



**University of
Zurich** ^{UZH}

Institute of Law

Corporate Personality

Gesellschaftsrecht (Master) – Lecture 3

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- L1 Introduction, Theory of the Firm, Common Principles of Corporate Law across Jurisdictions, Role of Shareholders (KA)**
- L2 Management & Agency problems, Role of Board of Directors (KA)**
- L3 Corporate Personality, Formation, Separate Legal Entity Principle, Limited Liability (KA)**
- L4 Investor Protection, Shareholder Control Issues, and Minority Shareholders Rights (DR)**
- L5 EU Free Movement (KA)**
- L6 Insider Dealing, Market Abuse and Fraud (KA)**
- L7 Data Law (DR)**
- L8 Corporate Finance, Capital Raising and Maintenance – The Prospectus and related requirements (KA)**
- L9 Compensation and Bonuses (DR)**
- L10 Corporate Governance, Stakeholders and Corporate Social Responsibility (KA)**
- L11 Takeovers and Mergers (KA)**
- L12 Role of Gatekeepers – Accountants, Auditors and Rating Agencies - a 'True and Fair View' (KA)**
- L13 Multinational corporate groups, Ethics, and Corruption (DR)**
- L14 Selected Topics and Exam Review (KA)**



Addendum to L2: New board duties due to Covid-19?

- Capital distribution restricted during Covid-19
 - Supervisory restrictions/expectation not to distribute capital.
 - Market pressure not to distribute capital.
- Rationale for restriction according to ALIBRANDI/FRIGENI:
 - Traditional approach: use company resources prudently in times of crisis to maintain ability to cope with possible repercussions.
 - Innovative approach: No shareholder primacy but stakeholder interests must be taken into account.
- ECB's Recommendation to restrict capital distribution refers explicitly to role banks/insurers play inside the society in general.
- Move towards *stakeholderism* and new understanding of corporate purpose.



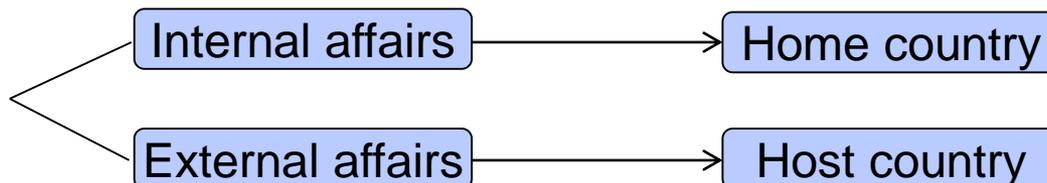
Main Points

- Review: Separation of ownership and control, agency problems
- Formation
- Limited liability
- Separate legal entity
- Salomon principle
- Piercing the corporate veil
- Corporate groups
- Memorandum of association
- Articles of association
- Choice of law
- Societas Europaea



Choice of Law

- What jurisdiction's law is to be applied in the context of cross-border companies
- Corporate existence
 - Whether a corporation exists or not is a question to be resolved by the law of the jurisdiction where the company was incorporated.
- Internal affairs doctrine
 - The law of incorporation governs the internal operations of the company, including any decisions of its directors, officers and shareholders taken in the name of the company.





Formation

- Incorporation by registration in the official register
 - UK:
 - Copy of the required documents (including memorandum of association and articles of association) – Application for registration
 - Companies Act 2006 s. 15(1): issue of the certificate of incorporation by the Registrar
 - Switzerland, Germany, France, Italy:
 - Copy of the required documents (including deed of incorporation and articles of association) – Application for registration
 - Registration in the Commercial Register
- Unincorporated companies
 - unincorporated joint-stock companies, civil partnerships, associations



Limited Liability

- Partnerships usually have unlimited liability, whilst companies usually have limited liability
- Limited liability: Members can only be called upon to pay the full price of their shares
- Limited liability for corporate obligations limited to corporate property
- Limited liability enabling & incentive to invest. Facilitating efficient management of business (ie., 1855 UK Limited Liability Act)

