


Shareholder withdrawal in close corporations: an Anglo-German comparative analysis

Alan K. Koh 

Division of Business Law, Nanyang Business School, Nanyang Technological University, Singapore, Singapore

ABSTRACT

Small and medium enterprises (SMEs) are important to most economies, but the laws of close corporation entities used by SMEs are underrepresented in comparative corporate law scholarship. This Article critically analyses 'withdrawal' regimes in Germany's GmbH (*Austritt aus wichtigem Grund*) and the UK's private company limited by shares (unfair prejudice remedy) that respond to shareholder conflicts in close corporations. Comparative analysis reveals how the two jurisdictions differ in treatment of 'non-fault' scenarios and their underlying visions of shareholder protection. Potential reform of the UK's withdrawal regime based on German and Singapore law is also explored.

ARTICLE HISTORY Received 21 March 2021; Accepted 27 November 2021

KEYWORDS Comparative corporate law; shareholder remedies; unfair prejudice; close corporations; small and medium enterprises

I. Introduction

Small and medium enterprises (SMEs) are the vehicle for entrepreneurship and a crucial engine of innovation and economic growth. They have a substantial presence in virtually every developed economy's¹ private sector, including leading economies like the United Kingdom ('UK')² and Germany.³ The legal form taken by SME firms is often that of unlisted,

CONTACT Alan K. Koh  alan.koh@ntu.edu.sg  50 Nanyang Avenue, S639798, Republic of Singapore. www.alankkoh.com

¹See eg Organisation for Economic Co-operation and Development (OECD), *SMEs, Entrepreneurship and Innovation* (Paris, OECD 2010) 5; Asian Development Bank, *Asia SME Finance Monitor 2014* (Mandaluyong, Philippines, Asian Development Bank 2015) 7.

²European Commission, '2019 SBA Fact Sheet: United Kingdom' (2019), archived 1 February 2021 at <<https://perma.cc/GQP3-VYDT>>.

³Federal Ministry for Economic Affairs and Energy (Germany), 'The German Mittelstand as a model for success' (*BMW i – Federal Ministry for Economic Affairs and Energy*, 2021) archived 7 March 2021 at <<https://perma.cc/BBW4-QXYX>>.

closely-held business entities offering separate legal personality and limited liability.⁴ These entities – or, in comparative corporate law parlance, ‘close corporations’ – vastly outnumber widely-held entities, and account for a significant share of economic output and employment in these two economies.⁵

Close corporations are characterised by a relatively small number of shareholders⁶ who face restrictions on exit, with shares that are not traded on capital markets, subject to transfer restrictions, or both.⁷ Internal conflict between majority and minority shareholders pose a ‘cardinal problem’ in close corporations.⁸ Conflict can begin as an act of majority opportunism against the minority, a good-faith disagreement over business affairs, or any other variation. This can in turn escalate into an irreconcilable fall-out and a breakdown in trust between the participants. Trust, once broken, is difficult to restore.⁹ When conflict becomes intractable and feuding parties turn to legal dispute resolution, it is at best difficult, if not impossible, for the parties to go back to business as usual; the enterprise as a going concern with its pre-conflict membership is dead. Unless the parties themselves reach and commit to a mutually acceptable settlement, a legal solution is necessary.

In leading jurisdictions, this legal solution takes the form of a remedy that enables an aggrieved shareholder to exit the close corporation by severing their ties with the close corporation and other shareholders, give up their shares and other rights as a shareholder, and receive a sum of money in exchange. Examples of these – which I call ‘withdrawal remedies’ – include the unfair prejudice (or ‘oppression’) remedy familiar to English and Anglo-Commonwealth jurists, as well as *Austritt aus wichtigem Grund* (‘withdrawal for good cause’) for *Gesellschaft mit beschränkter Haftung* (GmbH) in Germany. Their ability to permanently resolve intractable conflict between close corporation shareholders make withdrawal remedies valuable, if not essential, to modern corporate law.

Withdrawal regimes all perform shareholder protection functions by facilitating both exit and recovery of otherwise locked-in investment when amicable solutions cease to work. However, they exhibit diversity as well.

⁴Gregor Bachmann, Horst Eidenmüller, Andreas Engert, Holger Fleischer and Wolfgang Schön, *Regulating the Closed Corporation* (Berlin, De Gruyter 2014) v.

⁵Department for Business, Energy & Industrial Strategy (UK), ‘Business population estimates for the UK and regions 2020: Statistical Release’ (8 October 2020) 4 tbl A, archived 1 February 2021 at <<https://perma.cc/DV7G-FVJT>>; Institut für Mittelstandsforschung, ‘Overview – Mittelstand’ (2021), archived 1 February 2021 at <<https://perma.cc/HY9A-YZ9B>>.

⁶Equity holders of UK Ltds (‘members’ or ‘shareholders’) and German GmbHs (*Gesellschafter*) are both referred to as ‘members’. Conversely, ‘shareholder’ is used as parts of phrases such as ‘shareholder conflict’, and not as a legal term of art.

⁷Bachmann, Eidenmüller, Engert, Fleischer and Schön (n 4) 1, 6.

⁸ibid 29.

⁹See Maurice E Schweitzer, John C Hershey and Eric T Bradlow, ‘Promises and Lies: Restoring Violated Trust’ (2006) 101 *Organizational Behavior & Human Decision Processes* 1.

Through an in-depth, comparative analysis of the unfair prejudice remedy and *Austritt aus wichtigem Grund*, this Article demonstrates that withdrawal regimes can be based on two distinct rationales, each of which affects how each regime operates in practice differently. First, withdrawal may be used to achieve full protection of shareholders from targeted, value-decreasing ill-treatment by persons in control of the close corporation – as is the case for the unfair prejudice remedy. To capture the targeted and focused nature of such regimes in *correcting* wrongs suffered by the withdrawing member, I call this paradigm the ‘corrective model’. Second, withdrawal is also a mechanism by which co-ownership of business enterprise may be dissolved, with one co-owner exiting the business, for reasons other than fault attributable to any of the participants – as exemplified by *Austritt aus wichtigem Grund*. As this model figuratively *insures* shareholders against some of business life’s vicissitudes, I call it the ‘quasi-insurance’ model of withdrawal.

This Article contributes to the growing body of comparative literature on shareholder protection in close corporation law by developing the two models of withdrawal and showing how each, in emphasising different aspects, demonstrate distinct strengths and weaknesses. Juxtaposing the two models reveals opportunities and obstacles for reform. Specifically, the German withdrawal regime’s coverage of non-fault grounds exposes the limitations of the UK’s existing withdrawal regime, but also highlights the difficulties of filling the non-fault gap through reforming the UK’s unfair prejudice remedy. Drawing on insights from German law and recent reforms introduced by Singapore, an Anglo-Commonwealth jurisdiction, this Article explores how non-fault withdrawal might be introduced into UK law seamlessly.

This Article proceeds as follows. Section II introduces and defines ‘withdrawal’ and other critical concepts and terminology. In Section III, two models of withdrawal – each corresponding to either the UK’s or Germany’s withdrawal regimes – will be developed (Section III.C) based on salient points of difference identified through a functional comparative framework (Sections III.A–III.B). Section IV explores the challenges of reforming the UK’s unfair prejudice regime to incorporate non-fault withdrawal and offers a potential alternative drawn from Singapore’s recent law reform experience. A brief Conclusion follows.

II. The concept of withdrawal

In this Article, ‘withdrawal’ is used as the umbrella term for a category of shareholder remedies that includes the unfair prejudice remedy (UK) and *Austritt aus wichtigem Grund* (Germany). Section II.A defines the term ‘withdrawal’ and its subtypes, distinguishes them from related concepts, and highlights withdrawal’s distinctive advantages (protective range and enterprise

preservation). Section II.B introduces the unfair prejudice remedy and *Austritt aus wichtigem Grund*.

A. Terminology, definition, and scope

'Withdrawal' (or 'withdrawal remedy') is defined for this Article as follows:

voluntary exit from a close corporation by a shareholder desirous of exit resulting in a monetary claim payable to the withdrawing shareholder in exchange for the latter's loss of status, rights, duties, and other interests in the close corporation, without terminating the corporation's existence.

The word 'withdrawal' is selected as the jurisdiction-neutral name for a category of shareholder remedies because it is, in contrast to alternatives such as 'oppression',¹⁰ not being currently used as a legal term of art in any major English-language jurisdiction, although it sees sporadic use in scholarly literature.¹¹

For this Article's purposes, unless modified or where context indicates otherwise, 'withdrawal' means *non-contractual* or *extra-contractual* rights or remedies in *corporate law*. 'Withdrawal remedy' is used instead of 'withdrawal right' to reflect how judges have discretion over relief in withdrawal regimes such as the UK's. 'Withdrawal' when used without qualification also specifically means withdrawal 'on grounds'. This means that the circumstances relied upon to establish the legal availability of withdrawal are verifiable by a third-party adjudicator, eg a court of law.¹² Grounds for withdrawal may be categorised into 'fault' and 'non-fault' subtypes (Section III.A). Although withdrawal 'on grounds' may be conceptually distinguished from withdrawal 'at will', the latter will not be discussed in this Article.¹³

¹⁰eg Cem Veziroğlu, 'Buy-Out of the Oppressed Minority's Shares in Joint Stock Companies: A Comparative Analysis of Turkish, Swiss and English Law' (2018) 19 *European Business Organisation Law Review* 527. 'Buy-out' is rejected as it evokes consensual share purchases pursuant to pre-existing agreements (eg put options).

¹¹Cf Hugh T Scogin, 'Withdrawal and Expulsion in Germany: A Comparative Perspective on the "Close Corporation Problem"' (1993) 15 *Michigan Journal of International Law* 127 and Alan K Koh, 'Shareholder Protection in Close Corporations and the Curious Case of Japan: The Enigmatic Past and Present of Withdrawal in a Leading Economy' (2020) 53 *Vanderbilt Journal of Transnational Law* 1207 ('withdrawal') with Bachmann, Eidenmüller, Engert, Fleischer and Schön (n 4) 66–68 ('exit rights').

¹²A shareholder relying on a ground unverifiable by a third-party adjudicator cannot be meaningfully distinguished from a shareholder withdrawing on a whim. For withdrawal at will see n 13 below.

¹³Withdrawal 'at will' does not require, as a matter of law, any fact to be proved or legal test to be met; the mere intent of the relevant member to withdraw and that member's compliance with any applicable procedural formalities would be sufficient for withdrawal to be effective.

