textsuperscript{46} The insolvent enterprise will be managed by the insolvency administrator according to the insolvency plan once this plan has been accepted by the creditors\textsuperscript{47} and approved by the Insolvency Court.\textsuperscript{48}

\textsuperscript{41} § 22 InsO.
\textsuperscript{42} § 29 (1) no. 1; §§ 156, 157 InsO.
\textsuperscript{43} §§ 207, 209 InsO.
\textsuperscript{44} § 211 InsO.
\textsuperscript{45} §§ 157, 217, 219 et seqq. InsO.
\textsuperscript{46} § 218 (1) InsO.
\textsuperscript{47} §§ 244 – 246 InsO.
\textsuperscript{48} § 248 InsO.
The insolvency proceedings end with the planned payment of the creditors if the insolvency receiver can successfully fulfil the insolvency plan. The enterprise is released from the residual debts, is on a sound financial basis and can continue operating.49

12.3  CLOSE CORPORATION

12.3.1  Deregistration

The registration of the close corporation can be erased without liquidation proceedings when a close corporation has no assets and no liabilities or in the case it has ceased to operate.50

It is possible for members to have their close corporation deregistered or for the Registrar to start the deregistration process.51 Deregistration is described as "the cancellation of the registration of the corporation's founding statement, resulting in the loss, by the association of

49 § 254, § 258 et seqq., § 268 InsO.
51 For details, see s 26 CCA.
members forming the corporation, of legal personality and corporate status. Deregistration does not terminate the existence of the corporation; on deregistration the association of persons sustaining the corporation merely loses its corporate personality.”

After the affairs of a close corporation have been completely wound-up, the Master sends a certificate to that effect to the Registrar, who then gives notice of the dissolution in the Government Gazette. It is also possible for the Registrar to restore the registration and give notice of restoration in the Gazette. “The dissolution of a close corporation may be declared void by a court upon the application of the liquidator or any other interested person.”

If the registration is erased although liabilities still exist, all members are jointly liable for claims against their former close corporation. Deregistration as such does not affect any liability of a member of the close corporation to the corporation or to any other person, and such liability may be enforced as if the close corporation was not deregistered.

12.3.2 Winding-up

There are different methods of liquidating a close corporation. Reflecting the options of the Act it is therefore submitted that "a corporation can be wound up either voluntarily, upon the initiation of members, or by the court upon the

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52 Close Corporations Service, 14.04. Ibid., "the existence of a close corporation is terminated by dissolution after completion of the winding-up procedure." See also s 1 CCA for the definition of "deregistration".
53 Close Corporations Service, 14.09 referring also to s 419 (1) and (2) CA.
54 See s 26 (6) and (7) CCA.
55 Close Corporations Service, 14.09, referring to s 420 CA.
56 Concerning their liability, see s 26 (4) and (5) CCA.
57 See s 66 CCA et seqq. For the reader interested in further aspects, see, i.a., for details Bonnet, Die likwidasie van Beslote Korporasies met besondere verwysing na die bepalings van die Maatskappywet, en die Insolvensiewet, 17 Med SOR (1992). Henning, "Judicial management and corporate rescues in South Africa", 1992, TRW 91 et seqq.
application of either members or creditors."\(^{58}\) The terms winding-up and liquidation are used interchangeably, describing the "process of dealing with its assets and liabilities before its existence is terminated by dissolution."\(^{59}\)

However, a voluntary winding-up by members can take place only if "the corporation is liquidated for some reason other than its insolvency."\(^{60}\)

The winding-up procedure is regulated by provisions contained in the CCA, the CA and the Insolvency Act.\(^{61}\) If a corporation is being wound up, the statement "In Liquidation" or "In Voluntary Liquidation", as the case may be, shall for the duration of such winding-up be subjoined to the name used by the corporation.\(^{62}\)

Given the new constitutional dimension, however, it is noteworthy that the provisions in the Companies Act that deal with the examination of directors and other persons during the process of winding up of a company or a closed corporation, have already been challenged against constitutional principles in court.\(^{63}\) Accordingly, it is submitted that these decisions demonstrate how the

\(^{58}\) Close Corporations Service, 11.01.

\(^{59}\) van Dorsten (1990), 57. As these terms have the same meaning, it is intended to use ‘liquidation’ in the future, Close Corporations Service, 11.01 fn. 1, referring to South African Law Commission Discussion Paper 66 on the Review of the Law of Insolvency.

\(^{60}\) Close Corporations Service, 11.04.

\(^{61}\) S 66 CCA et seq. See Close Corporations Service, chapters 11, 12 and 13 for a detailed description of the winding-up process. In this regard, cf. also de la Rey, "Beslote korporasies. Probleme in verband met likwidasie en akkord", 1986, 3 Med LSO, p. 84 et seqq.

\(^{62}\) S 22 CCA. Failure to comply with this provision is an offence, s 22 (4), s 82 (1)(c) CCA.

\(^{63}\) See in detail, Henning/du Toit, 2000, JFC 181 et seqq. Also du Toit, "The constitutionality of the Companies Act: Sections 415, 417 and 418", 2000, TRW 187 et seqq. drawing a conclusion from the judgements in question in how interrogation proceedings can remain constitutional. Wehmeyer v Lane NO and Others 1994 (2) BCLR 14 (C); Lynn NO and Another v Kreuger and Others 1995 (2) BCLR 167 (N), see at 171D for disagreement with some aspects of the judgement in Wehmeyer v Lane NO; Ferreira v NO and Others and Vryenhek and Others v Powell NO and Others 1996 (1) BCLR 1 (CC); Bernstein and Others v Bester NO and Others 1996 (4) BCLR 449 (CC), from a comparative viewpoint it is very interesting to see how the Constitutional Court in its judgement refers to authorities in, e.g. England, at 463 et seqq.; Australia, at 469 et seqq.; Council of Europe, at 486 et seqq.; USA and Canada, 487 et seqq.; and even the German BVerfG, at 489 et seqq.; Parbhoo and Others v Getz NO and Another 1997 (10)
Bill of Rights may influence existing law, "the evaluation of statutory and common-law rules against constitutional principles is not only inevitable, but also desirable in a political dispensation so different from the previous one."  

12.3.2.1 Voluntary winding-up

In the close corporation dissolution might come about if all the members so decide at a meeting and sign a written resolution, stating whether it shall be a voluntary winding-up by members or by creditors, as the case may be. The written resolution must be lodged within a certain period with the Registrar; failing to do so renders the resolution to lapse and be void. An additional resolution nominating a person for appointment as liquidator may accompany this one. The appointment itself, however, is done by the Master. Notice of the voluntary winding-up must appear in the Government Gazette. In addition, after the resolution has been registered the resolution must be

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64 Havenga, 1999, THRHR 495, 507.
65 As stated above, "a voluntary winding-up by members can only take place where a close corporation is liquidated for some reason other than its insolvency," Close Corporations Service, 11.04. In a voluntary winding-up "an application for the winding-up of that corporation by the court can be brought by the Master or creditor or any member of that corporation." Close Corporations Service, 11.06, referring to s 346 (1)(e) CA.
66 S 67 (1) CCA. As Close Corporations Service, 11.05 states, "although somewhat inappropriately termed a voluntary winding-up by creditors, this type of winding-up is initiated solely by a resolution of members. (...) After registration of the necessary resolution, the rest of the procedure in a voluntary winding-up by creditors is similar to that of a winding-up by court."
67 S 67 (2) and (3) CCA, see also sub-section (4) concerning the date the resolution takes effect.
68 Thus the Master may also appoint somebody of his own choice, s 74 (3) CCA.
69 S 356 (2) CA.
70 Registration will only take place after confirmation by the Master that the required security has been lodged or that he has dispensed with security, s 350 (2) CA.
brought to the attention of certain officials.71 "The powers of the liquidator are the same as in other types of winding-up, except that he may exercise the powers granted by section 386 (4) of the Companies Act only with the authority granted by a meeting of members."72

12.3.2.2 Liquidation by the court

In addition to this voluntary winding-up, the Act also makes provision for a liquidation by a court73 on the following grounds:

- members with more than 50 per cent of the total number of votes take a decision to this effect at a meeting of members and have signed a corresponding written resolution calling for the winding-up of the close corporation by a court;74

- the close corporation has not commenced its business within a year from its registration, or has suspended its business for a whole year;75

- the close corporation is unable to pay its debts;76 or

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71 Including the magistrate’s courts, see s 357 (1) CA for details. Generally to places where assets and property of the close corporation could be situated.
72 Close Corporations Service, 11.04.
73 The question which court has jurisdiction in respect of the liquidation of a close corporation was discussed controversially and also decided differently. According to ss 1 and 7 CCA, the court having jurisdiction in any matter generally is the magistrate’s court or high court within whose area of jurisdiction the office or main place of business of the corporation is situated or, in relation to any offence, any court having jurisdiction in respect to that offence. Ss 29 and 46 of the Magistrates’ Courts Act No. 32 of 1944 deal with the extent of the magistrate’s court jurisdiction. To resolve the conflict between the judgements that the provisions of the Magistrates’ Courts Act do not confer jurisdiction upon a magistrate’s court to liquidate a corporation and the judgements that it does, s 29 (1)(fA) was introduced in s 29 by the Fifth General Law Amendment Act No. 157 of 1993 to confer jurisdiction on magistrates’ courts in actions, including specifically an application for liquidation, under the Act. Cf. Close Corporations Service, 2.13. For detailed discussion of the various issues and different court cases, see de Waal, 24 Med SOR (1995), 7-42.
74 S 68(a) CCA.
75 S 68(b) CCA.
76 S 68(c) CCA, see with regard to the circumstances in which a close corporation is deemed unable to pay its debts, s 69 CCA.
- it appears that it is just and equitable that the close corporation should be wound-up.\textsuperscript{77}