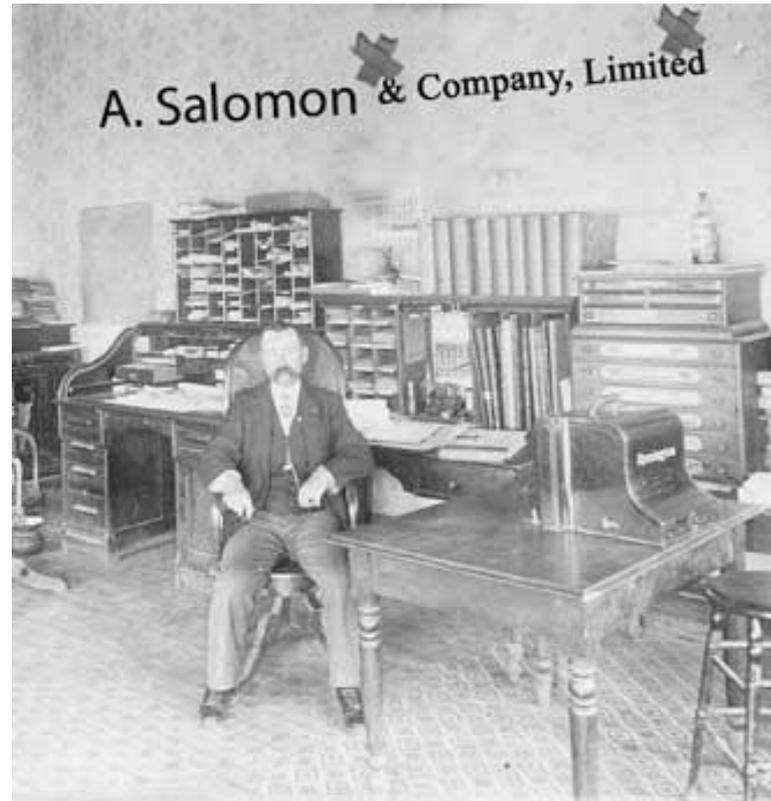


Separate Legal Entity

- Legal personality acquired on registration
- Legal personality distinct from the people who compose it
- Separate entity with perpetual existence
- Capacity of:
 - Entering into contracts and owning its own property
 - The question of pre-incorporation contracts
 - UK: founders are liable but company is not liable
 - CH: founders are jointly and severally liable and company may assume liability of the founders within three months of incorporation (Art. 645 I & II CO)
 - Germany: “Vorgesellschaft” = pre-incorporation company
 - Delegating authority to agents
 - Suing and being sued in its own name



Salomon Principle (1)





Salomon Principle (2)

- “The company is at law a different person altogether from [its founders] and, though it may be that after incorporation the business is precisely the same as it was before, [...] the company is not in law the agent of the subscribers or trustee for them. [...] If the view of the learned judge were sound, it would follow that no common law partnership could register as a company limited by shares without remaining subject to unlimited liability.” (*Salomon v. Salomon Co. Ltd* [1897])



Piercing the Corporate Veil

- Exception to the separate legal entity principle
- Preventing those with fraudulent tendencies from hiding behind the corporate veil
- Disregarding the existence of the company
- Case law
 - *Macaura v. Northern Assurance Co.* [1925] – House of Lords refused to lift the veil
 - *Jones v. Lipman* [1962] – Court lifted the veil because company was a sham
 - *Trustor AB v. Smallbone* [2001] – Court lifted the veil because company was a façade used to misappropriate Trustee's funds



Corporate Groups (1)

- Common law countries
 - UK: Statutory rules or court principles
 - *Adams v. Cape Industries* [1990] = strict application of the Salomon principle even though the group had been restructured so as to avoid liability
- Civil law countries
 - Germany: “*Konzernrecht*” = law of groups
- EU law does not regulate veil piercing in context of corp groups
 - Draft EC Ninth Company Law Directive on the conduct of groups was withdrawn



Corporate Groups (3/1)

- Switzerland
 - Principle: Parent company and subsidiary are separate legal entities – creditors of the subsidiary cannot get the parent company's assets
 - Exception: Possible to pierce the corporate veil if the parent company misuses the group structure in order to escape from liability – creditors can get the parent company's assets when the subsidiary is insolvent