Neither Germany nor the UK recognises withdrawal at will: Marcus Lutter, '§ 34 Einziehung von Geschäftsanteilen' in Marcus Lutter and Peter Hommelhoff (eds), *GmbH-Gesetz: Kommentar* (18th edn, Cologne, Otto Schmidt 2012) Rn 70; Lorenz Fastrich, 'Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern' in Adolf Baumbach and Alfred Hueck (eds), *GmbHG: Gesetz betreffend die Gesellschaften mit beschränkter Haftung* (21st edn, Munich, CH Beck 2017) Rn 21; Christoph H Seibt, 'Anhang § 34: Austritt und Ausschließung eines Gesellschafter' in Franz Scholz (ed), *Kommentar zum GmbH-Gesetz*, vol 1 (11th edn, Cologne, Otto Schmidt 2012) Rn 9; Lutz Strohn, § 34 Einziehung von Geschäftsanteilen' in Holger Fleischer and Wulf Goette (eds), *Münchener Kommentar zum Gesetz*

'Withdrawal' is a narrower concept than 'exit', which encompasses a broader range of legal remedies including appraisal and judicial winding-up/dissolution.¹⁴ Appraisal 'is a statutory right to dissent from specified fundamental or structural changes in the life of their corporation [and] requires the corporation to facilitate the shareholders' withdrawal by buying back their shares for fair value, or its equivalent, as determined through appraisal proceedings'.¹⁵ The critical distinction between appraisal and withdrawal is in their scope. Appraisal is restricted to 'specified fundamental or structural changes'¹⁶ that are clearly defined and statutorily enumerated.¹⁷ Conversely, withdrawal grounds are more open ended and rarely, if ever, defined by statute.¹⁸ Where appraisal is a set of *ex ante* defined rules, withdrawal is much more like a standard that relies more on *ex post* adjudication for clarification of content.¹⁹ This makes withdrawal able 'to respond to a wide range of controller misconduct or inter-shareholder conflict, whereas appraisal is much narrower in scope'.²⁰ A final distinction of practical relevance is that appraisal is available for – if not designed for – public, listed companies, but withdrawal on standard-like grounds is not available.²¹

A judicial order of dissolution leads to cessation of the business as a going concern, liquidation and distribution of the corporation's assets to creditors

betreffend die Gesellschaften mit beschränkter Haftung – GmbHG (3rd edn, Munich, CH Beck 2018) Rn 178; Volker Röhrich, 'Zum Austritt des Gesellschafters aus der GmbH' in Reinhard Goerdeler, Peter Hommelhoff, Marcus Lutter, Walter Odersky and Herbert Wiedemann (eds), *Festschrift für Alfred Keller-mann zum 70. Geburtstag am 29. November 1990* (Berlin, Walter de Gruyter 1991) 374; Alan K Koh and Samantha S Tang, 'Towards a "Just and Equitable Remedy" for Companies' (2017) 133 LQR 372, 375.

¹⁴In German GmbH law, 'exit' encompasses not only *Austritt aus wichtigem Grund*, but also *Veräußerung*, *Abandon*, *Kaduzierung*, *Auflösungsklage*, and *Ausschluss/Ausschließung aus wichtigem Grund*. See eg Maximilian Goette, *Der Exit der Minderheit aus der GmbH* (Cologne, Carl Heymanns 2014). In UK law, exit comprises unfair prejudice buyouts and just and equitable winding up (judicial dissolution).

¹⁵Hideki Kanda and Saul Levmore, 'The Appraisal Remedy and the Goals of Corporate Law' (1985) 32 UCLA Law Review 429, 429. Cf alternative definitions in Alan K Koh and Samantha S Tang, 'Direct and Derivative Shareholder Suits: Towards a Functional and Practical Taxonomy' in Afra Afsharipour and Martin Gelter (eds), *Comparative Corporate Governance* (Edward Elgar 2021) 443–444.

¹⁶Kanda and Levmore (n 15) 429.

¹⁷See, in English, eg Alan K Koh, 'Appraising Japan's Appraisal Remedy' (2014) 62 American Journal of Comparative Law 417, 424–425 (Japan); Paul P de Vries, *Exit Rights of Minority Shareholders in a Private Limited Company* (Deventer, Kluwer 2010) 185–205 (Germany); Mary Siegel, 'An Appraisal of the Model Business Corporation Act's Appraisal Rights Provisions' (2011) 74(1) Law & Contemporary Problems 231, 232–235 (USA).

¹⁸See Section III.A below.

¹⁹Cf John Armour and Luca Enriques et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, OUP 2017) 32 ('rules ... require or prohibit specific behaviors ... standards ... leave the precise determination of compliance to adjudicators after the fact') (italics in original).

²⁰Koh and Tang (n 15) 444.

²¹Koh and Tang (n 15) 439; but see Christian Hofmann, *Der Minderheitsschutz im Gesellschaftsrecht* (Berlin, De Gruyter 2011) 486 (observing that there has been little literature on *Austritt aus wichtigem Grund* for *Aktiengesellschaft* (AG) shareholders (*Aktionäre*) but argues that there are no fundamental objections to it). It is certainly possible to think of withdrawal and appraisal as varieties of non-dissolution-based shareholder exit. However, given differences in the factual scenarios in which they would be available and the types of corporations they are relevant to, there is little to be gained at this point by consolidating the two exit remedy types. I am grateful to Tobias Tröger and the anonymous reviewer for stimulating my thinking on this point.

and surplus to members, and termination of the intra-corporate relationships between the corporation and the members, as well as between the members *inter se*. Insofar as dissolution provides only a judicial choice between issuing a dissolution order or not, it is a form of exit separate and distinct from the withdrawal remedy, which preserves the corporation's existence. However, a dissolution/ winding up regime that also provides for a judicial discretion to order withdrawal instead of dissolution may be properly classified under both categories of exit; we explore one example of this below at Section IV.B.

Comparing withdrawal against appraisal and judicial dissolution reveals withdrawal's distinctive characteristics and greatest advantages: protective range and enterprise preservation. Withdrawal is, compared to appraisal, a more versatile tool that addresses the demand for shareholder protection in a wider range of scenarios. As compared to judicial dissolution, withdrawal achieves the shareholder protection objective while also preserving the close corporation's business as a going concern.

While the features of protective range and enterprise preservation are generally shared by withdrawal regimes, there is considerable diversity among jurisdictions. The next sub-section (Section II.B) introduces the two jurisdictional regimes that will be closely compared later in Section III: Germany and the UK.

B. Withdrawal on grounds in Germany and the United Kingdom: Austritt aus wichtigem Grund and unfair prejudice

Withdrawal in Germany was not intended by the German legislator to be a feature of the basic governing statute for the GmbH, *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* [Limited Liability Companies Act] ('GmbHG').²² Developed through court decisions including key judgments of the Federal Court of Justice (BGH) in 1953 and 1991²³ and scholarly opinion,²⁴ *Austritt aus wichtigem Grund* continues to this day to be an uncodified feature of GmbH law. The core concept of '*wichtiger Grund*' ('good cause' or 'important reason') in Germany's withdrawal regime is a non-statutory multi-factor test of whether it is unbearable (*unzumutbar*) for the member to remain in the GmbH.²⁵ To ascertain if a *wichtiger Grund* exists

²²Enacted 20.04.1892, RGBI S 477, in force from 10.05.1892. See *Entwurf eines Gesetzes betreffend die Gesellschaften mit beschränkter Haftung nebst Begründung und Anlagen, Amtliche Ausgabe* (Berlin, Franz Dahlen 1891) 86.

²³BGH Urt v 01.04.1953 – II ZR 235/52, BGHZ 9, 157; BGH Urt v 16.12.1991 – II ZR 58/91, BGHZ 116, 359.

²⁴The earliest of which may be Franz Scholz, *Der Austritt aus der GmbH* (Cologne, Dr Otto Schmidt 1930) 21–22.

²⁵Peter Ulmer and Mathias Habersack, 'Anhang nach § 34 Ausschließung und Austritt von Gesellschaftern' in Peter Ulmer, Mathias Habersack and Marc Löbbe (eds), *Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG): Großkommentar*, vol 2 (2nd edn, Tübingen, Mohr Siebeck 2014) Rn 51; BGHZ 116, 359, 369. An alternative formulation is 'unreasonable to expect or require the member to remain in the GmbH'.

in a particular case, an overall assessment (*Gesamtabwägung*) of the respective parties' circumstances and interests is conducted.²⁶ In being uncodified and built around an open-textured concept, Germany's withdrawal regime is of interest and value to jurisdictions with similarly open-ended concepts underlying their withdrawal regimes,²⁷ and jurisdictions that do not yet have legislation for a withdrawal regime.²⁸

Withdrawal in the UK is a subset of the broader statutory 'unfair prejudice' remedy introduced in 1980²⁹ that, save for one clarificatory amendment,³⁰ has remained substantively untouched by legislative reform. The regime is currently contained in sections 994–996 of the current Companies Act 2006.³¹ For the avoidance of doubt, strictly speaking 'withdrawal' and 'unfair prejudice' in the UK do not mean the same thing. The former is one specific relief (also known as 'buyout order' or 'share purchase order') under section 996(2)(e) that is just one of many reliefs that a court may grant under its statutory unfair prejudice jurisdiction.³² However, given that the unfair prejudice remedy is the exclusive basis for judicially-ordered withdrawal in the UK, and that withdrawal (ie the buyout order) is the most often-sought and granted relief,³³ the unfair prejudice regime is the proper subject of a comparative analysis of withdrawal. UK unfair prejudice jurisprudence may continue to be of interest to Anglo-Commonwealth jurisdictions with comparable unfair prejudice or 'oppression' remedies.³⁴

III. German *Austritt aus wichtigem Grund* and UK unfair prejudice: two models of withdrawal

To analyse the German and UK regimes on withdrawal on grounds, this Section adopts a functional comparative framework that examines two

²⁶Gerhard K Balz, *Die Beendigung der Mitgliedschaft in der GmbH* (Berlin, Duncker & Humblot 1984) 106–107; Fastrich (n 13) Rn 19–20; Hans-Friedrich Müller, *Das Austrittsrecht des GmbH-Gesellschafters* (Cologne, Carl Heymanns 1996) 52; Röhrich (n 13) 378; Hendrik Schindler, *Das Austrittsrecht in Kapitalgesellschaften* (Munich, CH Beck 1999) 52–60; Seibt (n 13) Rn 10–13; Strohn (n 13) Rn 180.

²⁷Eg Japan; see Koh (n 11) 1261–1262.

²⁸Eg Taiwan; see 王文宇 (Wallace Wen-yue Wang), *公司法論 [Corporation Law]* (6th edn, Angle Publishing 2018) 246–247, 302 (incorporated unlimited partnerships (*wuxian gongsi*) and incorporated limited partnerships (*lianghe gongsi*) have withdrawal (*tuigu*) regimes featuring grounds including 'important grounds' (*zhongda shiyou*)), 271, 359 (limited liability companies (*youxian gongsi*) and companies limited by shares (*gufen youxian gongsi*) do not have withdrawal regimes).

²⁹Companies Act 1980 (c 22), s 75. The precursor to this is the 'oppression' remedy in Companies Act 1948 (c 38), s 210.

³⁰Companies Act 1989, Schedule 19, para 11.

³¹Previously Companies Act 1985, ss 459–461.

³²See Companies Act 2006, s 996(2)(a)–(d) (specifying five other remedies), s 996(1) (providing the court with general discretion over relief).