In the case of the close corporation being insolvent, as mentioned, the winding-up is accomplished according to the Law of Insolvency and the relevant provisions of the CCA and the CA.\textsuperscript{78}

If the court grants a winding-up order\textsuperscript{79} it is brought to the attention of certain officials by sending them a copy of the order, and to the public by giving notice in the Gazette.\textsuperscript{80}

The winding-up proceedings\textsuperscript{81} are to be conducted through a liquidator, a suitable natural person who is appointed by the Master.\textsuperscript{82} His duties are, for example, to meet as soon as possible with the creditors and the members,\textsuperscript{83} to hold a general meeting of creditors and members in which he must submit a report, \textit{inter alia}, on the state of the close corporation and the progress and prospects in respect of winding-up.\textsuperscript{84}

Special emphasis is put on the liquidator's duty to determine the liability of members.\textsuperscript{85} He has to ascertain whether members or former members (or any other person) have incurred any personal liability to a creditor or the close corporation itself\textsuperscript{86} and/or whether they are liable to make repayments to the corporation.\textsuperscript{87}

\begin{itemize}
\item \textsuperscript{77} S 68(d) CCA.
\item \textsuperscript{78} S 66 (1) CCA and s 339 CA.
\item \textsuperscript{79} With regard to the application and the necessary security, see s 346 (1) and (3) CA. For the powers of the court, compare ss 347 (1), 354 (1) CA.
\item \textsuperscript{80} See \textit{Close Corporations Service}, 11.04 and 13, referring to the relevant provisions of the CA, ss 375 (5)(b), 357 (1), 356 (1).
\item \textsuperscript{81} For details of the liquidation procedure, see \textit{Close Corporations Service}, chapter 12.
\item \textsuperscript{82} See s 74 \textit{et seqq}. CCA for further details concerning the appointment.
\item \textsuperscript{83} S 78 CCA; for his further duties, see s 78 \textit{et seqq}. CCA.
\item \textsuperscript{84} S 79 CCA, except in the case of a members' voluntary winding-up, \textit{ibid}.
\item \textsuperscript{85} Ss 80, 81 CCA. See also s 73 CCA with regard to repayments, payments of damages and restoration of property by members and others.
\item \textsuperscript{86} Ss 81, 63, 64 and 65 CCA.
\item \textsuperscript{87} Ss 80, 70 (2), (3) and 71 (1), (2) CCA.
\end{itemize}
Regarding the liability for repayments, the following exception is noteworthy: The general rule is that upon liquidation of a corporation, "no member is liable for the repayment of any payment made to him by the corporation by reason only of his membership, if such payment complied with the requirements of s 51 (1) CCA". Notwithstanding this general rule, however, repayment is possible due to the exceptions in ss 70 and 71 CCA dealing with repayments as such and repayment of salary or remuneration both of taking place within a period of two years before the commencement of the winding-up.

After fact-finding, the liquidator may take the necessary steps he deems appropriate. If any surplus assets remain after payment of the costs incurred during the winding-up and the various claims of the creditors, they are distributed among the members according to their interest in the close corporation.

12.3.3 Composition

Composition is another possibility for handling the financial problems of a corporation.

When following the compromise procedure in the Act, the compromise procedure as provided for in company law is expressly excluded and no

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88 Delport-Pretorius (1989), 64.
89 Cf. s 81 (2), (3) CCA. Regarding the repayment regulated in s 80 CCA the enforcement is regulated in s 70 (4) of the CCA giving the notice the effect of a civil judgement. Without adhering to the normal steps "of issuing summons and taking judgement", Close Corporations Service sees this as "a very drastic and rather contentious remedy", 12.55 fn. 1. Some legal protection, however, is provided for in sub-section (5).
90 Close Corporations Service, 13.16 referring to s 342 (1) CA.
91 Which is called "unique", Close Corporations Service, 11.01. Close Corporations Service, 14.01 compares it to "a procedure, in some aspects similar to composition proceedings in sequestration". Note that s 72 has been replaced in toto by s 16 of the Close Corporations Amendment Act of 1997. For the background to the new provision, see Henning/de Waal, 1994, 1 CLDS 155, 156-159.
92 S 66 (1) CCA mentions, i.a., ss 311 to 313 of the Companies Act. Before the amendment it was not clear whether a compromise in terms of s 311 of the Companies Act was available in the case of a close corporation. For further literature on this aspect, see Close Corporations Service, 14.01 fn. 1. See also
provision is made for the judicial management of a corporation, or for any similar procedure.\textsuperscript{93}

Without going into detail,\textsuperscript{94} only the following is to mention. In the winding up of a corporation unable to pay its debts any person (referred to as the "offeror") may, at any time after the commencement of the liquidation of the close corporation submit to the liquidator a written offer of composition.\textsuperscript{95} If the liquidator is of the opinion that creditors will probably accept the offer, he must inform the creditors and the Master.\textsuperscript{96}

The offer of composition is brought to the attention at a general meeting of creditors of the corporation.\textsuperscript{97} This offer must be accepted by creditors whose votes amount to not less than two-thirds in value and two-thirds in number of proved creditors.\textsuperscript{98}

The Act then prescribes further conditions and steps to be taken to proceed with the composition.\textsuperscript{99} However, at all stages of the composition proceedings, the various interested parties may oppose decisions being made.\textsuperscript{100}

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\textsuperscript{93} Close Corporations Service, 11.01.
\textsuperscript{94} Cf. Close Corporations Service, 11.01 et seqq. in this respect.
\textsuperscript{95} For the important role the liquidator plays in composition proceedings, see, \textit{i.a.}, s 72 (10) CCA.
\textsuperscript{96} S 72 (1) and (2) CCA. Close Corporations Service, 14.01.
\textsuperscript{97} S 72 (6) CCA. See for some interesting aspects in connection with the interrogation of members and others at meeting of creditors, \textit{Du Plessis NO v Oosthuizen en 'n Ander 1999 (2) SA 191 (O)}. Cf. also Close Corporations Service, 12.37; at footnote 7 regarding constitutional questions.
\textsuperscript{98} S 72 (7) CCA, see also sub-sections (a) to (c).
\textsuperscript{99} Ss 72 (8) to (11) CCA.
\textsuperscript{100} See, \textit{i.a.}, s 72 (4), (12) CCA.
12.4 CONCLUSION

Regarding a GmbH due to specific defects of its articles relating to its share capital or its purpose, a company may be declared invalid. The company may be declared invalid by the court upon an action brought by a shareholder, a managing director or a member of the supervisory board and will be wound up according to the provisions relating to dissolution.

A GmbH is dissolved upon resolution of members and by court order under specific circumstances. In such a case the process consists of the following steps, liquidation, striking of the GmbH of the records and thus the cessation of its juristic personality.

Concerning the winding-up of a company in liquidation the procedure is as follows. The notice of dissolution must be given for entry in the commercial register and public notice of the dissolution must be given by the liquidators. The company becomes an 'Abwicklungsgesellschaft' or 'Liquidationsgesellschaft'. Otherwise, liquidation follows the normal procedure, giving liquidators the task of terminating current business transactions, fulfilling the obligations of the dissolved company, collecting its book debts and converting its assets into cash.

Regarding bankruptcy and composition proceedings, the 'Insolvenzordnung' (Insolvency Act) replaced the previous regulations as of 1 January 1999. Under the unified 'Insolvenzordnung' new procedures are specified and creditor rights remodelled. The reorganisation procedures contain a debtor in possession feature and thus reflect American influence. The central element of the new 'Insolvenzordnung' is the insolvency plan and the possible waiver of any residual debts for an entrepreneur and his business.

Concerning the close corporation its registration can be erased without liquidation proceedings when a close corporation has no assets and no liabilities or in the case it has ceased to operate. It is possible for members to have their close corporation deregistered or for the Registrar to start the deregistration process.

Regarding the winding-up there are different methods of liquidating a close corporation. Reflecting the options of the Act a corporation can be wound up
either voluntarily, upon the initiation of members, or by the court upon the application of either members or creditors.

If a corporation is being wound up, the statement "In Liquidation" or "In Voluntary Liquidation", as the case may be, shall for the duration of such winding-up be subjoined to the name used by the corporation.

Given the new constitutional dimension, however, it is noteworthy that the provisions in the Companies Act that deal with the examination of directors and other persons during the process of winding up of a company or a closed corporation, have already been challenged against constitutional principles in court.

Composition is another possibility for handling the financial problems of a corporation with the aim to prevent the final termination. In the winding up of a corporation unable to pay its debts any person (referred to as the "offeror") may, at any time after the commencement of the liquidation of the close corporation submit to the liquidator a written offer of composition. The Act then prescribes further conditions and steps to be taken to proceed with the composition. However, at all stages of the composition proceedings, the various interested parties may oppose decisions being made.
CHAPTER THIRTEEN

13 MERGER, CONVERSION, GROUPS

13.1 INTRODUCTION

As both entities play an important role in their respective economies, it is relevant to discuss in which way provision is made in case the organizational form of the entities changes. It will be interesting to see if closeness of the entities reflects on these matters. Regarding the GmbH the 'Umwandlungsge- setz' of 1995 (Act on Conversions and Mergers) is relevant.

13.2 GMBH

Until 1995 the Law on Conversions and Mergers was found in different Acts, which is why the Federal Ministry of Justice presented a Government draft for the adjustment of the Law on Conversions. This draft proposed changes through which all merger and conversion proceedings of all corporational forms should be concentrated and regulated in one Act regardless of the various legal forms.