Corporate Groups (3/2)

Liability for the Corporate Parent under Swiss law

- Principally the parent company as a mere share holder of the subsidiary has no duties going beyond the obligation to pay in full for its shares and is not liable for the debts of its subsidiary (Art. 620 II and Art. 680 I OR).
- However the parent company might be liable if she is found to be a «de facto corporate organ» of the subsidiary. The same applies for her employees or members of her corporate bodies who are «de facto» corporate organs of the subsidiary (UBS Case BGer 4A_306/2009 from 8. February 2010).
- «De facto» corporate organs are «legal or natural persons who do in fact make decision reserved for management or occupy themselves with actual administration and thus determine the company's aims and direction in a decisive way» (BGE 107 II 349; 114 V 213).



Liability for administration, business management and liquidation in Swiss Law

Art. 754 OR

A. Liability

III. Liability for administration, business management and liquidation

- ¹ The members of the board of directors and all persons engaged in the business management or liquidation of the company are liable both to the company and to the individual shareholders and creditors for any losses or damage arising from any intentional or negligent breach of their duties.

General Prerequisites of a Liability Claim (CH)

- Damage
- Unlawfulness
 - Breach of contract, or;
 - Breach of legally imposed duty
- Causality
- Fault → (Willfully or negligently)



Corporate Groups (3/3)

Liability for the Corporate Parent under Swiss law

- Liability for a Swiss corporate parent that has acted as a de facto corporate organ in case of violation of a duty (Art. 754 OR)
- Liabilities arising from other legal grounds:
 - Liability arising from trust in the group
(*Swissair Decision*, BGE 120 II 331)
 - Liability arising from Swiss tort law in the event that a corporate organ of the parent company harms a subsidiary through an unlawful act in terms of Art. 41 et seq. OR
 - Liability arising from the impossibility to tell apart the parent company and the subsidiary
(eg. the entities have similar names of their firms, same headquarters, same buildings, same persons with authorisation powers, same telephone lines etc., see the Givaudan-Case, BGE 137 III 550)



Constitutional Documents

- UK:
 - Memorandum of association
 - Articles of association
- Switzerland, Germany, France, Italy:
 - Deed of incorporation
 - Articles or statutes



The Memorandum of Association (UK) (1)

- The function of the memorandum of association
 - External aspects of the constitution
 - Personality fundamentals
- Mandatory statements by subscribers (Companies Act 2006 s. 8)
 - Wish to form a company under this Act
 - Agree to become members of the company
- Registration documents (Companies Act 2006 s. 9)
 - The company's name
 - Location of the registered office in England and Wales or Scotland
 - Whether the liability of the members is limited (by shares or by guarantee)
 - Whether the company is to be a private or a public company (Ltd or Plc).
 - Authorized share capital and the nominal value of the shares
 - Proposed officers



The Memorandum of Association (UK) (2)

- Principle: The company will have unlimited objects unless it is specifically stated that its objects remain restricted (company purpose?)
- Amendment of the objects clause comes into effect only from the moment of the registration by the Registrar of Companies
 - Constructive notice
- *Ultra vires* doctrine
 - When a company acted beyond its purpose or powers
 - Imperfectly abolished by the Companies Act 2006
 - Left open to:
 - A shareholder who discovers in advance that an *ultra vires* action is planned and seeks an injunction
 - A member who alleges that there is a breach of duty by a director because he is acting *ultra vires*



The Articles of Association (UK) (1)

- Function
 - Internal organisation
 - Division of power between the shareholders and the board
- Typical content (flexible content)
 - Procedures for convening and conducting shareholder and board meetings
 - Rules for appointing and removing directors
 - The regulation of share transfers
 - The payment of dividends
- Table A default articles
 - The Companies (Model articles) Regulations 2008
 - Gap filler



The Articles of Association (UK) (2)