³³*Grace v Biagioli* [2005] EWCA Civ 1222, [2006] 2 BCLC 70 [75]; Robin Hollington, *Hollington on Shareholders' Rights* (8th edn, London, Sweet & Maxwell 2017) para 8–44.

³⁴Cf Alan K Koh, '(Non-)Enforcement of Directors' Duties in Corporate Groups: *Goh Chan Peng v Beyonics Technology Ltd*' (2018) 81 MLR 673, 687–688 (arguing that legally-independent Anglo-Commonwealth jurisdictions should, especially in areas with limited domestic jurisprudence, continue to consider the jurisprudence of other Anglo-Commonwealth jurisdictions).

main aspects: the grounds on which withdrawal is available (the question of ‘when?’ – Section III.A), and the withdrawing shareholder’s monetary claim (questions of ‘who pays?’ and ‘how much?’ – Section III.B). Piecing together the key differences between German and UK withdrawal law as revealed by the comparative analysis, this Section develops a typology of withdrawal comprising two contrasting models (Section III.C).

The two models may be described briefly. The UK’s unfair prejudice remedy may be characterised as a ‘corrective’ model of withdrawal, which protects an aggrieved member from conduct of other wrongdoing members or directors that is unlawful or otherwise contrary to the aggrieved member’s expectations. This protection takes the form of a monetary claim against the members at fault in exchange for the withdrawing member’s shares; the withdrawing member may also claim their *pro rata* share of reflective loss arising from the wrongdoer’s misconduct, if applicable. By contrast, Germany’s *Austritt aus wichtigem Grund* takes on a ‘quasi-insurance’ character by protecting a member not only against misconduct of other members, but potentially against changes in the GmbH’s business environment that severely affect the member’s economic interests as well. The withdrawing member may assert a monetary claim against the GmbH, albeit subject to strict capital maintenance rules.

A. Grounds for withdrawal

As mentioned above at Section II, grounds for withdrawal, which are in Germany and the UK encapsulated respectively by the concepts of ‘*wichtiger Grund*’ and ‘unfair prejudice’, may be further subdivided into ‘fault’ and ‘non-fault’ types.

1. Fault of other parties

The first type of grounds for withdrawal is the fault of members other than that of the member seeking to withdraw. ‘Fault’ is by its nature a *standard* rather than a *rule*.³⁵

a. Germany. In Germany, ‘fault’ corresponds closely to the category of situations under the broader *wichtiger Grund* (‘good cause’) concept³⁶ termed in some commentaries as ‘behaviour of other members’ (*Verhalten der Mitgesellschafter*).³⁷

A classic example of fault is repeated abuse of majority power.³⁸ Isolated abuses may be amenable to redress via alternatives to withdrawal such as

³⁵On rules versus standards in corporate law see Armour and Enriques et al (n 19) 32–33.

³⁶Section II.B.

³⁷See eg Strohn (n 13) Rn 186–188 and Ulmer and Habersack (n 25) Rn 54.

³⁸Lutter (n 13) Rn 72; Seibt (n 13) Rn 13; Ulmer and Habersack (n 25) Rn 54; Müller (n 26) 63–64.

invalidation of members' resolutions³⁹ or the *actio pro socio*, a derivative action-esque mechanism that may be used against a wrongdoing member.⁴⁰ However, where majority abuses are recurring, it would be unreasonable for the law to expect the minority member victim to seek judicial intervention for each individual incident indefinitely. Withdrawal on *wichtiger Grund* is therefore available in repeated abuse of power scenarios to minority members, even though legal alternatives to withdrawal are possible in a technical, albeit not in a practical, sense.⁴¹

Aushungern (freeze-out) of the minority is a concrete subtype of repeated abuse of majority power. Examples include the majority's consistent refusal to distribute profits⁴² or adoption of an unreasonable earnings retention policy given the GmbH's financial situation,⁴³ and repeated refusal to consent to the sale or transfer⁴⁴ of a minority member's membership interest.⁴⁵

Withdrawal may also be available in the presence of other wrongful acts by other members causing harm or prejudice to the member.⁴⁶ Acquiescence of the majority in one member's serious breach of that member's duty of loyalty ('*Treuepflicht*'⁴⁷) may also constitute *wichtiger Grund*.⁴⁸ When another member has conducted themselves in a way that justifies that member's expulsion from the GmbH, a member may elect between withdrawal and attempting to expel the other member.⁴⁹

b. UK. Unfairness is recognised under UK withdrawal law primarily in two scenarios: breach of formal, written rules; or of informal, unwritten expectations by other members in control.

Breaches of formal, written rules. Contraventions of the corporate constitution (to which the member has not consented or acquiesced) generally constitute unfair prejudice.⁵⁰ Non-compliance with the law, such as breaches of directors' duties, may be grounds for relief.⁵¹ Successful claims featured

³⁹See RG [Reich Court of Justice] Urt v 09.10.1914 – Rep II 223/14, RGZ 85, 311, 313ff; Bachmann, Eidenmüller, Engert, Fleischer and Schön (n 4) 63–64.

⁴⁰BGH Urt v 14.05.1990 – II ZR 125/89, NJW 1990, 2627, 2628; see also Koh and Tang (n 15) 452.

⁴¹Seibt (n 13) Rn 14; Strohn (n 13) Rn 187; Ulmer and Habersack (n 25) Rn 54.

⁴²Cf *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* [GmbHG], § 29 Abs 2 (default rule that GmbH members may decide on disposition of profits by resolution).

⁴³OLG Köln [Higher Regional Court, Cologne] 26.03.1999 – 19 U 108/96, NZG 1999, 1222, 1223; Seibt (n 13) Rn 13; Michael Becker, *Der Austritt aus der GmbH* (Kehl am Rhein, NP Engel 1985) 99–107; Müller (n 26) 63–64. Cf Fastrich (n 13) Rn 20 (not grounds).

⁴⁴Transfers of membership interests may be restricted by provision in the constitution: GmbHG, § 15, Abs 5.

⁴⁵Lutter (n 13) Rn 72; Strohn (n 13) Rn 188. Cf Seibt (n 13) Rn 9; Müller (n 26) 46–51.

⁴⁶Strohn (n 13) Rn 186, 188; Goette (n 14) 125–128, 130.

⁴⁷On *Treuepflicht* see further n 165 below and text thereto.

⁴⁸Lutter (n 13) Rn 72; Ulmer and Habersack (n 25) Rn 54.

⁴⁹Strohn (n 13) Rn 186; see also Röhrich (n 13) 382.

⁵⁰*Fisher v Cadman* [2005] EWHC 377 (Ch), [2006] 1 BCLC 499 [90]–[93]. However, mere 'trivial or technical infringements of [the corporate constitution]' do not suffice: *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA) 18.

⁵¹*Re Tobian Properties Ltd, Maidment v Attwood* [2012] EWCA Civ 998, [2013] 2 BCLC 567 [22].

misapplication of corporate assets,⁵² self-dealing,⁵³ diversion of business opportunities,⁵⁴ or secret profits.⁵⁵ However, relief for petitions founded on directorial negligence is less readily granted by the courts,⁵⁶ and the few successful cases feature exceptional facts.⁵⁷ Breach of contractual obligations (eg shareholder agreements) may theoretically found an action in unfair prejudice,⁵⁸ although no well-known examples of relief granted on this basis exist.⁵⁹

Breaches of informal unwritten expectations. Companies are as a practical matter unlikely to be governed exclusively by exhaustive, formal, written rules. From a 'contractual' perspective, the members' bargain extending beyond formal contractual instruments to informal 'agreements' or 'understandings' might not be legally enforceable in their own right as formal contracts.⁶⁰ This is in line with the relatively formalist approach adopted in contractual interpretation under English law,⁶¹ and which is not necessarily shared by other jurisdictions.⁶² Conduct otherwise lawful and fully compliant with the formal rules may nonetheless be 'unfair' for the purposes of unfair prejudice.⁶³

It is only when certain circumstances exist that the otherwise lawful exercise of legal rights may be constrained by informal unwritten expectations – ie 'equitable considerations'.⁶⁴ When precisely 'equitable considerations' arise is unclear. The mere fact that the company at issue is small or private is not decisive. Rather, something akin to a multi-factorial test is applied to distinguish between purely commercial relationships, and relationships that are 'something more'.⁶⁵ The three non-exhaustive factors laid down by Lord Wilberforce in *Ebrahimi* are (1) a personal relationship of mutual trust between members, (2) an agreement or understanding that members will actively participate in the business, and (3) transfer restrictions on the company's shares.⁶⁶ A company with at least one factor is often classified a

⁵²*Re Elgindata Ltd (No 1)* [1991] BCLC 959 (ChD) 1004.

⁵³*Lloyd v Casey* [2002] 1 BCLC 454 (ChD) [102]–[103]; *Dalby v Bodilly* [2004] EWHC 3078 (Ch), [2005] BCC 627.

⁵⁴*Allmark v Burnham* [2005] EWHC 2717 (Ch), [2006] 2 BCLC 437.

⁵⁵*Re Baumler (UK) Ltd, Gerrard v Koby* [2004] EWHC 7673 (Ch), [2005] 1 BCLC 92.

⁵⁶*Oak Investment Partners XII Ltd Partnership v Boughtwood* [2010] EWCA Civ 23, [2010] 2 BCLC 459 [8].

⁵⁷eg *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354 (ChD) 406.

⁵⁸Hollington (n 33) para 7–82.

⁵⁹Where relief under contract law is available for breach of shareholder agreement, the unfair prejudice remedy may be less crucial.

⁶⁰*O'Neill v Phillips* [1999] 1 WLR 1092 (HL) 1101.

⁶¹'English law' is not synonymous with 'UK law' for general private law (including contract law) purposes. I make no comment about contract law or interpretation in Scotland or Northern Ireland.

⁶²I am grateful to the reviewer for pointing out that German courts fuss less about distinguishing 'formal' contract from 'informal' expectations.

⁶³*Saul D Harrison* (n 50) 19–20.

⁶⁴*O'Neill* (n 60) 1102.

⁶⁵*Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) 379.

⁶⁶*ibid.*

quasi-partnership, although this label is only a necessary but insufficient condition for equitable considerations.⁶⁷

Protected expectations of quasi-partnership members may be classified into two types. The first is expectations as to participation in management of the company. Breaches of such expectations comprise most unfair prejudice petitions.⁶⁸ Removal of the member as director is a common example.⁶⁹ The second is expectations regarding returns on investment. Such returns for a close corporation member are not limited to distributions (dividends), but also remuneration or salary for services rendered to the company as director or employee. The precise form often depends on tax considerations.⁷⁰ Breach of an express⁷¹ or informal⁷² agreement as to dividends, failure to pay dividends despite corporate profits and substantial reserves,⁷³ or failure of the directors to consider issuing dividends⁷⁴ or to adopt a dividend policy⁷⁵ are all potentially unfairly prejudicial. Further, breach of an informal agreement on remuneration by paying remuneration when the agreement was that none would be paid,⁷⁶ or payment of remuneration in excess of the terms of the informal agreement,⁷⁷ would be unfair prejudice.

c. Comparison. Both jurisdictions clearly recognise fault of parties other than the withdrawing member as a basis for withdrawal on grounds. However, the legal basis of ‘fault’ is different. The focus in German law seems to be on breaches of *legal*, rather than contractual or informal contract-like obligations as in the UK. Where the UK has come to adopt a contractarian paradigm in drawing the line between ‘unfairly’ prejudicial behaviour and merely prejudicial behaviour,⁷⁸ Germany has kept *wichtiger Grund* relatively flexible. However, under German law, there is a greater expectation that members would seek alternative legal remedies, possibly repeatedly, before withdrawal would be permitted as a last resort. Compared to UK law, such expectations may seem impractical because alternatives may be futile in putting an end to the conflict.