This draft has since been enacted and became the new 'Umwandlungsgesetz' of 1995. This new Act (and associated tax legislation) enables business

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enterprises to change their legal status with relative ease and with minimal adverse fiscal consequences. The ownership of the enterprise is deemed not to change. Under these new regulations mergers and divisions are made easier as are conversions from corporate to non-corporate forms (and vice versa). The conversion of companies into limited partnerships is one possibility worth mentioning here. These conversion arrangements are important because of the large number of partnership options currently available under German law.4

A systematization of existing laws was also achieved through this adjustment, e.g.,
- share capital increase out of company assets has been transferred from the simultaneously abrogated KapErhG5 (§ 1 et seqq.) into the GmbHG (§§ 57c - 57o GmbHG);
- the provisions regarding mergers of GmbHs, previously regulated in § 19 et seqq. KapErhG, as well as the previous whole 4th Book of the AktG (merger, transfer of assets, conversion) now reappear in the new UmwG 1995.6

However, most of the previous regulations emerge virtually unchanged in the new 'Umwandlungsgesetz' 1995.

13.2.1 Mergers

Previously, rules regarding the GmbH governing mergers ('Verschmelzung')7 and conversion ('Umwandlung') could be found in the AktG, the former 'Umwandlungsgesetz'8 and the former 'Kapital Erhöhungs Gesetz'.9

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Regierungsentwurf zum Umwandlungsrecht", 1994, ZIP 165 et seqq.; Lüttge, "Das neue Umwandlungs- und Umwandlungssteuerrecht", 1995, NJW 417 et seqq. Through the Act EU-Directives were also transferred into national law, cf. Lutter-Hommelhoff, GmbHG introduction, note 22 with further references. See also Kiem, Unternehmensumwandlung (2000).

4 Milman (1999), 30.
5 'Kapital Erhöhungsgesetz' (Act Regulating the Raising of Capital).
6 For example, before the enactment of the new 'Umwandlungsgesetz' provisions regarding the conversion and merger of a GmbH could be found also in the §§ 355, 356, 358a, 369-383, 386-392 'Aktiengesetz'.
7 Concerning consolidated annual accounts for groups where a company is a member of a group, see § 290 et seqq. HGB.
Like the preceding Acts, the new 'Umwandlungsgesetz' allows a variety of changes of the legal form of the GmbH.

Regarding mergers, one must distinguish between mergers done through absorption\(^{10}\) and mergers resulting in a new formation.\(^{11}\)

The previous regulations, enabling an AG to merge with one or more GmbHs (or other companies) through a take over\(^{12}\) while one GmbH instead was only allowed to take over one AG (or KGaA)\(^{13}\) or one GmbH\(^{14}\) respectively, have been eased regarding the latter through the new provisions.\(^{15}\)

In addition, it remains possible for two or more GmbHs to merge by forming a new GmbH or forming a new AG.\(^{16}\)

With regard to mergers as such one has to keep in mind that they are subject to the 'Gesetz gegen Wettbewerbsbeschränkungen'.\(^{17}\) Concerning cross-border mergers, the discussion in Europe lasted nearly as long as regarding the SE. Already in 1985 a Tenth EC-Directive was proposed.\(^{18}\) After twenty years of discussion, EU ministers have reached agreement on a directive on cross-border mergers. This is expected to make it easier for smaller businesses to operate in more than one EU Member State. The measure will allow cross-border mergers of limited liability companies within the European Union. Currently, such mergers are either impossible or difficult and expensive. The

\(^{8}\) UmwG 1969.
\(^{9}\) KapErhG. This Act has also been abrogated.
\(^{10}\) 'Aufnahme', one company takes over the property of the other.
\(^{11}\) 'Neubildung', the companies are being terminated and their properties are being transferred to a new one.
\(^{12}\) §§ 355, 358a AktG.
\(^{13}\) §§ 33, 34 KapErhG.
\(^{14}\) § 19 (1) no. 1 KapErhG.
\(^{15}\) Cf. § 2, § 3 (4) UmwG 1995.
\(^{16}\) §§ 19 (1) no. 2, 32 KapErhG; § 358a AktG. Compare § 2, § 3 (4) UmwG 1995.
\(^{17}\) GWB, Law against Restraints of Competition; see also the Decree on Merger Control ('Fusionskontrollverordnung') No. 4064/89 of the EC-Council of 21 December 1989, Official Journal No. L 395/1 of 30 December 1989.
new directive helps small and medium sized companies (SMEs) that wish to operate in more than one Member State - but not throughout Europe - which means they cannot seek incorporation under the European Company Statute.\(^{19}\)

### 13.2.2 Conversions

Until 1995 the relevant provisions could be found in the different Acts already mentioned.

The new Act makes it easier for firms to change their legal form. Concerning conversions the various options remain.\(^{20}\) It is possible to convert the entities as described in § 3 UmwG 1995, e.g., conversion of a GmbH into an AG or KGaA and *vice versa*.\(^{21}\) Other provisions allow, for example, the conversion of the GmbH to a commercial and civil-law partnership\(^ {22}\) and conversion of a commercial partnership into a GmbH.\(^ {23}\) The previous prohibition of a conversion of a GmbH into a GmbH & Co. KG\(^ {24}\) has not been transferred into the new Act.

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\(^{20}\) One has to distinguish between ‘formwechselnde Umwandlung’ (the company changes its legal form without changing its identity) and ‘übertragende Umwandlung’ (the company changes its legal form and the identity of the company).

\(^{21}\) Cf. the previous provisions, conversion of: AG in a GmbH §§ 369-375 AktG; GmbH in an AG §§ 376-383 AktG; KgaA in a GmbH §§ 386-388 AktG; GmbH in a KGaA §§ 389-392 AktG. Regarding the new provisions, see §§ 2, 3 UmwG 1995 and the relevant sections in the Act.

\(^{22}\) §§ 16-22, 24 UmwG 1969. See § 3 (1) no.1, (2) no.2 UmwG 1995 and the relevant sections in the Act.

13.2.3 Group of companies

The law on the GmbH does not contain any provisions regarding a group of companies. Provisions dealing with this aspect can be found in the AktG. A direct application of the AktG is possible only when an AG or KGaA is involved on one side. In the non-codified GmbH-Law concerning groups of companies ('GmbH-Konzernrecht'), however, some of these provisions are used analogously besides the doctrines developed from the application of the GmbHG.

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24 § 1 (2) of the UmwG 1969.

25 In the bill for the 'Grosse Reform' (major reform) of the GmbHG which did not materialize (only the small reform was enacted in 1981) provision was made for regulations in this regard, see "Regierungs Entwurf GmbHG", BT-Drucksache VI/3088 = 7/253, 1971, Zweites Buch "Verbundene Unternehmen", §§ 230-260; cf. in this regard also Ulmer, "Der Gläubigerschutz im faktischen GmbH-Konzern beim Fehlen von Minderheitsgesellschaftern" 1984, ZHR (148) 391, 392 et seq. Instead of 'group of companies' the terms 'associated companies', 'connected companies' or 'linked companies' are also used.

26 §§ 15-19, 291-318 AktG.


For a discussion on the European level, see Forum Europaeum Corporate Law Group, "Corporate Group Law for Europe", 2000, EBOR 165 et seqq.
13.3 CLOSE CORPORATION

13.3.1 Mergers

Unlike for the GmbH there are no statutory rules governing mergers of close corporations.

13.3.2 Conversions

Concerning conversion, both the CCA and the CA make provision for converting a close corporation into a company and vice versa. Even though the close corporation limits the number of members to ten, a great number of companies have been converted into close corporations.

28 Conversion of a company into a close corporation regulated in s 27 CCA; the 1992 amendment changing s 27 (4) CCA to give the Registrar a more active role, in that he must be satisfied that the company concerned has complied materially with the requirements of the Companies Act 61 of 1973, before he proceeds with the conversion. For a conversion of a close corporation into a company, see ss 29 A, 29 B, 29 C and 29 D of the CA (introduced by Companies Amendment Act of 1984).

29 For the relevant figures, see chapter 1.2, 'Important role in respective economies'. Interesting in this regard are also tables comparing the number of incorporated public and private companies in South Africa and England. At the time, private companies in both countries accounted for ca. 98 per cent!, Ribbens, 1983, TSAR 118,124 fn. 274. See also Hyman, "Close corporations", 1985, De Rebus 476 et seqq. Regarding the UK in Modernising Company Law, p. 15 it is stated that "there are now 1.5 million companies in Great Britain. (...) A few are household names, employing many thousands and with shares traded internationally, but most are small private companies with relatively few employees." The Company Law Review Steering Group, Final Report, regarding
13.3.3 Group of close corporations

It is only possible to give a short introduction of the complex aspects in this regard. Covering this aspect the CCA relies on an analogous application of company law features where possible. Due to restrictions regarding membership it is not possible for other juristic persons such as a public company to take over a close corporation. Therefore "companies are precluded from doing business through the instrumentality of close corporation subsidiaries, and such group formation is avoided." For the close corporation, however, there are no such restrictions and thus it is stated, "although a company may not be a member of a close corporation, a close corporation may be a member (i.e., a shareholder) of a company" and even control it.

As submitted "it would be undesirable to allow a close corporation to control companies free from the restraints imposed by company law on holding companies." Subsequently, section 55 CCA aims "to prevent evasion of the 'abuse of control' provisions of the Companies Act, which could be effected by simply putting a close corporation on top of one or more companies in a pyramid."

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a slightly earlier period states that small and private companies constitute the vast majority of companies. "As at 31 March 2000, there were over 1.3 million private companies limited by shares, compared with just 12,400 public companies", page 23, footnote 12.