- Contractual nature
 - Chief instrument for regulating the relationship between a shareholder and the company and the balance of power among shareholders
- Outsiders
 - Non-shareholders cannot be affected by the contract in the articles
 - Strangely, however, the rights of such outsiders are often set out in the articles
 - *Eley v. Positive Government Security Life Association* [1876]: The clause stating that the plaintiff should be solicitor to the company did not create any contract between the plaintiff and the company



The Articles of Association (UK) (3)

- Alteration
 - **S. 21 Companies Act 2006**: General rule = amendment by special resolution (75 per cent majority)
 - **S. 22 Companies Act 2006**: Entrenched provisions = in the company's articles on formation or by an amendment agreed to by all members
 - *Bona fide* for the benefit of the company as a whole
 - *Brown v. British Abrasive Wheel* [1919]: 98 per cent majority willing to provide capital if they were given power to buy up the 2 per cent minority; no direct link between the provision of the extra capital and the proposed alteration of the articles
 - Remedies
 - Injunction: e.g. where the alteration does not pass the *bona fide* test
 - Damages: e.g. if causes a contract with an outsider to be broken
 - Rectification cannot be ordered by the court



The Articles of Association (CH) (1)

- Articles or statutes
- Single governing document
- Mandatory content (Art. 626 Swiss Code of Obligations)
 - Name
 - Registered office
 - Objects
 - Share capital and amount of the contributions made
 - Number, nominal value and type of the shares
 - Convening the general meeting
 - Voting rights of shareholders
 - Board of directors and auditors
 - Form of communications issued by the company



The Articles of Association (CH) (2)

- Alteration
 - Art. 703 CO: Principle = amendment by absolute majority
 - Art. 704 I CO: Important amendments = mandatory double hurdle (resolution with the consent of at least two thirds of the represented votes and an absolute majority of the represented capital)
 - Art. 704 II CO: Higher quorums may be required = resolution with the consent of this same envisaged higher quorums and included in the articles of association



De facto corporations

- De facto corporations
 - applies in all situations of tort and contract
 - but third party can sue and/or challenge company's capacity to act
 - 'close-enough' to forming a de jure corporation to allow proprietors to escape personal liability
- 3 requirements:
 1. Statute under which incorporation would be permitted
 2. "an exercise of corporate powers"
 3. Proprietors made a 'good faith' effort to establish the corp (unaware and came close)

Courts impose liability on proprietors who actively manage the business



Estoppel - hypothetical

- Estoppel doctrine can apply as follows:
- ‘P has 2 co-agents, A & B. P has notice that B, acting without actual or apparent authority, has represented to T that A has authority to enter into a transaction that is contrary to P’s instructions.

T does not know that P’s instructions forbid A from engaging in the transaction. T cannot establish conduct by P on the basis of which T could reasonably believe that A has the requisite authority. T can, however, establish that P had notice of B’s representation and that it would have been easy for P to inform T of the limits on A’s authority. T detrimentally changes position in reliance on B’s representation by making a substantial down payment to A on behalf of P. If it is found that T’s action was justifiable, P is estopped to deny B’s authority to make the representation.

- Third party must establish detrimental change in position.



Partnership and estoppel

- A partnership is only formed if the legal definition of a 'partnership' is met
- Partnership can be formed by third party estoppel – representing that a person is a partner to a third party, and by inducing reliance by the third party on the representation of partnership.
- *“if a person, by words or conduct, purports to be a partner, or consents to being represented by another as a partner, in a partnership or with one or more persons not partners, the purported partner is liable to a person to whom the representation is made, if that person, relying on the representation, enters into a transaction with the actual or purported partnership”*



Societas Europaea (SE)

- Agreement reached in 2001 with a Council Regulation providing for the European Company Statute
- Formation in one of 4 ways:
 - Merger of 2 or more existing public limited companies from at least 2 different EU Member States
 - Formation of a holding company promoted by public or private limited companies from at least 2 different Member States
 - Formation of a subsidiary of companies from at least 2 different Member States
 - Transformation of a public limited company which has, for at least 2 years, had a subsidiary in another Member State
- Minimum share capital of €120'000
- Registered office in the Member State where it has its head office
- Applicable law: in the Regulation and Directive / where no provision is made: law of the registered office