⁶⁷*Re Coroin Ltd (No 2)*, *McKillen v Mislend (Cyprus) Investments Ltd* [2012] EWHC 2343 (Ch), [2013] 2 BCLC 583 [635]; *Fisher v Cadman* (n 50) [84].

⁶⁸Law Commission, *Shareholder Remedies* (Law Commission Report No 246, Cm 3769, London, Stationery Office 1997) para 3.13 fn 18.

⁶⁹See eg Victor Joffe, David Drake, Giles Richardson, Daniel Lightman and Timothy Collingwood, *Minority Shareholders: Law, Practice, and Procedure* (6th edn, Oxford, Oxford University Press 2018) para 6.150 fn 366.

⁷⁰*Baker v Potter* [2004] EWHC 1422 (Ch), [2005] BCC 855 [117].

⁷¹*Croly v Good* [2010] EWHC 1 (Ch), [2010] 2 BCLC 569 [97].

⁷²*Rahman v Malik* [2008] EWHC 959 (Ch), [2008] 2 BCLC 403 [99]–[109], [119].

⁷³*Quinlan v Essex Hinge Co Ltd* [1996] 2 BCLC 417 (ChD) 427.

⁷⁴*Re McCarthy Surfacing Ltd*, *Hequet v McCarthy* [2008] EWHC 2279 (Ch), [2009] 1 BCLC 622 [84].

⁷⁵*Routledge v Skerritt* [2019] EWHC 573 (Ch) [139]–[144].

⁷⁶*Fisher v Cadman* (n 50) [98]–[99].

⁷⁷*Croly* (n 71) [96].

⁷⁸Law Commission (n 68) para 3.66; *O'Neill* (n 60) 1105.

2. Unclear attribution of fault / multiple parties at fault

A withdrawing member might not be completely innocent of incompetence, greed, unreasonableness, sloth, or other poor conduct. When combined with other acts or conduct by other members that are unreasonable or detrimental to the withdrawing member's interests, there can be enough fault to go around to make precise attribution a challenge. Fault attribution also becomes unclear when the withdrawing member had consented to or acquiesced in some or all the acts or conduct subsequently complained of.

a. Germany. If fault rests solely or primarily with the withdrawing member, their demand to withdraw can seem unmeritorious or even an abuse of right.⁷⁹ However, withdrawal may be justified by a serious breakdown in the relationship between members that makes it unreasonable for the members to continue working together.⁸⁰ Fault is an important consideration in this context, although there is debate over whether the withdrawing member's fault in causing the relationship breakdown would bar them from withdrawal entirely,⁸¹ or would just form part of the overall assessment for *wichtiger Grund*.⁸²

An act of the GmbH relevant to the *wichtiger Grund* test must nonetheless be excluded from the overall assessment if the member had voluntarily consented to or abstained from the decision leading to that act.⁸³ A right to withdraw should be exercised without delay; the member may not take a 'wait-and-see' attitude and take steps to withdraw only when the act of the GmbH results in failure.⁸⁴ However, a member duty-bound to consent or abstain (ie did so involuntarily) may possibly still withdraw if they take steps to withdraw without delay.⁸⁵

b. UK. The withdrawing member's own poor behaviour is taken into consideration by the court; possible adverse consequences range from cost consequences⁸⁶ to the complete denial of relief⁸⁷ on the basis that the prejudice suffered by the withdrawing member would not be unfair in the circumstances.⁸⁸ Examples of poor behaviour include disinterest in management,⁸⁹

⁷⁹Strohn (n 13) Rn 180; Seibt (n 13) Rn 10. See also Ulmer and Habersack (n 25) Rn 51 and Fastrich (n 13) Rn 19 (withdrawing member's fault taken into account but it is not preclusive).

⁸⁰Seibt (n 13) Rn 13; Strohn (n 13) Rn 188. Cf Goette (n 14) 111.

⁸¹See Goette (n 14) 111.

⁸²Müller (n 26) 65.

⁸³Ulmer and Habersack (n 25) Rn 51.

⁸⁴Strohn (n 13) Rn 180; Fastrich (n 13) Rn 19.

⁸⁵Fastrich (n 13) Rn 19.

⁸⁶*Richardson v Blackmore, Capital Cabs Ltd v Blackmore* [2005] EWCA Civ 1356, [2006] BCC 276 [62].

⁸⁷See eg *ibid* [53]; *Grace v Biagioli* (n 33) [68]–[70].

⁸⁸*Re London School of Electronics Ltd* [1986] Ch 211 (ChD) 222–223.

⁸⁹*Re R A Noble & Sons (Clothing) Ltd* [1983] BCLC 273 (ChD) 292.

and creating and sending a forged letter to induce other members to sell the withdrawing member their shares at a lower price.⁹⁰

Withdrawing members are also barred from relying on matters that they have consented to in founding their complaint because consent removes any unfairness. There is an exception where the respondent should not have relied upon the withdrawing member's consent.⁹¹ Consent or acquiescence to something that would otherwise be unfairly prejudicial may, with reasonable notice, be revoked.⁹² There is a risk that the court would refuse to grant relief to a withdrawing member who delays the commencement of unfair prejudice proceedings without justification and who thereby causes 'prejudice or an irretrievable change of position' to the respondents.⁹³

c. Comparison. Both jurisdictions take a critical view of less-than-blameless withdrawing members, although there is considerable leeway for the courts to decide the extent to which the withdrawing member should be disadvantaged by their own conduct (ie whether withdrawal would be completely ruled out). Logically, there is no way for a member to withdraw on grounds by relying only on circumstances attributable solely to their own fault.⁹⁴

3. Non-fault

Circumstances resulting from either voluntary action taken in good faith and without ulterior motive, or circumstances not attributable at all to the voluntary action of majority or minority shareholders fall under 'non-fault' grounds.

a. Germany. The second category of situations falling under *wichtiger Grund* relate to circumstances of the GmbH (*Verhältnisse der Gesellschaft*). One example is a complete breakdown in the relationship between members that threatens the viability of the GmbH as a going concern.⁹⁵ Another is the sustained unprofitability of the GmbH over a long period of time,⁹⁶ albeit possibly subject to additional conditions. These might include all efforts at salvaging the situation having failed and that dissolution of the GmbH is under consideration;⁹⁷ the withdrawing member suffers special hardship due to personal circumstances;⁹⁸ or where

⁹⁰*Richardson v Blackmore* (n 86) [11], [27].

⁹¹*Re Batesons Hotels (1958) Ltd, Bateson v Bateson* [2013] EWHC 2530 (Ch), [2014] 1 BCLC 507 [53], [54].

⁹²*Fisher v Cadman* (n 50) [93]–[94].

⁹³*Re Edwardian Group Ltd, Estera Trust (Jersey) Ltd v Singh* [2018] EWHC 1715 (Ch), [2019] 1 BCLC 171 [571].

⁹⁴The only possibility is withdrawal at will, which has no requirement as to any party's fault. This is neither accepted under German nor UK law; see n 13 above.

⁹⁵Ulmer and Habersack (n 25) Rn 56.

⁹⁶Seibt (n 13) Rn 13; Strohn (n 13) Rn 182.

⁹⁷Strohn (n 13) Rn 182.

⁹⁸Röhrich (n 13) 386.

the majority members' decision not to dissolve the GmbH was tainted by wrongfulness or bad faith and kept the withdrawing member unreasonably locked in the GmbH.⁹⁹

Changes in the GmbH's circumstances detrimental to the member's legal or economic position may constitute withdrawal grounds. A capital increase conducted without the member's voluntary consent and which subjects the member to the risk of *pro rata* liability to make up any unpaid shortfall¹⁰⁰ would be grounds for withdrawal,¹⁰¹ subject to the requirement that the member takes steps to withdraw immediately.¹⁰² Other changes, such as to the GmbH's objects (*Unternehmensgegenstand*),¹⁰³ would also justify withdrawal.¹⁰⁴ Withdrawal is permissible in such circumstances because a member cannot be expected to continue an investment when the basis upon which they joined the GmbH (or upon which the GmbH was founded) no longer exists.¹⁰⁵ This is especially the case where the GmbH changes its business to compete with the member.¹⁰⁶ Similarly, significant expansion in the GmbH's business operations (*Geschäftstätigkeit*) or investments that increases business risk significantly may also constitute *wichtiger Grund*.¹⁰⁷ Other possibilities include withdrawal or expulsion of another member;¹⁰⁸ change in the controlling majority;¹⁰⁹ or move of the GmbH's administrative seat to a foreign jurisdiction.¹¹⁰

Finally, circumstances that are personal to the withdrawing member (*Persönliche Gründe*) can constitute *wichtiger Grund* in exceptional situations. This encompasses personal circumstances so closely connected to the GmbH as to be practically equivalent to the GmbH's own circumstances,¹¹¹ or at least those substantially linked to the member's continued participation in the GmbH.¹¹² Examples where the withdrawing member would find it extremely difficult to exercise their membership rights or to discharge their membership obligations include a change in residence¹¹³ and severe illness over an extended period of time.¹¹⁴

⁹⁹Goette (n 14) 115–116.

¹⁰⁰GmbHG, § 24.

¹⁰¹Fastrich (n 13) Rn 20; Seibt (n 13) Rn 13; Strohn (n 13) Rn 183.

¹⁰²LG Mönchengladbach [Regional Court, Mönchengladbach] Urt 23.10.1985 – 7 O 45/85, NJW-RR 1986, 837, 838; Strohn (n 13) Rn 183.

¹⁰³Strohn (n 13) Rn 183. The GmbH's objects must be stated in its constitution (*Gesellschaftsvertrag/Satzung*): GmbHG, § 3 Abs 1, Nr 2.

¹⁰⁴Strohn (n 13) Rn 183; Ulmer and Habersack (n 25) Rn 53.

¹⁰⁵Strohn (n 13) Rn 183; Müller (n 26) 53; Röhricht (n 13) 379.

¹⁰⁶Seibt (n 13) Rn 13; Strohn (n 13) Rn 183; Ulmer and Habersack (n 25) Rn 53.

¹⁰⁷Lutter (n 13) Rn 73; Strohn (n 13) Rn 183.

¹⁰⁸Strohn (n 13) Rn 183.