32 See chapter 6.5.2, 'Close corporation'.
33 Close Corporations Service, 5.27.
34 Delport-Pretorius (1989), 19, ibid. 49. Compare s 55 CCA.
35 Close Corporations Service, 5.28.
36 Close Corporations Service, 5.29. As stated the section "provides for the application of sections 37 and 226 of the Companies Act where the relationship between a company and a close corporation is such that the corporation (the
In the case of a close corporation controlling a number of wholly-owned subsidiary companies, s 55 CCA applies regarding loans or securities.\textsuperscript{37} Concerning loans or security furnished to a holding corporation or fellow subsidiary company, s 55 (1) CCA provides for the \textit{mutatis mutandis} application of the provisions of s 37 CA.\textsuperscript{38} In connection with the prohibition on loans and security furnished to certain members, officers, directors and controlled bodies corporate s 226 (1) CA read with s 55 (3) CCA is applicable.\textsuperscript{39} Further prohibitions on loans and the provision of security involving close corporations are regulated through section 226 (1) of the Companies Act.\textsuperscript{40}

However, one must also take into account that some structural differences exist between groups in the company and those in the corporation context.\textsuperscript{41} For instance, regarding group annual financial statements no general statutory obligation exists for a holding corporation to prepare them. Nevertheless, it is submitted that "in accordance with generally accepted accounting practice it may be necessary in specific circumstances to prepare consolidated financial statements."\textsuperscript{42}

13.4 CONCLUSION

Regarding the GmbH the 'Umwandlungsgesetz' of 1995 (and associated tax legislation) enables business enterprises to change their legal status with

\textsuperscript{37} For details, \textit{cf.} Delport-Pretorius (1989), 48 \textit{et seqq}. See also for definition problems, Jooste, "A glaring loophole persists in the definition of a subsidiary company", 1999, \textit{SALJ} 414 \textit{et seqq}.

\textsuperscript{38} For further details, \textit{cf.} Close Corporations Service, 5.31. Regarding liability, see s 37 (3) CA; s 55 (2) CCA.

\textsuperscript{39} For further details, \textit{cf.} Close Corporations Service, 5.34. Contravention is treated as an offence and liability may occur, \textit{cf.} s 55 (4) CCA and s 226 CA.

\textsuperscript{40} For further details, \textit{cf.} Close Corporations Service, 5.35.


\textsuperscript{42} Close Corporations Service, 5.40.
relative ease and with minimal adverse fiscal consequences. The ownership of the enterprise is deemed not to change. Under these new regulations mergers and divisions are made easier as are conversions from corporate to non-corporate forms (and *vice versa*). The conversion of companies into limited partnerships is one possibility worth mentioning here. These conversion arrangements are important because of the large number of partnership options currently available under German law.

Concerning group of companies the law on the GmbH does not contain any provisions regarding a group of companies. Provisions dealing with this aspect can be found in the AktG. A direct application of the AktG is possible only when an AG or KGaA is involved on one side. In the non-codified GmbH-Law concerning groups of companies ('GmbH-Konzernrecht'), however, some of these provisions are used analogously besides the doctrines developed from the application of the GmbHG.

Unlike for the GmbH there are no statutory rules governing mergers of close corporations.

Concerning conversion, both the CCA and the CA make provision for converting a close corporation into a company and *vice versa*. Even though the close corporation limits the number of members to ten, a great number of companies have been converted into close corporations.

Regarding the complex aspects of a group of close corporations, the CCA relies on an analogous application of company law features where possible. Due to restrictions regarding membership it is not possible for other juristic persons such as a public company to take over a close corporation. Consequently it is not possible for companies to have close corporation subsidiaries. For the close corporation, however, there are no such restrictions and accordingly, a close corporation can become a shareholder of a company and even control it. However, to also impose controls on such a holding corporation, section 55 CCA aims to cover this aspect providing for the application of certain provisions of the Companies Act.
CHAPTER FOURTEEN

14 TAX ASPECTS

14.1 INTRODUCTION

A wide variety of factors must be taken into account regarding both commercial intentions and taxation considerations. Investment objectives, expected profit levels and distribution policies must be examined when deciding which organizational form is preferable from a tax point of view. Due to the vast number of tax aspects, it is only possible to give a brief outline in this context.1

14.2 GMBH

Similar to the South African system, in Germany the tax status of a business entity depends on whether or not it is incorporated. Corporations are treated as taxable entities and are subject to trade tax2 and corporation income tax.3 However, while the government is seeking to find ways to counter the current economic problems in Germany, i.a., the regulations concerning taxes for businesses are in a state of flux. In a recent policy statement in the German 'Bundestag' on 17 March 2005, the Chancellor suggested, e.g., a reduction of the corporation tax from currently 25 to 19 per cent.4


2 'Gewerbesteuer', abbr. GewSt.

3 'Körperschaftssteuer', abbr. KSt.

4 Policy Statement ('Regierungserklärung'); see also Frankfurter Allgemeine Zeitung (FAZ), 18 March 2005. However, the required consent of the opposition party, which has the majority in the Upper House of Parliament, could not be
Partnerships, on the other hand, are not taxable entities for income tax purposes. The income of the partnership is determined on the level of the partnership-to-be, subsequently allocated to the individual partners. Profit allocable to an individual partner is subject to income tax at his individual income tax rate; profit allocable to a corporate partner is subject to corporate income tax at the level of the corporation. The partnership itself is only subject to trade tax.

The first tax on the profits of any business operation is the trade-tax, which is levied by the local municipality. This tax is a deductible expense for income tax purposes, however. Large, economically attractive cities will normally impose the highest trade tax rates, less attractive locations usually impose a lower one in order to make themselves more attractive for investors.

Second is the corporation income tax. Generally there are no differentiations made between AG’s or GmbH’s.

The applicable Corporations Tax Act integrates taxation at the corporate and the shareholder level (imputation tax system). As mentioned, at the moment the basic rate of corporation tax is 25 per cent. Distributed profits (the capital yield tax is 20 per cent) are taxed in the hands of an individual shareholder, but the imputed tax is credited against the recipient’s personal tax liability. Or, in other words, the corporation tax on dividends and the capital yield tax are credited to the individual income tax or corporation tax of the shareholders; the gross dividends serve as the basis for calculation. Taxation of

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5 As mentioned, the non-corporate entities, i.e., 'Offene Handelsgesellschaft', 'Kommanditgesellschaft', 'Gesellschaft bürgerlichen Rechts'.

6 'Körperschaftssteuergesetz', abbr. KStG. The generally lower corporation tax in the new EU-Member countries of Eastern Europe will increase the competition, for a comparison, see KPMG, "Körperschaftssteuersätze in osteuropäischen EU-Beitrittsländern – Standortwettbewerb verschärft sich für Deutschland", 2003, GmbHR R 445.
distributed profits is thus ultimately determined by the shareholder's respective
tax rate. Therefore applicable taxes are here those for undistributed profits,
distributed profits and a capital yield tax.

A special tax in Germany is the solidarity surcharge or supplement (related to
German reunification).\textsuperscript{7} This surcharge of 5.5 per cent is currently imposed on
all taxpayers, subsequently also corporations.

However, even though tax reasons in general do not particularly favour the
GmbH compared to an AG, the GmbH remains the most popular form of doing
incorporated business in Germany.\textsuperscript{8}

\subsection*{14.3 CLOSE CORPORATION}

With the introduction of the dual corporate tax system established through the
Income Tax Act of 1993 previous tax advantages for the close corporation
compared to a company were neutralised.\textsuperscript{9}

For both entities the normal income tax is now 30 per cent and a secondary tax
of 12.5 per cent on dividends distributed is levied on both.\textsuperscript{10}

Before this change shareholders of companies were taxed on their dividend
income, subject to a minimum exemption of one third. Now dividends distributed
by both are exempted from normal tax. Subsequently, there is no difference
whether the dividend was paid by a company or a close corporation. Thus "the

\footnotesize{
\textsuperscript{7} 'Solidaritätszuschlag', abbr. SolZ.
\textsuperscript{8} Regarding European Tax Law, see Dine/Hughes (2004), 18 (1 et seqq.) and 19 (1
et seqq.). For some recent changes from an auditors view, see Schiffers,
"Änderung der ertragssteuerrechtlichen Rahmenbedingungen für die GmbH und
die GmbH & Co. KG zum 1.1.2004 – Eine erste Bestandsaufnahme", 2004,
GmbHR 69 et seqq.
\textsuperscript{9} Cf. the Income Tax Act 58 of 1962, as amended by the Income Tax Act 121 of
1984 to provide for the taxation of close corporations.
\textsuperscript{10} Close Corporations Service, 9.01, "prior to the 1991 year of assessment there
was an undistributed profit tax applicable to private companies only", ibid. fn. 2.
The second tax is known as secondary tax on companies (STC).
}
need therefore to convert a company to a close corporation solely for the purposes of dividend exemption has fallen away."¹¹

There is, however, an advantage for the close corporation concerning the sale of a members’ interest compared to that of a share in a private company. No stamp duties are payable for such a change in the close corporation.¹²

However, notwithstanding the mentioned changes and although the dividend gap between the company and the close corporation has now been neutralized "there is still a continuous stream of conversions to close corporations."¹³

14.4 CONCLUSION

Similar to the South African system, in Germany the tax status of a business entity depends on whether or not it is incorporated. Corporations are treated as taxable entities and are subject to trade tax, corporation income tax and the solidarity surcharge or supplement. However, while the government is seeking to find ways to counter the current economic problems in Germany, i.a., the regulations concerning taxes for businesses are in a state of flux. However, even though tax reasons in general do not particularly favour the GmbH compared to an AG, the GmbH remains the most popular form of doing incorporated business in Germany.

With the introduction of the dual corporate tax system established through the Income Tax Act of 1993 previous tax advantages for the close corporation compared to a company were neutralised. There is, however, an advantage for the close corporation concerning the sale of a members’ interest compared to that of a share in a private company. No stamp duties are payable for such a change in the close corporation.

¹¹ Close Corporations Service, 9.02 fn. 1.
¹² Close Corporations Service, 9.12. Stamp duty is a charge on certain documents and transactions.
¹³ Close Corporations Service, 9.11, explaining this with the "reduction in legal and administrative requirements applicable to close corporations," ibid. This even though "a close corporation may not be the most suitable instrument for incorporation especially where long term tax planning is envisaged," Close Corporations Service, 9.14, after describing tax advantages of the business trust.
CHAPTER FIFTEEN

15 ONE-MAN GMBH

15.1 INTRODUCTION

As an interesting option noteworthy to mention is the one-man GmbH. This type of company corresponds to the particular needs of entrepreneurs while at the same time offering flexibility and limited liability.

15.2 MAIN FEATURES

One of the important innovations of the GmbH Amendment Act of 1980 is the recognition of the corporation of a one-man GmbH. Until then a GmbH had to be incorporated by at least two members. However, once formed it was permitted that a GmbH could continue to exist with one member only if the shares of all other members were transferred over to him. Accordingly, except for the pure formation stage, the one-man GmbH had long been accepted. The 1980 Amendment, effective as of 1 January 1981, enabled the formation of a one-man GmbH right from the outset.1 As in the 'normal' GmbH the articles of association must be set up. Accordingly, the founder of the one-man GmbH also has the duty to establish articles of association.2

Once formed, all provisions with regard to the GmbH apply to the one-man GmbH. It is a legal entity and as such must have the corresponding organs.

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1 With regard to the one-man GmbH with further references, see Hueck, GmbHG § 1, note 48 et seqq.; Lutter-Hommelhoff, GmbHG § 1, note 7. Compare with regard to questions of a pre-incorporation one-man GmbH ('Einmann-Vor-GmbH'), i.a., John, "Zur Problematik der Vor-GmbH insbesondere bei der Einmann-Gründung", 1982, BB 507, 513; Ulmer/Ihlig, "Die Rechtsnatur der Einmann-Gründungsorganisation", 1988, GmbHR 373; Schmidt, 1980, NJW 1769, 1774; Lutter-Hommelhoff, GmbHG § 11, note 18.

2 §§ 1, 2 (1) GmbHG. Even though just one individual cannot conclude a contract with himself, the Act uses the term 'Gesellschaftsvertrag' (a better term in this context would be 'Errichtungserklärung' <act of foundation>).
Special regulations, however, apply; for example, the record of decisions of the only member and self-dealings ('Insichgeschäfte') of the only member being also the managing director.³

There are also increased controls with regard to securing the raising of the share capital. In addition, there is a clear distinction between transactions of the company and of the sole member.⁴ Piercing of the corporate veil arises especially in connection with the one-man GmbH. Here, the economic identity is very apparent even though formally different legal personalities exist.⁵

15.3 CONCLUSION

The advantage of this specific form of a GmbH is the possibility to achieve limited liability and nevertheless have full control over the business. Once formed, all provisions with regard to the GmbH apply to the one-man GmbH. It is a legal entity and as such must have the corresponding organs. Special regulations, however, apply; for example, the record of decisions of the only member and 'Insichgeschäfte' ('doing business with oneself') of the only member being also the managing director. There are also increased controls with regard to securing the raising of the share capital. In addition, there is a clear distinction between transactions of the company and of the sole member. Piercing of the corporate veil arises especially in connection with the one-man GmbH.

³ § 48 (3), § 35 (4) GmbHG. As previously mentioned, 'Insichgeschäfte' can be translated as 'doing business with oneself', 'self-dealing'. This describes situations where somebody is acting as principal and agent and as such concludes transactions with himself as representative of another. Therefore it is not possible for the same person to act on both sides of the transaction unless this is expressly permitted.

⁴ Compare some of the provisions relevant for the GmbH § 7 (2) 3rd sentence; § 8 (2) 2nd sentence; § 19 (4) subsequent creation of one-man GmbH; § 35 (4); § 48 (3); § 56a; § 57 (2); § 60 (1) no. 5; § 65 (1) 2nd sentence GmbHG.

⁵ Scholz-Emmerich, GmbHG § 13, before note 49; note 49 et seqq., note 75 et seqq.
CHAPTER SIXTEEN

16 GMBH & CO. KG

16.1 INTRODUCTION

One cannot describe the legal form of a GmbH without mentioning the GmbH & Co. KG. Thus, it is necessary to at least briefly discuss this type of company, and introduce the main features of this widely used combination between the GmbH and a commercial partnership.¹

16.2 MAIN FEATURES

This unique legal form of a combination between a 'Kapitalgesellschaft' and a commercial partnership owes its existence to aspects of tax law and company law. The aim is to combine liability limitations of a GmbH and tax benefits of a partnership with the subsequent founding of a 'Kommanditgesellschaft'.²

Generally, the GmbH is used as the 'Kapitalgesellschaft', however, sometimes the AG can be found also in this function.³

The KG is one of the two principal forms of commercial partnerships, the other one being the OHG.⁴ Even though commercial partnerships are not legal entities

¹ With regard to the various other forms of a GmbH, see Sudhoff (1992), 64 et seqq. GmbH & Co. KG is a limited partnership (KG) with a limited liability company (GmbH) as general (personally liable) partner. As mentioned in the discussion which resulted in the so-called small reform of 1981, i.a., also a company on deposits ('Handelsgesellschaft auf Einlagen') was suggested as an alternative to the GmbH & Co. KG. However, it was unsuccessful; Arbeitskreis GmbH (ed.), Die Handelsgesellschaft auf Einlagen – eine Alternative zur GmbH & Co. KG (1971).

² As previously mentionend, abbr. KG, limited partnership.

³ Yet in small numbers, with regard to this entity, see Beckmann, Die AG & Co. KG (1992).

⁴ As previously mentioned, OHG = 'Offene Handelsgesellschaft', unlimited/general partnership.
separate from their partners, they have the legal ability to own assets and incur liabilities. Although internal regulations can change this, the GmbH as the 'Komplementär’\(^5\) via its managing director(s), manages and represents the GmbH & Co. KG.

A creditor can choose between suing the partnership or the partners, which are jointly and severally liable for the partnership's liabilities. The personal liabilities of the partners are unlimited in the OHG, while in the case of the KG the (personal) liability of at least one (or more) active partners acting as 'Komplementär' is unlimited, while the liability of the other partner(s), called 'Kommanditist(en)'\(^6\), is limited to the partnership capital brought in by him or them.

As in the normal GmbH it is possible, for example, to appoint non-members to become managing directors.

The form of GmbH & Co. KG is very attractive for individuals because of the possibility to reach a large degree of continuity with regard to the KG. In the KG as a 'Personengesellschaft', normally the death of a member leads to the dissolution of the KG.\(^7\)

With regard to publicity of the GmbH & Co. KG, through the mentioned 'Kapitalgesellschaften-& Co Richtlinie-Gesetz' the GmbH & Co KG's lost their exemption from the auditing and disclosure requirements.\(^8\)

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\(^5\) General partner. A 'Komplementär' is a partner of a KG or KGaA with full personal liability for the liabilities of the partnership. With regard to a foreign 'Kapitalgesellschaft' acting as 'Komplementär', see BayObLG, 1986, NJW 3029 dealing with a private limited company of British origin. See also Brooks, "The status of foreign juristic persons in South Africa", 1986, MB 91 et seqq.

\(^6\) Limited partner. Unless a partnership agreement provides otherwise, the partners in the OHG may each participate in the management of the partnership and its representation. In the KG this applies to the active partner(s) whereas the non-active partners are excluded from these opportunities. Even though this can be prevented by corresponding provisions in the articles.

\(^7\) In force since 9 March 2000. As mentioned, a conviction through the European Court of Justice was needed to enact the corresponding provisions into German law, cf. chapter 11.2.1, 'Changes through the Bilanzrichtliniengesetz'.

\(^8\)
Previously the provisions for 'Kapitalgesellschaften' regulated in §§ 264 - 289 HGB were not applicable but instead those found in §§ 238 - 263 HGB. However, before the recent change, §§ 264 - 289 HGB were relevant for the 'Komplementär' GmbH.

16.3 VARIOUS FORMS

The most common combination between a commercial partnership and a 'Kapitalgesellschaft' is the GmbH & Co. KG. This is a 'Kommanditgesellschaft' in which the GmbH is the only unlimited (or general) partner while the limited partners normally being also the shareholders in the GmbH. In this way the liability of all the individuals concerned is limited, while the requirement that a limited partnership must have a general partner is met.

This combination can take on various forms, for example,

- a GmbH becomes 'Komplementärin' of a KG without having any personal connections with the KG;
- a GmbH is founded by the intended 'Kommanditisten'. With the GmbH as 'Komplementärin' they then establish a KG in which they become 'Kommanditisten';
- a one-man GmbH is founded in which the only member becomes the managing director. As 'Kommanditist' he then establishes a KG with the GmbH as the 'Komplementär'. This enables one natural person to run a KG without his personal liability being unlimited.