¹⁰⁹Seibt (n 13) Rn 13; Strohn (n 13) Rn 184; Ulmer and Habersack (n 25) Rn 53.

¹¹⁰Goette (n 14) 123.

¹¹¹Klaus Rudolf Mäusl, *Der Austritt eines GmbH-Gesellschafters auf schadensrechtlicher Grundlage* (Dr iur dissertation, Free University of Berlin 2001) 270–271.

¹¹²Goette (n 14) 101; Müller (n 26) 65; Seibt (n 13) Rn 10, 12.

¹¹³Strohn (n 13) Rn 181. See also Ulmer and Habersack (n 25) Rn 52.

¹¹⁴Seibt (n 13) Rn 12; Strohn (n 13) Rn 181.

By contrast, circumstances purely within the member's personal sphere and which are completely irrelevant to the GmbH are unlikely to constitute *wichtiger Grund*. Personal insolvency of the member is not *wichtiger Grund*.¹¹⁵ On the other hand, an urgent need of money that can be met only by liquidating one's membership interest may be *wichtiger Grund*,¹¹⁶ although this is a controversial proposition.¹¹⁷ Another controversial possibility is divorce between two members in a family-owned GmbH.¹¹⁸

b. UK. Withdrawal on non-fault grounds is not permitted.¹¹⁹ Even a breakdown in trust and confidence that results in deadlock and the company's loss of ability 'to conduct its business in the manner initially contemplated' is not recognised as unfair prejudice,¹²⁰ even though loss of trust and confidence is a 'non-fault' ground *par excellence* long recognised in English corporate law for other purposes.¹²¹ The complete rejection of non-fault grounds may be traced back to *O'Neill v Phillips*, a 1999 decision of the House of Lords,¹²² in which the court refused to permit withdrawal for breakdown of trust and confidence.¹²³ Given that there have been no unfair prejudice decisions from either the House of Lords or its successor institution (the Supreme Court of the United Kingdom) since then, there has yet to be opportunity to judicially reconsider the limitation imposed by *O'Neill* on UK withdrawal law.

c. Comparison. German law is open to the possibility of withdrawal in a wide range of scenarios in which there is no party to blame, demonstrating the flexibility of the *wichtiger Grund* concept to respond, if need be, to new fact patterns and demands. By contrast, the UK excluded non-fault grounds outright from the scope of unfair prejudice with a single apex court decision that has not been revisited since. This meant that the UK has never developed

¹¹⁵Seibt (n 13) Rn 12; Goette (n 14) 106.

¹¹⁶Lutter (n 13) Rn 72; Ulmer and Habersack (n 25) Rn 52.

¹¹⁷Cf Fastrich (n 13) Rn 20; Seibt (n 13) Rn 12 (against) with Müller (n 26) 66; Röhrich (n 13) 386–387; Strohn (n 13) Rn 181 (offering more nuanced approaches).

¹¹⁸For: Strohn (n 13) Rn 181. Against: Goette (n 14) 110.

¹¹⁹Koh and Tang (n 13) 375; see also Cheng-Han Tan and Meng-Seng Wee, 'Equity, Shareholders and Company Law' in Paul S Davies and James Penner (eds), *Equity, Trusts and Commerce* (Hart 2017) 15. Dissolution however may be available: see *Re Neath Rugby Ltd, Hawkes v Cuddy* [2009] EWCA Civ 291, [2010] BCC 597 [104], [108].

¹²⁰*Neath Rugby* (n 119) [108].

¹²¹Most importantly as a basis for judicial dissolution (ie just and equitable winding up) in Insolvency Act 1986 (UK), s 122(1)(g), first enacted as Joint Stock Companies Winding-up Act 1848, s 5(8). See generally Derek French, *Applications to Wind Up Companies* (Stuart Sime ed, 4th edn, OUP 2021) paras 8.131–8.293, 8.340–8.417.

¹²²Then the UK's apex court for most civil matters.

¹²³*O'Neill* (n 60) 1104. Of the five Law Lords on the panel deciding the case, only Lord Hoffmann gave a reasoned speech (ie judgment). On scholarly reactions to *O'Neill*, cf Jennifer Payne and DD Prentice, 'Section 459 of the Companies Act 1985 – The House of Lords' View' (1999) 115 *Law Quarterly Review* 587, 589 (fully positive) with Koh and Tang (n 13) 375 (noting that Lord Hoffmann conflated 'at will' and 'non-fault' grounds).

a solution to the timeless problem of broken trust between shareholders in circumstances where precise attribution of fault is no longer possible or meaningful.

The UK's choice to renounce non-fault withdrawal and limit the potential of its pioneering and widely-emulated unfair prejudice statutory framework forces feuding close corporation shareholders into a perennial dilemma: grit their teeth and carry on unhappily, kill the company through a just and equitable winding up, or walk away empty-handed. The prospect of changing this through law reform is explored later (Section IV).

B. Monetary claim

As discussed above,¹²⁴ the withdrawing shareholder's right to payment in exchange for their loss of status and rights as a shareholder is a fundamental feature of withdrawal. For withdrawal to be meaningful, someone must be liable to pay the withdrawing shareholder – involuntarily if necessary – the latter's monetary claim. On this, Germany and the UK differ considerably. This Subsection looks at *who* is liable to pay, and *how much*.

1. Liable parties

The withdrawing member's prospect of realising their monetary claim turns on being able to enforce it against a liable party who is legally able, even if unwilling, to pay. This Section III.B.1 examines who – from among the close corporation, at-fault members, and innocent members – is financially liable for paying the claim. The difficulties of enforcing the liability to pay against the close corporation – as opposed to another member – will also be discussed here.

a. Germany. The withdrawing member has no right to compel any other member or third party to purchase their membership interest.¹²⁵ The liability to pay compensation (*Abfindung*) to the withdrawing member rests with the GmbH, which it may discharge by paying the withdrawing member directly.¹²⁶ Alternatively, the GmbH may arrange for payment by a third-party assignee of the withdrawing member's membership interest,¹²⁷ although in the second scenario the GmbH still retains secondary liability to pay.¹²⁸ When the GmbH may lawfully pay the compensation but fails to do so within a reasonable time, commentators are divided as to whether

¹²⁴Section II.A.

¹²⁵Seibt (n 13) Rn 20; Strohn (n 13) Rn 206; Ulmer and Habersack (n 25) Rn 49.

¹²⁶Strohn (n 13) Rn 202.

¹²⁷Strohn (n 13) Rn 202.

¹²⁸Strohn (n 13) Rn 206.

an action for payment (*Zahlungsklage*)¹²⁹ or dissolution¹³⁰ is the appropriate mode of enforcement.

However, the greatest legal impediment to lawful payment by the GmbH is Germany's strict capital maintenance regime. Distributions may only be made to members out of the GmbH's 'free assets' (*freie Vermögen* or *ungebundene Vermögen*), which is the amount exceeding its registered capital (*Stammkapital*).¹³¹ Members may freely set the registered capital at any amount not less than the mandatory minimum of EUR 25,000, creating a risk that even a well-capitalised GmbH may not have sufficient assets above a high registered capital to satisfy a compensation claim.

If the GmbH may not lawfully pay the withdrawing member the value of their membership interest, the member has two possible options. The first is to apply to dissolve the GmbH,¹³² which would in such cases be exempt¹³³ from the 10% ownership requirement¹³⁴ or the statutory grounds for dissolution.¹³⁵ This mode of enforcement is problematic as it negates the largest advantage of withdrawal, which is preserving the GmbH as a going concern.

The other possibility – recourse against the remaining members – has its own difficulties. The remaining GmbH members are not personally liable to the withdrawing member¹³⁶ – at least not directly.¹³⁷ While there are no *Austritt aus wichtigem Grund* cases directly on point, cases concerning redemption (*Einziehung*) of a membership interest may be instructive.¹³⁸

In two relatively recent cases on redemption, the Federal Court of Justice (BGH) laid down principles governing when remaining members might be personally liable to the exiting¹³⁹ member for the value of that member's membership interest. In the first case (decided 2012)¹⁴⁰ where the plaintiff member's membership interest was involuntarily redeemed,¹⁴¹ the BGH Second Civil Senate stated that the members who passed the redemption resolution should be liable *pro rata* to the exiting member if they do not either ensure the exiting member's compensation claim may be paid out of free assets (such as by topping up the capital shortfall), or dissolve the

¹²⁹Seibt (n 13) Rn 21; Müller (n 26) 122; Strohn (n 13) Rn 204.

¹³⁰BGH [Federal Court of Justice] Urt v 26.10.1986 – II ZR 87/83, BGHZ 88, 320, 326; Fastrich (n 13) Rn 24; Lutter (n 13) Rn 77.

¹³¹GmbHG, § 30 Abs 1; Strohn (n 13) Rn 72.

¹³²Fastrich (n 13) Rn 23; Strohn (n 13) Rn 204.

¹³³Seibt (n 13) Rn 21; Strohn (n 13) Rn 204; Ulmer and Habersack (n 25) Rn 56; Müller (n 26) 121.

¹³⁴GmbHG, § 61 Abs 2 S 2.

¹³⁵GmbHG, § 61 Abs 1.

¹³⁶Fastrich (n 13) Rn 24; Lutter (n 13) Rn 77; Seibt (n 13) Rn 22; Ulmer and Habersack (n 25) Rn 49, 63.

¹³⁷See Strohn (n 13) Rn 207.

¹³⁸The rest of Section III.B.1.a owes much to the anonymous reviewer, to whom I am grateful for suggesting that I analyse the two BGH judgments because the German courts might adopt similar reasoning in withdrawal cases.

¹³⁹Note the use of 'exiting' rather than 'withdrawing' as this is not a withdrawal context.

¹⁴⁰BGH Urt. v. 24.1.2012 – II ZR 109/11, BGHZ 192, 236; NZG 2012, 259.

¹⁴¹For *wichtiger Grund*, which is a recognised basis for expulsion (*Ausschließung*) of a member. Expulsion is beyond the scope of this Article.