Even though also a legal person like the GmbH acting as 'Komplementär' is liable with all its assets (this being according to § 5 (1) GmbHG 25,000 Euros as the minimum amount of its share capital), the above-mentioned options have an impact on the personal liability. Seen from the point of company law in all those instances the personal liability of the 'Komplementär' or general partner, which is a main feature of the law of partnerships, becomes farcical in the case of a

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10 Hesselmann-Tillmann (1991), 184 et seqq.
GmbH & Co. KG, with a thinly capitalized GmbH acting as the general partner.11

16.4 CONCLUSION

The form of GmbH & Co. KG is very attractive for individuals because of the possibility to reach a large degree of continuity with regard to the KG. In the KG as a ‘Personengesellschaft’, normally the death of a member leads to the dissolution of the KG. This unique legal form of a combination between a 'Kapitalgesellschaft' and a commercial partnership owes its existence to aspects of tax law and company law. The aim is to combine liability limitations of a GmbH and tax benefits of a partnership with the subsequent founding of a 'Kommanditgesellschaft'. Generally, the GmbH is used as the 'Kapitalgesellschaft', however, sometimes the AG can be found also in this function.

11 See for further reading, Sudhoff, GmbH & Co.KG (2000).
CHAPTER SEVENTEEN

17 CONCLUSION

In conclusion it can be said that within their socio-economic context both Acts are brief and uncomplicated statutes. This can be stated especially with regard to the CCA, which in an admirable and efficient way bridges the gap between the necessary legal structures of an industrial society and the abilities of a developing informal sector of the 'Rainbow Nation'.

The GmbH as well as the close corporation play an important role in their respective economies. The number of entities incorporated as GmbH and close corporation speaks for itself.

The rapid progression of the GmbH in the former East Germany is another success story for this business entity.

The acceptance of the close corporation more than fulfilled the expectations. Since its introduction on 1 January 1985 its numbers until 31 July 2005 reached approximately 1,092,428 and are expected to rise substantially in the future as well.

Both legal forms are easy to establish and administer and they are especially suited for small and medium sized businesses. In particular, in case of the GmbH, however, even large business enterprises often choose this legal form.

The two have in common not only the nearly same amount of statutory regulations, 86 in the GmbHG compared to 83 in the CCA. However, briefness and simplicity have their price in that a number of important questions are not dealt with in either Act. Therefore, it is important to bear in mind that the regulations applicable are more complex than reflected in the paragraphs and sections of the respective Acts.

Not every aspect could be dealt with fully here and due to its complexity sometimes is attended to in comprehensive writings (e.g., questions of cession, groups, tax aspects). Therefore I often gave additional references.

As shown, both Acts offer a wide variety of possibilities for arranging the legal entities according to the particular objectives of their respective members.
Thus, the GmbH and the close corporation within their respective legal context provide alternative legal options for small and medium sized business entities, giving them a simpler and less expensive legal form, thus satisfying the need for flexibility while guaranteeing liability limitations and continuity. They offer an exception to the complicated and expensive founding provisions and often compulsory regulations, which were designed for business entities with many members and the need for vast amounts of capital. Concerning the GmbH noteworthy to mention is the possibility of a one-man GmbH and the GmbH & Co. KG, a widely used combination between the GmbH and a commercial partnership.

The status of a legal person grants both entities many rights, be it to sue, acquire rights, hold property or achieve perpetual existence. In the South African context due to the discussion on the new constitution, the Constitutional Court already had to decide on the question whether juristic persons are entitled to the protection of constitutional rights. In the First Certification Judgement the Constitutional Court decided this positively.

Both entities differ significantly regarding the possible number of members and also on the question of who can become a member. While the maximum number in the GmbH is unlimited, the close corporation is restricted to ten members underlying its closeness. The possibility of becoming a member is extensive in the GmbH. Membership is open to natural and juristic persons alike. The close corporation is, generally speaking only open to natural persons. No other juristic person can become a member and neither can a trust or a trustee of a trust *inter vivos* nor a partnership.

Regarding the exclusion of juristic persons as members in the close corporation, one must concede that this indeed prevented complex inter group relationships\(^1\) and it seems reasonable to leave it this way. In connection with the restriction to ten members, however, the situation of the LLP in the UK should be monitored closely, since no such limitation exists there. The development there could give an indication of whether the limitation in the close corporation should be changed and, *e.g.*, increased to fifteen or even twenty members.

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\(^1\) Delport-Pretorius (1989), 19. See also Venter, 1984, TRW 109, 113.
In order to incorporate their business entities and to achieve the status of a juristic person for the respective entity, members must comply with certain regulations dealing with the entity’s foundation. These regulations share the aim that members must commit themselves to the business entity being established and provide it with the necessary means to start business. They also share the fact that they have to be registered with an official authority, this being the local court for the GmbH and the Registrar of close corporations for the close corporation. In both cases, after registration the public has to be informed.

Membership as such is expressed through shares in the GmbH and members' interests in the close corporation. The transfer of a share and a member’s interest is allowed. However, the regulations for transfer and restrictions vary. For the transfer of a GmbH share only notarial form is required for the transfer as well as the agreement imposing on a member an obligation to transfer his share. However, these requirements make the procedure for the transfer of a share formal. Thus, stock exchange dealings in GmbH shares are impossible. This being the only requirement by the GmbHG, one must keep in mind that through the articles of association further requirements can be agreed upon. In the close corporation the consent of the other members is necessary for a transfer of a member’s interest. Also every time there is a change in the membership of the close corporation, the names of members of a close corporation must be registered by way of an amended founding statement. Subsequently, fewer restrictions apply to the transfer of a share compared to a member’s interest.

The participation of the entities in the process of purchasing a share and a member’s interest differ. Concerning the close corporation the Act contains provisions to facilitate such transfer or disposal enabling the corporation to purchase its members' interests and to finance their purchase by others. The capital maintenance concept remains in force and thus acts of the company to purchase its own shares are very restricted and only possible when the share capital is not endangered by doing so.

In both entities the members as such are the highest decision making organ, in the GmbH acting through the shareholder's meeting. Regarding organs, compared to the close corporation, the GmbH is more formally structured and
has, as mandatory organs, the managing director and the shareholders' meeting. Such a strict distinction is not embodied in the CCA; and while the GmbH-members must appoint a managing director to represent the GmbH, the close corporation uses the partnership principle of *mutua praepositio* (mutual agency). Each member of the close corporation also has the right to participate in the management of the affairs of the corporation underlining its 'closeness'. The position of a GmbH-member as such does not include such a right.

While for the GmbH articles of association are compulsory, in the close corporation it is up to the members whether they conclude an association agreement or refrain from doing so. However, it is interesting to note that both Acts offer members wide-reaching powers to regulate the internal affairs of their entities. The flexibility offered here is another important factor for the overwhelming acceptance of the entities. Nevertheless, regarding internal relations it is noteworthy that the Acts set out certain minimum requirements from which the members may deviate through articles of association or an association agreement only, provided that these minimum requirements are not compulsory.

In the context of financial rights a prominent aspect in this regard is the right to claim the net profits and the amounts (if any) due in the case of a liquidation. The Acts provide for the protection of the financial well-being of the entities. The GmbHG requiring that assets of the company needed for the maintenance of the share capital may not be distributed to the members while the CCA allows only payments which do not endanger the solvency and liquidity of the corporation.

The different ways to protect the financial well-being of the entities accordingly play a role when, for example, the GmbH as 'Kapitalgesellschaft' requires strict compliance with specific obligations from its members regarding their share capital contribution, while for the close corporation various aspects of liability and external relations are equally important. Regarding the innovative liability solution found in the CCA, one must concur with the statement that "this is one of the most outstanding characteristics of the close corporation"\(^2\) and it can only

be underlined that it "provides law reformers with an enforcement model," and, as submitted, not only within the South African context.

Concerning transparency of financial matters the approach is a different one. The close corporation requires the position of an accounting officer, and through this achieves some kind of control with regard to the financial matters, which are otherwise an internal affair of the corporation. The GmbH is 'forced' to make its financial matters more transparent. Subject to specific conditions, i.e., companies are required to have their financial results audited and approved by a certified public accountant. Regarding the GmbH one has to keep in mind that the number of members is not restricted through the Act. Accordingly one aim of the annual financial statements in the GmbH is to present substantiated information to the members who may be not so close to the actual day-to-day business. Through the annual financial statements they can obtain the relevant information they need, e.g., in connection with their decisions regarding the distribution of profits. Another aim is the protection of creditors. Given the capital of maintenance approach through the annual financial statements they can obtain the necessary information regarding the capital fund of the company.

The CCA makes no provision concerning publicity of the corporation's financial statements. Given the fact that the report of the accounting officer is not an audit and that the creators of the close corporation intended a closely held membership, the distribution of the financial statements is generally limited to the members. Information must only be disclosed in case of crucial aspects of the corporation's financial well-being. In such a case the accounting officer must inform the Registrar. In addition, the financial statements do not have the importance as in the GmbH for members not involved in the daily business of the corporation or for creditors, because their interests are safeguarded by the provisions in the CCA pertaining to the personal liability of members.

There are different ways through which an entity may be terminated. Invalidity, dissolution, liquidation, insolvency proceedings and composition are each the

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3 de Koker, 1999, JJS 17.
result of certain developments. Specific provisions deal with these developments. Given the new constitutional dimension in South Africa, however, it is noteworthy that the provisions in the Companies Act that deal with the examination of directors and other persons during the process of winding up of a company or a closed corporation, have already been challenged against constitutional principles in court.

Provision is also made in case the organizational form of the entities changes. Regarding the GmbH the 'Umwandlungsgesetz' of 1995 (and associated tax legislation) enables business enterprises to change their legal status with relative ease and with minimal adverse fiscal consequences. These conversion arrangements are important because of the large number of partnership options currently available under German law. Unlike for the GmbH there are no statutory rules governing mergers of close corporations. Concerning conversion, both the CCA and the CA make provision for converting a close corporation into a company and vice versa. Even though the close corporation limits the number of members to ten, a great number of companies have been converted into close corporations. Regarding the complex aspects of a group of close corporations, the CCA relies on an analogous application of company law features where possible. Due to restrictions regarding membership it is not possible for other juristic persons such as a public company to take over a close corporation. Consequently it is not possible for companies to have close corporation subsidiaries. For the close corporation, however, there are no such restrictions and accordingly, a close corporation can become a shareholder of a company and even control it. However, to also impose controls on such a holding corporation, section 55 CCA aims to cover this aspect providing for the application of certain provisions of the Companies Act.