GmbH.¹⁴² If the GmbH is dissolved, the exiting member's claim would rank after other creditors'.¹⁴³

In the second case (decided in 2016),¹⁴⁴ which featured a voluntary redemption, the same Senate clarified that the basis for the remaining members' personal liability lies in behaviour contrary to good faith (*treuwidrig*).¹⁴⁵ Such behaviour is demonstrated by the remaining members continuing to operate the business, and in so doing, retaining the value of the membership interest redeemed without ensuring the exiting member is properly compensated.¹⁴⁶ Deterioration in the GmbH's financial position post redemption but prior to the compensation claim falling due – and which causes the GmbH to be unable to lawfully pay the compensation claim – does not result in personal liability for the remaining members if they dissolve the GmbH.¹⁴⁷ If the GmbH were objectively able to pay the claim lawfully, the remaining members cannot, without more, be personally liable.¹⁴⁸ Mere failure of the GmbH to pay does not necessarily mean that the remaining members had acted contrary to good faith.¹⁴⁹ The risk that the GmbH might refuse to pay the claim voluntarily rests with the exiting member, and it is for them to assert their claim against the GmbH, with judicial assistance if necessary.¹⁵⁰

To summarise, the GmbH is, in principle, the sole party liable for paying the withdrawing member their compensation claim. The withdrawing member may enforce this claim against the GmbH either by an action for payment or by applying for judicial dissolution of the GmbH. Assuming BGH jurisprudence developed in the related area of membership interest redemption were to apply to withdrawal, the GmbH's remaining members may be personally liable, on a *pro rata* basis, to pay the withdrawing member provided that (1) the GmbH had insufficient free assets to pay the withdrawing member's compensation claim at the time the claim fell due, and (2) the remaining members fail to either top up the shortfall or dissolve the GmbH.

b. UK. The parties most often ordered by the court to purchase the withdrawing member's shares – and therefore, to pay the withdrawing member – are the members at fault, ie those whose acts or conduct constituted unfair prejudice

¹⁴²BGH NZG 2012, 259, 261 (paras 21–22).

¹⁴³ibid 261 (para 22); see also Strohn (n 13) Rn 77a (adding that the exiting member's claim would rank ahead of the remaining members' share of distributions in liquidation).

¹⁴⁴BGH Urt. v. 10.5.2016 – II ZR 342/14, BGHZ 210, 186; NZG 2016, 742.

¹⁴⁵BGH NZG 2016, 742, 743 (para 23).

¹⁴⁶ibid 744 (para 24). See also Holger Altmeppen, 'Wer schuldet die Abfindung bei Einziehung eines Geschäftsanteils in der GmbH?' [2013] Neue Juristische Wochenschrift 1025, 1028 (arguing that the basis of personal liability of remaining members lies in the 'accrual principle' ('*Anwachsungsprinzip*') by which the remaining members receive the value of the redeemed membership interest *pro rata* at the expense of the exiting member).

¹⁴⁷BGH NZG 2016, 742, 743–744 (para 23).

¹⁴⁸ibid 744 (paras 25, 28).

¹⁴⁹ibid 744 (para 25).

¹⁵⁰ibid.

to the withdrawing member.¹⁵¹ The forced purchaser's impecuniosity is not a defence to liability, although the trial judge may consider each respondent's circumstances when deciding on the relief.¹⁵² The details of how the purchaser should be compelled to pay is up to the withdrawing member and not the court.¹⁵³ It is open to the court to consider ordering payment on deferred terms.¹⁵⁴

Section 996(2)(e) of the Companies Act 2006 provides that the company itself may theoretically be ordered to purchase the withdrawing member's shares, but this is exceedingly rare.¹⁵⁵ Although there is no statutory provision to the effect or any line of authority stating this, there seems to be not even a single case where the court made a clearly innocent member liable to the withdrawing member against the former's will.

c. Comparison. Under German law, the financially liable party is the GmbH. By contrast, under UK law, the party at fault – which is almost always another member – is the one held financially liable in practice. This is consistent with differences in the types of grounds recognised for withdrawal in the two jurisdictions. Germany permits withdrawal in non-fault scenarios in which there is no party on whom the financial liability to pay compensation may be justly pinned; the logical subject is therefore the GmbH itself. As UK jurisprudence thus far seems to require *de facto* that a particular party other than the company must be found to be at fault in order for unfair prejudice relief to be granted and a share purchase order be made at all, it makes sense that such an order would be made only against this very party at fault.

Enforcement against a GmbH, especially when it is disabled by capital maintenance rules from paying the withdrawing member's compensation claim, is a fraught issue. Other than dissolution of the GmbH, there is jurisprudence, albeit not from cases featuring withdrawal for *wichtiger Grund*, suggesting that the GmbH's remaining members may be liable to pay the withdrawing member's claim under certain circumstances. By contrast, enforcement in the UK is, at least conceptually, a relatively straightforward matter against the person of the forced purchaser.

2. Payment quantum: equity valuation and compensation for harm

Conceptually, depending on whether withdrawal is for fault or non-fault grounds, the monetary claim by a withdrawing member may comprise one or two components. The first component is the value of the withdrawing

¹⁵¹See (n 33) above.

¹⁵²*Re Cumana Ltd* [1986] BCLC 430 (CA) 436–437, 439, 443–444.

¹⁵³*ibid* 437.

¹⁵⁴*Re Phoenix Office Supplies Ltd* [2002] EWHC 591 (Ch), [2002] 2 BCLC 556 [121]–[122], reversed on unrelated grounds sub nom *Re Phoenix Office Supplies Ltd, Phoenix Office Supplies Ltd v Larvin* [2002] EWCA Civ 1740, [2003] 1 BCLC 76.

¹⁵⁵The sole example seems to be *Edwardian* (n 93) [630]–[631] (share purchase order made against both the defendant CEO and the company).

member's equity interest, ie 'equity valuation'. Equity valuation is a component of the monetary claim for both fault and non-fault withdrawal.

The second component, which I call for convenience 'compensation for harm', applies only in cases of withdrawal on fault grounds. In fault scenarios, actions of managers or other members may cause loss to the close corporation and thereby reduce its net value. The value of the withdrawing member's equity interest in the close corporation would correspondingly be diminished in proportion to the size of the interest. If only the first component of equity valuation is accounted for, the withdrawing member would suffer uncompensated harm in the form of reflective loss (or *Reflexschaden*) proportionate to the size of their membership interest. The second 'compensation for harm' component thus addresses the withdrawing member's reflective loss in fault-based withdrawal.

a. Germany. For the equity valuation component of the monetary claim, the compensation (*Abfindung*) is, as a starting point, the full market value (*Verkehrswert*) of the withdrawing member's membership interest¹⁵⁶ with the valuation reference date (*Bewertungsstichtag*) being the date on which the member's declaration of withdrawal is received by the GmbH.¹⁵⁷ This is not based on the market value of the membership interest itself, but rather on the actual enterprise value of the GmbH as a going concern.¹⁵⁸ This is the price that a third party acquiring the business as a whole would be willing to pay,¹⁵⁹ and should be proved by expert evidence.¹⁶⁰ The court has discretion over the applicable valuation standard.¹⁶¹

The value of the withdrawing member's membership interest is its corresponding *pro rata* share of the GmbH's enterprise value, with no discount for any transfer restrictions that apply equally to all members.¹⁶² Although a particular member's membership interest may attract an individual premium or discount where necessary, such as a control premium (*Paketzuschlag*) when a majority stake is involved,¹⁶³ there is no suggestion that a minority discount is applicable to minority stakes.

The position on the compensation for harm component is more complicated.¹⁶⁴ German law does recognise that GmbH members owe each other

¹⁵⁶BGH 01.04.1953 – II ZR 235/52, BGHZ 9, 157, 168; OLG Köln [Higher Regional Court, Cologne] 26.03.1999 – 19 U 108/96, NZG 1999, 1222, 1224; BGHZ 116, 359, 370; Fastrich (n 13) Rn 25; Lutter (n 13) Rn 78; Ulmer and Habersack (n 25) Rn 64.

¹⁵⁷Fastrich (n 13) Rn 25; Seibt (n 13) Rn 22; Strohn (n 13) Rn 215; Ulmer and Habersack (n 25) Rn 65.

¹⁵⁸BGHZ 116, 359, 370.

¹⁵⁹ibid.

¹⁶⁰ibid 371; Lutter (n 13) Rn 79.

¹⁶¹BGHZ 116, 359, 371.

¹⁶²Strohn (n 13) Rn 208.

¹⁶³ibid.

¹⁶⁴I thank the anonymous reviewer for suggesting that I discuss the *ITT* judgment and claims for breach of duty of loyalty; the following paragraphs are in response to this suggestion.

a duty of loyalty under business associations law (*gesellschaftsrechtlicher Treuepflicht*), the breach of which results in, among other possible sanctions, liability to pay monetary compensation.¹⁶⁵ However, whether and under which circumstances a member may recover reflective loss – that is, the decrease in value of their membership interest attributable to a breach of the duty of loyalty – is not entirely clear.

A personal claim by the member for reflective loss appears to be impossible. Consider the leading 1975 BGH case on the duty of loyalty of GmbH members *inter se*, 'ITT'.¹⁶⁶ In this case, the defendant GmbH majority member allegedly breached its duty of loyalty by extracting monetary benefits from the GmbH's subsidiaries. The plaintiff GmbH minority member's claim against the defendant was for compensation to be made to the subsidiaries, and not for the defendant to compensate the plaintiff personally. The BGH Second Civil Senate appears to have assumed that the reduction in value of the plaintiff's GmbH membership interest was not recoverable by the plaintiff.¹⁶⁷ This position has been maintained in subsequent cases¹⁶⁸ and by leading commentaries.¹⁶⁹

For completeness, it is possible for a member to pursue a compensation claim on behalf of the GmbH, where members in breach of their duty of loyalty have caused loss to the GmbH, via the *actio pro socio* (or *actio pro societate*).¹⁷⁰ It is settled law that recovery for claims via *actio pro socio* goes only to the GmbH and not the member personally.¹⁷¹ Commentators generally agree that a member in the process of withdrawal maintain the standing to pursue an *actio pro socio* provided they still remain on the list of members.¹⁷² Even if recovery were successfully obtained for the GmbH, it is not entirely clear as to how the portion of the recovered monies corresponding to a withdrawing member's *pro rata* reflective loss would be paid to that member.¹⁷³ Nonetheless, the requirement of an entirely separate set of

¹⁶⁵This duty is also owed by members to the GmbH, and by the GmbH to the members. See generally Hanno Merkt, '§ 13 Juristische Person; Handelsgesellschaft' in Holger Fleischer and Wulf Goette (eds), *Münchener Kommentar zum Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG* (3rd edn, Munich, CH Beck 2018) Rn 88ff. On the duty of loyalty in other business associations, see Sebastian Reif and Tim Walter, 'Die gesellschaftsrechtliche Treuepflicht' [2021] *Juristische Schulung* 630.

¹⁶⁶BGH Urt v 05.06.1975 – II ZR 23/74, BGHZ 65, 15; NJW 1976, 191 ('ITT').

¹⁶⁷Peter Ulmer, 'Anmerkung' [1976] *Neue Juristische Wochenschrift* 192, 193 (case comment on BGH Urt v 5.6.1975 – II ZR 23/74, BGHZ 65, 15; NJW 1976, 191).

¹⁶⁸See BGH [Federal Court of Justice] Versäumnisurteil [Default Judgment] v 14.05.2013 – II ZR 176/10, NJW 2013, 2586 paras 15, 16, 18 and cases cited therein.

¹⁶⁹See Merkt (n 165) Rn 204 and fn 556 (with further references).

¹⁷⁰See n 40 above and text thereto.

¹⁷¹See eg BGH NJW 2013, 2586 para 16 and references therein.

¹⁷²See Lea Katharina Kumkar, 'Die actio pro socio im GmbH-Recht: Zur Entwicklung und Anwendung der Gesellschafterklage in der Gesellschaft mit beschränkter Haftung' [2020] *Neue Zeitschrift für Gesellschaftsrecht* 1012, 1017 and references cited therein.