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the close corporation concerning the sale of a members’ interest compared to 
that of a share in a private company. No stamp duties are payable for such a 
change in the close corporation.

Given the demanding political and economical situation in South Africa, since its 
introduction the close corporation has been a more than remarkable answer. On 
the one hand this allows the strengthening of a market economy⁴ while on the 
other its introduction achieved, as previously cited that "the legal system looked 
beyond the class interests of the business elite, doing justice to all classes, 
applying the moral imperative."⁵

With the political changes happening in South Africa it is necessary and an 
ongoing, time consuming process that the parties involved try to set up a certain 
framework in which, inter alia, the structure and organization of a federal state, 
the relationship between the central government and the new nine provinces or 
questions of land are all regulated. It is understandable that the debate about 
the constitution which, inter alia, makes provision regarding economic activity, 
labour relations and property rights also required time.

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⁴ Or, as was expressed by Venter, "waarmee die vrye markstelsel onder die 
algemene publiek bevorder kan word" (possibly the quickest and best way 
through which the free market system can be promoted among the general 
public), 1984, TRW 109, 110.

⁵ du Toit, 1984 (November), TRW (The Editor). As background information, the 
political and legal discussions in South Africa itself during these years were quite 
progressive, unlike sometimes believed. This shows in the legal context, for 
example, the reader by Hund, Law and Justice in South Africa (1988).
In addition, the new labour law establishes facts and ends long and controversial discussions. Of significance on the economic field is also the fact that South Africa joined the Southern African Development Community (SADC) in 1994 and thus contributes to the aim of a free trade area among the 14 countries. In addition, the Free Trade Agreement between the EU and South Africa is a milestone to get an easier access to a big market.

However, before South Africa can really spread "its international wings" it is of utmost importance for the new era to show visible improvements, *inter alia*, in the standard of living for the greater part of the population. Notwithstanding possible problems between the 1994 initiated Reconstruction and Development Program (RDP) and the macroeconomic strategy of Growth, Employment and Redistribution (GEAR) introduced in 1996, the former must step up its progress to stop the growing frustration and disillusionment and put a halt to the increasing crime wave. In addition, the opportunities given through the Nedlac Act, 1994 (National Economic Development and Labour Council) and the National

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6  Cf. Mayer, "Das neue südafrikanische Arbeitsgesetz", 1996, *RIW* 924, stating that this is one of the most progressive in the world where collective labour relations are concerned, on p. 928. See regarding affirmative action, Gabbert, "Die Umsetzung von 'affirmative action' in Südafrika: Employment Equity Act", 1999, *RIW* 279 et seqq., giving an overview and describing potential problems.

7  Beginning 1 January 2000. As the quality remains high, I am sure consumers, including me, will become used also to other names of South African products no longer carrying the words "Porto" or "Sherry". As this, *i.a.*, was a problem in the negotiations for Spain and Portugal, see *Neue Züricher Zeitung*, 12 October 1999. See for the imbalance regarding the necessary bureaucratic backup in negotiations like these, Sibanda, "Integrating Africa into the World Trade Organisation: constraints and challenges facing the African Union and the New Partnership for Africa’s Development (NEPAD)", 2004, *Codicillus* 47, 58.


9  Department of Finance, Republic of South Africa, 1996. Macroeconomic policies in terms of an integrated strategy referred to as GEAR.
Small Business Act, 1996 must be utilized to their fullest extent to combat the progress-hindering unemployment.\(^\text{10}\)

One aim of the institutions created especially through the latter Act should also be to focus on barriers which still existing between the informal sector and the formal sector to ease the transition.

Political and social progress will not occur without economic stability. Therefore the population must experience the new system as something which is achievable. In this regard the legal entity called close corporation has the chance to introduce and subsequently integrate a developing middle-class of entrepreneurs into stable structures and thereby create and strengthen South Africa’s social framework. Only then will substantially more of the necessary direct foreign investment needed find its way to South Africa, achieving a genuine economic revival, producing jobs and thus enabling a free market economy with strong social commitments.\(^\text{11}\)

In furthering these objectives the close corporation has the opportunity to function as an example for similar countries looking for such a business entity to promote their economic development. Especially in the African context the close corporation could be an answer to some of Africa's problems in achieving genuine economic revival and support the 'African Renaissance'.

Given South Africa’s role as the economic powerhouse not only of the subcontinent it would be a strategically very sound decision to open the research ambit of the Standing Advisory Committee on Company Law (SAC) and focus it also on "the Southern African region with regard to rationalising corporate law and so facilitating trade between the members of the SADC."\(^\text{12}\)

\(^\text{10}\) Regarding policy challenges in this context, see International Labour Office, A Global Agenda for Employment (2001), 29 et seqq.

\(^\text{11}\) Cf. Martinek, 1991, RIW 116 et seqq., at that time seeing risks but also great chances. See also Lunk/Steyn, 1997, RIW 826, describing, i.a., also possible business forms for investing in South Africa.

\(^\text{12}\) The previously mentioned press release (1997) of the SAC issued through the Department of Trade and Industry, see Close Corporations Service, Part 7, no. 6. at 6. The press release states that this was a topic being discussed with the Minister of Trade and Industry. As the experience with the Societas Europaea
As neighbouring countries, Namibia and Zimbabwe, already have experience with their own form of close corporations this should be an adequate departure point for further discussions on a multi-national level.

In the African context it is noteworthy to mention that the principal objectives of the new African Union\textsuperscript{13} are, \textit{inter alia}, accelerating the political and socio-economic integration of the continent; establishing conditions necessary to enable the continent to become a recognised player in the global economy; coordinating and harmonising the policies between existing and future Regional Economic Communities.\textsuperscript{14} However, the economic governance aspect of the African Union falls under the framework established under the African Economic Community and New Partnership for Africa’s Development.\textsuperscript{15} The African Economic Community seeks to forge a greater economic development and integration amongst African states. The New Partnership for Africa’s Development, being the implementation plan of the New African Initiative,\textsuperscript{16} is "Africa’s long-term grand multicomponent plan, intended to provide a holistic and comprehensive review and strategic framework for contemporary Africa’s socio-economic development."\textsuperscript{17} NEPAD is based on fundamental principles of African shows (discussions lasted for more than three decades), it is never too early to start aiming at improvements involving different legislatures.

\textsuperscript{13} The Organisation of African Unity (OAU) was conversed into the African Union. The African Union Act was adopted by the OAU on 11 July 2000 and was launched at the inaugural meeting in Durban on 10 July 2002, marking the formal dissolution of the OAU. See Sibanda, 2004, \textit{Codicillus} 47, 51. For further information on NEPAD, see \url{http://www.dfa.gov.za/au.nepad/index.html}.


\textsuperscript{16} Adopted by the OAU Summit in Lusaka on 11 July 2001 and integrating the Millennium Partnership for the African Recovery Programme (MAP) with the OMEA Plan (OMEGA is an anonymous name not an abbreviation). Note that on this summit final steps were taken to transform the OAU into the new organizational entity, the African Union. Regarding Germany’s commitment to support the Millennium Plan, see \textit{Die Welt}, 29 June 2001 (reporting on President Mbeki’s visit to Germany).

\textsuperscript{17} Sibanda, 2004, \textit{Codicillus} 47, 52.
ownership, African leadership, self reliance, and mutual respect and cooperation.18

Given the apparent success of the close corporation in Southern Africa, regarding the African context it can be therefore submitted that this legal form, a *Societas Africaea*, utilized for smaller entrepreneurs, can play a role in trying to achieve these noble goals.

Also here the departure point is supportive, given the fact that a large number of countries have been influenced by English Law. In addition, also in these countries ways have to be found to deal, *inter alia*, with integrating the informal sector into the economy. Thus there is a realistic chance that the arguments and reasons which led to the enactment of the close corporation in South Africa should be followed quite readily.

However, for the reform countries of Middle and Eastern Europe the close corporation could also be an interesting option in providing an alternative business form for their developing economies.

Therefore it is of utmost importance that the ongoing reform process initiated through the SA DTI and its policy paper keep in mind that the creation of wealth in South Africa is achieved by companies in which the close corporation plays an important part and that necessary reforms must be pursued with precaution in order not to hamper this creation of wealth.

Regarding a possible one-Act approach for South African company law, Faber's prediction should be kept in mind, that "the first decade of the 21st century will see extensive reforms of business association law. (...) The new laws will provide a range of options and so recognise the diversity among businesses and their owners."19 Therefore a differentiation between various types of enterprises should not easily be put aside.20 However, when looking at the wide spectrum of how business is conducted in South Africa, one should assume that reality indeed is better off with a spectrum of various provisions than with a uniform company law forcing this wide enterprise variety under one umbrella.

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19 Faber, Foreword in Rider/Andenas (eds.) (1999), p. V.
With regard to the GmbH and close corporation, notwithstanding the changes and modifications already made and yet to come, both entities have been proven themselves as useful, flexible and popular forms of business enterprises. Therefore, it is only a consequence that the most essential parts of both Acts thus remain unchanged.

Being such popular legal forms both entities are and will remain a rewarding field of study. In the future it will be interesting to see, e.g., how the GmbH takes on the challenge in connection with the introduced new legal forms within Germany and the competition with similar foreign business forms now allowed to enter the German market as consequence of the ECJ’s recent judgements in Centros, Überseering and Inspire Art and how the close corporation develops within the context of a company law being newly shaped. Even though it goes without saying that intra-South African aspects play the dominant role, it is also of great relevance for the South African reform process to follow the developments in Britain. Here the aim is clear, the Steering Group proclaimed as its objective that as a result of the review British law should rank with the best in the world. This aim also influences the ongoing reform process of partnership law in the United Kingdom. However, the close corporation has been commented on positively not only within South Africa, but also internationally, i.a., seeing the CCA as an impressive statute and a model worth very serious consideration. The recent discussion in the USA on the close corporation

21 Regarding proposed reforms different information circulated. According to reports in the media at the beginning of the year 2005, the Federal Ministry of Justice planned to introduce a "One-Euro-GmbH", Frankfurter Allgemeine Zeitung (FAZ) 9 February 2005, Handelsblatt 9 February 2005. See also Grunewald/Noack, "Zur Zukunft des Kapitalsystems der GmbH – Die Ein-Euro-GmbH in Deutschland", 2005 GmbHR 189 et seqq. However, that this discussion was in a state of flux showed the information in the media that the creation of a "One-Euro-GmbH" is not an aim any more but rather plans of the Federal Ministry of Justice to reduce the minimum capital and to tighten the liability for managing directors of financially shaken GmbHs, Handelsblatt, 6 April 2005. Indeed, as mentioned, the Federal Government proposed a bill on 1 June 2005 aiming to reduce the minimum capital from 25,000 Euros to 10,000 Euros. In a second step, at a later stage, the liability for managing directors of financially shaken GmbHs will be tightened. See http://www.bmj.bund.de/media/archive/950.pdf.
approach and the corporations legal structure, which found strong praise, is remarkable. In the South African context it remains to be seen how the developments in the UK will find their place in the reform process of South African company law as envisaged in the SA DTI policy paper and how, *i.a.*, the Coordinating Research Institute for Corporate Law (CRIC) will include them in its own research.

Regarding the legal forms of the GmbH and the close corporation it would also be an interesting additional comparison to study some aspects of the North American close corporation, given the appreciation the South African close corporation received.

In conclusion, given their remarkable achievements in the past, for the future one cannot be nothing but optimistic and is tempted to give an *ex cathedra* judgement that both will remain the dominant incorporated business form in their respective economies. Regarding the close corporation, however, one can only trust that proposed reforms do not unnecessarily challenge this business form too much, because especially in the African context, it has the potential to become South Africa’s most successful export product in the field of law.
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Summary

The GmbH and the close corporation within their respective legal contexts provide alternative legal options for small and medium sized business entities, giving them a simpler and less expensive legal form, thus satisfying the need for flexibility while guaranteeing liability limitations and continuity. While the maximum number of members in the GmbH is unlimited, the close corporation is restricted to ten members. Membership in the GmbH is open to natural and juristic persons alike. The close corporation is, generally speaking, only open to natural persons. Membership as such is expressed through shares in the GmbH and members’ interests in the close corporation. The transfer of a share and a member’s interest is allowed. The regulations for transfer and restrictions vary.

In both entities the members as such are the highest decision making organ. Regarding organs, the GmbH is more formally structured and has, as mandatory organs, the managing director and the shareholders’ meeting. Such a strict distinction is not embodied in the CCA; and while the GmbH-members must appoint a managing director to represent the GmbH, the close corporation uses the partnership principle of *mutua praepositio*. Each member of the close corporation has the right to participate in the management of the affairs of the corporation.

While for the GmbH articles of association are compulsory, in the close corporation it is up to the members whether they conclude an association agreement or refrain from doing so.

The applicable legislative measures provide differently for the protection of the financial well-being of the entities. The GmbH as 'Kapitalgesellschaft' requires strict compliance with specific obligations imposed by its members regarding their share capital contribution, while for the close corporation various aspects of liability and external relations are equally important. The innovative liability solution found in the CCA is remarkable.

Concerning transparency of financial matters the close corporation requires the position of an accounting officer, and through this achieves some kind of control with regard to the financial matters, which are otherwise an internal affair of the corporation.
The GmbH is 'forced' to make its financial matters more transparent. Subject to specific conditions, companies are required to have their financial results audited and approved by a certified public accountant.

In the African context it is noteworthy that the principal objectives of the African Union aim at accelerating political and socio-economic integration. Given the success of the close corporation this legal form, a *Societas Africaea*, utilized for smaller entrepreneurs, can play a role in achieving these goals.

The reform process initiated through the SA DTI must take into account that the creation of wealth in South Africa is achieved by companies in which the close corporation plays an important part. Necessary reforms must therefore be pursued with precaution.

A possible one-Act approach for South African company law is to be viewed critically as the differentiation between various types of enterprises should not easily be put aside.

It will be interesting to see how the GmbH takes on the challenge of the new legal forms within Germany and the competition with similar foreign business forms now entering the German market as a consequence of the ECJ’s recent judgements and how the close corporation will develop within the context of a company law in the process of reform. It is also of relevance for the South African reform process to follow the developments in Britain. The close corporation has been commented on positively not only within South Africa. The recent discussion in the USA on the close corporation approach and its legal structure is of relevance here.
Opsomming

Die GmbH en die beslote korporasie binne hul onderskeie wetlike raamwerke voorsien alternatiewe opsies vir klein- en medium-grootte besigheidsentiteite en verskaf 'n eenvoudiger en goedkoper besigheidsinstelling. Sodoende word die behoefte vir buigsaamheid bevredig terwyl beperkte aanspreeklikheid en kontinuïteit steeds gewaarborg word.

Terwyl die maksimum aantal lede in die GmbH onbeperk is, word die beslote korporasie beperk tot tien lede. Lidmaatskap in die GmbH is oop vir natuurlike en regspersone. Die beslote korporasie is, in die algemeen, slegs oop vir natuurlike persone.

Lidmaatskap as sodanig word verwesenlik deur aandeelhouding in die GmbH en deur ledebelang in die beslote korporasie. Die oordra van 'n aandeel en 'n ledebelang is toelaatbaar. Die reëls vir oordrag en die beperkings daarop verskil egter.

In beide entiteite is die lede as sodanig die hoogste besluitnemende orgaan. Wat organe betref is die GmbH meer formeel gestruktueer en het, as verpligende organe, die besturende direkteur en die aandeelhouersvergadering. So 'n streng onderskeid is nie beliggaam in die CCA nie, terwyl die GmbH-lede 'n besturende direkteur moet aanstel om die GmbH te verteenwoordig. Daarenteen gebruik die beslote korporasie die vennootskapsbeginsel van *mutua praeposito*. Elke lid van die beslote korporasie het die reg om deel te neem aan die bestuur van die korporasie se sake.

Terwyl vir die GmbH die artikels van assosiasie verpligend is, hang dit in die geval van die beslote korporasie daarvan af of die lede 'n samewerkingsooreenkoms aanvaar het, of nie.

Toepaslike wette maak verskillend voorsiening vir die beskerming van die finansiële welstand van die onderskeie entiteite. Die GmbH as 'Kapitalgesellschaft' vereis streng nakoming van spesifieke verpligtinge wat verband hou met lede se aandelekapitaalhydrae, terwyl vir die beslote korporasie verskeie aspekte van aanspreeklikheid en eksterne verhoudings ewe
belangrik is. Die nuwe aanspreeklikheidsooplossing in die CCA is noemenswaardig.

Insake deursigtigheid van finansiële aangeleenthede vereis die beslote korporasie die amp van 'n rekeningkunde beampte wat beheer oor sulke aangeleenthede, wat andersins 'n interne aangeleenthed van die korporasie is, moet uitoefen. Die GmbH word gedwing om finansiële aangeleenthede meer deursigig te maak. Onderworpe aan spesifieke voorwaardes word van ondernemings vereis om hulle finansiële uitslae te laat oudit en deur 'n gesertifiseerde rekenmeester te laat goedkeur.

In die Afrika konteks is dit opmerklik dat die hoofoogmerke van die Afrika Unie gerig is op toenemende politieke en sosio-economies integrasie. Gegewe die sukses van die beslote korporasie kan hierdie besigheidsvorm, as 'n Societas Africana, aangewend word vir kleiner entreprenieurs om die vermelde oogmerke te bereik.

Die hervormingsproses wat ingelei is deur die SA DTI moet in aanmerking neem dat die skepping van rykdom in Suid-Afrika bereik word deur ondernemings waarvan die beslote korporasie 'n belangrike deel uitmaak. Hervorming moet dus met die nodige omsigtigheid aangepak word. 'n Moontlike een-wet benadering vir die Suid-Afrikaanse maatskappyereg moet krities beskou word met inagmensing van die differensiasie tussen verskillende tipes van ondernemings wat nie te ligtelik geignoreer kan word nie.

Dit sal interessant wees om te sien hoe die GmbH op die nuwe besigheidsinstellings in Duitsland reageer en op die kompetisie met soortgelyke vreemde besigheidsvorms wat die Duitse mark betree as gevolg van die ECJ se onlangse beslissings en hoe die beslote korporasie gaan ontwikkel binne die konteks van 'n maatskappyewet wat besig is om nuwe vorm aan te neem. Dit is ook van toepassing vir die Suid-Afrikaanse hervormingsproses om ontwikkelings in Brittanie te volg. Die beslote korporasie is ook buite Suid-Afrika positief ontvang. Die onlangse debat in die VSA oor die beslote korporasiebenadering en die juridiese struktuur daarvan, is hier van belang.
Key terms

Comparison - GmbH - close corporation - success - societas africaea - company law reform - critical - one-act approach