¹⁷³It may be possible to account for the reflective loss in the withdrawal compensation claim's equity valuation component: Kumkar (n 172) 1017 fn 76 and text thereto.

proceedings with its own procedural challenges adds substantially to the withdrawing member's litigation risk, and it cannot be considered as an integral part of the German withdrawal regime.

Accordingly, the better conclusion is that there is no 'compensation for harm' component in the withdrawing member's monetary claim in German law; the only exception is perhaps where an *actio pro socio* for recovery of reflective loss is first or concurrently pursued successfully.

b. UK. The court, in determining the share purchase price payable by the forced purchaser to the withdrawing member, has very wide discretion.¹⁷⁴ Generally, a minority shareholding may be valued, in order of likelihood, as (1) a *pro rata* ('rateable proportion') share of the 'total value of the company as a going concern' without minority discount; (2) *pro rata* going concern value but with minority discount; and (3) *pro rata* share of the company's break up or liquidation value.¹⁷⁵

The court is free to adopt a *pro rata* valuation, a 'full' minority discount, or an intermediate discount.¹⁷⁶ Whether a minority discount should be applied depends on whether the company is a quasi-partnership. The starting point for quasi-partnerships where the withdrawing member is not at fault, and the respondent is ordered to purchase the former's shares, is a *pro rata* valuation without minority discount.¹⁷⁷ Conversely, a discount would be appropriate where the withdrawing member in a quasi-partnership 'deserved' to be excluded from management or had contributed to the unfairly prejudicial conduct complained of.¹⁷⁸

Further, UK law permits the courts to 'compensate' at their discretion the withdrawing member for their 'share' of the company's loss suffered in connection with the unfairly prejudicial acts or conduct. As a starting point, the court generally values the shares as if the unfairly prejudicial conduct had not occurred.¹⁷⁹ The court may adjust the real share values 'to reflect the effect on the company of all or any wrongs which the wrongdoer respondents have committed against it'.¹⁸⁰ Sums that may be taken into account in valuation include outstanding loans and other claims owed by members to the company,¹⁸¹ and 'loss' incurred by the company (ie

¹⁷⁴*Re Bird Precision Bellows Ltd* [1986] Ch 658 (CA) 669.

¹⁷⁵*CVC/Opportunity Equity Partners Ltd v Demarco Almeida* [2002] UKPC 16, [2002] 2 BCLC 108 [37].

¹⁷⁶*Richards v Lundy* [2000] 1 BCLC 376 (ChD) 398; *Fowler v Gruber* [2009] CSOH 36, [2010] 1 BCLC 563 [187].

¹⁷⁷*Profinance Trust SA v Gladstone* [2001] EWCA Civ 1031, [2002] 1 BCLC 141 [18]; *O'Neill* (n 60) 1107; *Strahan v Wilcock* [2006] EWCA Civ 13, [2006] 2 BCLC 555 [1], [17]. No control premium should apply to the shares of a majority member who is ordered to sell to the minority: *Hollington* (n 33) para 8–152.

¹⁷⁸*Re Bird Precision Bellows Ltd* [1984] Ch 419 (ChD) 431; *McCarthy* (n 74) [98]–[99].

¹⁷⁹*Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324 (HL) 364, 369; *Profinance* (n 177) [31].

¹⁸⁰*Tobian* (n 51) [26].

¹⁸¹*Re Scitec Group Ltd, Sethi v Patel* [2010] EWHC 1830 (Ch), [2011] 1 BCLC 277 [56], [70].

reflective loss)¹⁸² due to unfairly prejudicial conduct such as undervalue transactions,¹⁸³ improper or unnecessary litigation costs,¹⁸⁴ or excessive payments by the company.¹⁸⁵ The court may also make an adjustment for a member who has been unfairly deprived over many years of dividends.¹⁸⁶

By adjusting valuations to reflect the true value that the shares would have had if the unfair prejudice had not occurred, the courts also account for the respondent's fault. When choosing the valuation date, fairness is the court's overriding consideration.¹⁸⁷ Hence, although the date of the share purchase order often serves as a starting point,¹⁸⁸ an early valuation date may be applied in especially deplorable examples of unfair prejudice to insulate the valuation from general declines in market conditions after commencement of proceedings.¹⁸⁹ An early valuation date can be further combined with 'quasi-interest',¹⁹⁰ which can accrue starting on the selected valuation date even if this is much earlier than the share purchase order date.¹⁹¹

c. Comparison. Under both German and UK law, a withdrawing shareholder is generally entitled to claim a monetary sum of at least the equity valuation component, which is the value of their equity interest calculated as a *pro rata* share of the going concern value of the close corporation. The key difference between the two jurisdictions is with regards to the second component, compensation for harm. German withdrawal law does not equip courts to compensate withdrawing members affected by corporate value-decreasing acts or conduct; the withdrawing member's best recourse is to pursue a separate compensation claim for breach of the duty of loyalty through a quasi-derivative action (ie *actio pro socio*). Conversely, UK courts have an arsenal of tools they may deploy in their discretion to achieve fair outcomes – including the possibility of full compensation for harm arising from reflective loss – for withdrawing members within the unfair prejudice remedy itself.

¹⁸²See *Atlasview Ltd v Brightview Ltd* [2004] EWHC 1056 (Ch), [2004] 2 BCLC 191 [60]–[63]. On reflective loss, see generally Jennifer Payne, 'Sections 459–461 Companies Act 1985 in Flux: The Future of Shareholder Protection' (2005) 64 CLJ 647; Brenda Hannigan, 'Drawing Boundaries Between Derivative Claims and Unfairly Prejudicial Petitions' [2009] JBL 606; Stephen Griffin, 'Shareholder Remedies and the No Reflective Loss Principle – Problems Surrounding the Identification of a Membership Interest' [2010] JBL 461; Pearlie Koh, 'The Shareholder's Personal Claim: Allowing Recovery for Reflective Losses' (2011) 23 Singapore Academy of Law Journal 863; Alan K Koh, 'Reconstructing the Reflective Loss Principle' (2016) 16 JCLS 373.

¹⁸³*Richards v Lundy* (n 176) 400.

¹⁸⁴*Elgindata* (n 52) 1008; *Macro (Ipswich)* (n 57) 409.

¹⁸⁵Remuneration: *Irvine v Irvine (No 1)* [2006] EWHC 406 (Ch), [2007] 1 BCLC 349 [357]; *Lloyd v Casey* (n 53) [107]. Management charges: *Macro (Ipswich)* (n 57) 409. Rent: *Scitec* (n 181) [48].

¹⁸⁶*McCarthy* (n 74) [100]–[101].

¹⁸⁷*Profinance* (n 177) [60].

¹⁸⁸*London School of Electronics* (n 88) 224.

¹⁸⁹*Cumana* (n 152) 435–436, 444.

¹⁹⁰*Profinance* (n 177) [32].

¹⁹¹*ibid* [30]–[31].

C. Two models of withdrawal

Based on the individual differences between German and UK withdrawal law as revealed by the comparative analysis above, this Subsection identifies and critically evaluates two distinct models of withdrawal represented by the two jurisdictions.

1. Germany: the 'quasi-insurance' model

Germany's withdrawal regime is characterised by a broad range of grounds and a less potent remedy. Centred on a flexible concept (*wichtiger Grund*), the availability of withdrawal is not limited to when other members were at fault; non-fault scenarios such as relationship breakdown or deadlock, poor and irrecoverable business prospects, and even purely personal reasons affecting one's participation in the GmbH's business are all potentially situations in which an aggrieved member may have recourse to withdrawal.¹⁹² For GmbH members who have fallen on hard times or fallen out irretrievably with other participants in the enterprise, the law does not expect them to completely internalise their losses, or to throw themselves at the mercy of the controlling majority: withdrawal is often an option.

However, the remedy offered is less potent, with the interests of stakeholders other than the withdrawing member coming into play. In principle, it is the GmbH that is financially liable to pay the withdrawing member their compensation claim. This has several implications. First, the presence of a rigid, pro-creditor capital maintenance regime means that whether the GmbH can lawfully pay the withdrawing member's claim largely depends on whether the GmbH has free assets (ie in excess of its registered capital). If the GmbH lacks free assets, the only certain means of enforcement for the withdrawing member is to apply for judicial dissolution of the GmbH. This outcome would undermine one of the greatest advantages of the withdrawal remedy – enterprise preservation. A possible alternative might be a personal claim against the GmbH's remaining members, provided certain conditions were met. However, the remaining members would be entitled to avoid personal liability by dissolving the GmbH – which again would run counter to the goal of enterprise preservation.¹⁹³

The quantum recoverable by the withdrawing member may also fall short of what would be necessary to fully protect their interests. The withdrawing member's monetary claim is, in principle, limited to a *pro rata* share of the GmbH's value. This poses no difficulty when withdrawal is sought on non-fault grounds. However, this is problematic when withdrawal is sought because of the fault worthy conduct of other parties

¹⁹²Section III.A.1.a, III.A.3.a. In addition, withdrawal may also be available in situations where attribution of fault is unclear or where multiple parties are at fault: Section III.A.2.a.

¹⁹³Section III.B.1.a.

resulting in wrongful loss to the GmbH. In the latter scenario, unless someone pursues separate legal action against the wrongdoers, the withdrawing member would not get to recover their portion of reflective loss through their compensation claim, leaving them less than fully compensated for the true extent of their membership interest and associated loss.¹⁹⁴

Germany's withdrawal regime is thus characterised by a combination of inclusivity (in terms of grounds), reliance (on the GmbH and its asset pool), and subordination (to creditor interests represented by capital maintenance rules). The regime's focus is not on ensuring that certain persons, whose actions or behaviour led to the circumstances establishing the *wichtiger Grund* for withdrawal, are held personally liable to the withdrawing member. Rather, the GmbH performs a function not unlike a 'quasi-insurance fund', metaphorically *insuring* its members against part of the vicissitudes of business (and even personal) life. However, in deference to creditors' interests, the quasi-insurance is limited to the GmbH's free assets. As residual claimants with limited liability, GmbH members – even those subject to abusive behaviour of others – are only partly, and not completely, insulated from the risks of close corporation participation. I therefore adopt the nomenclature of 'quasi-insurance model' to describe a withdrawal regime centred on features like Germany's.

2. The UK: the 'corrective' model

By contrast, the UK's withdrawal regime is accessible in a narrower range of circumstances, but the resulting remedy is more potent. The seemingly open-ended statutory language of 'unfair' and 'prejudice' belie the relatively limited types of scenarios in which withdrawal is available. These are independently unlawful acts and breaches of 'equitable considerations' by other participants in the company; the latter category is applicable only in the ill-defined subclass of private companies known as 'quasi-partnerships'.¹⁹⁵ Withdrawal on non-fault grounds has been completely rejected by the UK's highest court.¹⁹⁶ Members who wish to withdraw but cannot point to any clear villain will find UK law rather unsympathetic to their troubles.

Conversely, the members who can prove to the court's satisfaction that their suffering can be attributed to someone else's fault would have access to a powerful remedy unhindered by the interests of other stakeholders. The solution is as simple as it is elegant: those who have harmed them without adequate justification would be held personally liable, as the forced purchaser of the withdrawing member's shares, to pay the

¹⁹⁴Section III.B.2.a.

¹⁹⁵Section III.A.1.b.

¹⁹⁶Section III.A.3.b. Members who were not completely blameless may have to roll the proverbial dice: Section III.A.2.b.

latter's monetary claim. Enforcement by the withdrawing member of their monetary claim against the liable party is also a relatively straightforward matter. Neither the company itself nor the remaining, innocent members are at risk of personal liability.¹⁹⁷ With the company off the hook, its creditors suffer no prejudice and require no special consideration. Save for exceptional circumstances,¹⁹⁸ enterprise preservation is ensured.

The withdrawing member has a reasonable chance of being fully compensated. They would be able to claim as equity valuation their *pro rata* share of the company's value. Additionally, they also stand a chance – the court's discretion permitting – of receiving, from the liable party, compensation for the withdrawing member's share of the reflective loss inflicted on the company.¹⁹⁹ The withdrawing member who wins, wins big.

In requiring that fault be clearly attributed to a particular party for relief to be ordered, the UK withdrawal regime is a more targeted, all-or-nothing form of shareholder protection. The ensuing remedy is a powerful one that targets only the wrongdoer and seeks to compensate victims fully. UK withdrawal law thus exhibits a strong focus on *correcting* wrongs in a way reminiscent of the law of extracontractual obligations; its role is not to provide broader protection against circumstances attributable to anything other than the fault of an identifiable person. By holding parties at fault accountable for their actions by making them personally liable to the victimised member, unfair prejudice might also deter people from exercising their powers abusively or prejudicially – a positive side effect. To capture the targeted and compensatory nature of unfair prejudice, I call this model of withdrawal the 'corrective model'.

3. Comparison

While the analysis in Section III has thus far focused on the differences between the German and UK withdrawal regimes, the fact that withdrawal remedies are, as a category of shareholder remedies, characterised by protective range and enterprise preservation²⁰⁰ should not be forgotten. All withdrawal remedies are protective of non-controlling shareholders in a range of scenarios by providing them exit from the close corporation and recovery of their investment. They also share the goal of preserving the corporation as a going concern and minimising detriment to innocent stakeholders. The differences between individual jurisdictional regimes lie in the circumstances in which relief is available ('when'), the parties liable to pay ('who'), and the payment quantum ('how much').

¹⁹⁷Section III.B.1.b.

¹⁹⁸It is theoretically possible that the forced purchaser would be impecunious and thus forced to liquidate the company to pay for the withdrawing member's shares.

¹⁹⁹Section III.B.2.b.

²⁰⁰Section II.A.

Under the quasi-insurance model, any shareholder who suffers serious hardship or prejudice not caused by their own voluntary acts is regarded as 'deserving' of protection. This is consistent with permitting withdrawal relief at least in some cases to even a shareholder who falls so ill as to become incapable of participating in the business – as this is not their fault ('when'). The 'innocent' stakeholders that the quasi-insurance model cares for are the corporation's creditors and other shareholders not responsible for causing the withdrawing shareholder's hardship. These stakeholders' interests are accordingly protected by the rule that the close corporation is the party liable to pay, and by rules that limit enforcement of the withdrawing shareholder's monetary claim to the extent permitted by capital maintenance rules ('who').²⁰¹ The quantum recoverable by the withdrawing shareholder may not reflect the full loss when withdrawal is triggered by the fault of others ('how much'), as the focus is not on identifying and imposing legal consequences on a specific wrongdoer, but rather on providing a basic level of protection for all deserving shareholders. The quasi-insurance model may be summarised as one that focuses on breadth, rather than depth, of protection.

The corrective model trades comprehensive protection of shareholders against a wide range of risks and circumstances for excellent protection against a narrower range of scenarios: targeted ill-treatment by persons in control of the close corporation. Only shareholders harmed personally by blameworthy conduct of other shareholders or controllers are considered 'deserving' under this model and qualified to have access to withdrawal ('when'). The close corporation and its business, corporate creditors, and truly 'innocent' shareholders are regarded as innocent stakeholders that are uninvolved in the dispute. Relief for the aggrieved shareholder is achieved only at the specific expense of the wrongdoers, as withdrawal primarily takes the form of legally compelling only the specific party at fault to personally buy out – and pay – the withdrawing shareholder through a share purchase order ('who'). Full compensation of a qualified victim, including recovery of reflective loss, is contemplated by a corrective withdrawal regime ('how much'). The corrective model's focus is therefore on achieving, through identifying and imposing legal liability on culpable persons, targeted and thorough protection for the benefit of a narrower class of shareholders.

By emphasising different aspects of withdrawal – most notably, breadth (availability) versus depth (strength) – each model has its strengths and weaknesses. While no jurisdiction is required to adhere strictly to the features or constraints of either model, the complementarities between the key

²⁰¹As discussed above at Section III.B.1.a, liability of the remaining members is not yet recognised in German withdrawal law. Even if it were, members' liability would be at most subsidiary to the GmbH's liability and may be avoidable by commencing dissolution.

aspects (when, who, how much) within a jurisdictional regime hewing closely to one of the models make it difficult to contemplate the alternative(s). Neither model standing alone offers truly comprehensive shareholder protection.

IV. Should the UK reform its withdrawal regime? Challenges and possibilities

A. The problem with the UK's withdrawal regime

UK law excels at protecting members suffering from unlawful or promise-breaking conduct by those in control of the company by granting them a claim for full compensation (including reflective loss recovery, where applicable) against the wrongdoers.²⁰² However, in refusing to recognise withdrawal for non-fault grounds, UK withdrawal law fails to protect members suffering from hardships arising from other situations, such as irreparable breakdowns in trust and confidence due to shareholder conflict or changes in the internal or external business environment.²⁰³ Members seeking relief from difficulties caused by situations other than the fault of specific individuals must look outside the law of withdrawal.

German law, on the other hand, demonstrates that non-fault withdrawal is possible – and valuable – in extending protection to shareholders experiencing forms of hardship other than harm caused by identifiable parties. However, with no party at fault on whom liability can be justifiably pinned, the financial liability of non-fault withdrawal must fall, by a process of elimination, on the GmbH. The cost of making non-fault withdrawal available is placing burdens on the close corporation, but this in turn cannot be allowed to unduly prejudice the interests of innocent stakeholders such as corporate creditors. The balancing of the withdrawing member's, remaining members', and creditors' interests necessarily results in a weaker remedy for non-fault withdrawal, and one that may be difficult to enforce without triggering dissolution.

Reforming UK law to include non-fault withdrawal along the German quasi-insurance model creates formidable difficulties – specifically, the consequences for the liable party's identity and enforcement. As discussed above (Section III.C.2), under the corrective model exemplified by the UK, both the personal liability of another member to purchase the withdrawing member's shares, and direct enforcement by the withdrawing member against the financially liable purchaser, are premised on the forced

²⁰²Sections III.A.1.b, III.B.1.b, III.B.2.b, III.C.2.

²⁰³Section III.A.3.b; see also *Neath Rugby* (n 119) [108] ('Deadlock and the inability of a company to conduct its business as initially contemplated when the parties trusted and had confidence in each other may be inherent in the breakdown of that trust and confidence, but in my judgment do not without more satisfy the requirements of [the UK withdrawal regime].')

purchaser's fault. Introducing non-fault withdrawal by reforming the *unfair prejudice* regime risks destroying the internal conceptual consistency of that regime by forcing two distinct models of shareholder protection into a single wrapper.

B. A potential way forward: the case of Singapore

The notion that members may seek exit for 'non-fault' reasons is not completely alien to UK law. Voluntary winding-up on the 'just and equitable' ground – which is a non-fault concept with a body of jurisprudence²⁰⁴ – and subsequent liquidation may be an obvious solution of long vintage in the UK. However, dissolution and liquidation would be wasteful and in fact against the interests of the member seeking exit.²⁰⁵ Effecting a 'corporate divorce' – even if neither party is at fault – without killing the company is a better solution, and which is precisely withdrawal's greatest advantage over dissolution.

How then might the corrective—quasi-insurance tension be resolved in UK withdrawal reform? One example might be Singapore's reformed just and equitable winding up (judicial dissolution) regime. For the longest time, Singapore's regime was a virtual carbon copy of section 122(1)(g) of the UK Insolvency Act 1986 and its precursors, and in similar vein did not offer withdrawal (in the form of a share purchase order) as an alternative to winding up. However, Singapore's just and equitable winding up regime was reformed in 2014 to codify pre-existing judicial practice²⁰⁶ by adding a general power of the court to order, in lieu of winding up, that the shares of one or more shareholders shall be purchased by the company or other shareholders.²⁰⁷

Since then, Singapore's 'winding up' regime would be more appropriately characterised as a 'just and equitable remedy for companies'.²⁰⁸ The Court of Appeal (Singapore's apex court) quickly endorsed the practice of shareholders resorting to the regime to seek not dissolution but rather withdrawal, provided that shareholders do so on grounds not recognised by other remedies²⁰⁹ – specifically the fault-based and corrective model-type 'oppression' regime²¹⁰

²⁰⁴See n 121 above and text thereto.

²⁰⁵See eg *Elder v Elder & Watson Ltd* 1952 SC 49 (1st Div) 54 (Lord Cooper LP) ('the cure [of granting dissolution] would have been worse than the disease, owing to the prejudice likely to be inflicted upon the applicants for relief as a result of a compulsory liquidation of the company').

²⁰⁶Koh and Tang (n 13) 375.

²⁰⁷Singapore Companies Act (Cap 50, 2006 Rev Ed), s 254(2A) as introduced by Companies (Amendment) Act 2014 (Act 36 of 2014); repealed and re-enacted as the Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) ('IRDA'), s 125(3), effective from 30 July 2020. Another way of looking at it is that withdrawal reform has gone full circle back to the UK Companies Act 1948, s 210, which was introduced following the Cohen Committee report's recommendation (Cohen Committee, *Report of The Committee on Company Law Amendment* (Cmd 6659, 1945) para 60).

²⁰⁸Koh and Tang (n 13) 377.

²⁰⁹*Ting Shwu Ping (administrator of the estate of Chng Koon Seng, deceased) v Scanone Pte Ltd* [2016] SGCA 65, [2017] 1 SLR 95 [59]–[61].

²¹⁰Singapore Companies Act (Cap 50, 2006 Rev Ed), s 216.

that is the direct equivalent of the UK unfair prejudice regime. Consequently, the 'just and equitable remedy' now provides an independent statutory basis for non-fault withdrawal that is separate and distinct from the oppression-based fault withdrawal regime.²¹¹

Singapore's non-fault withdrawal regime has already seen action. In the recent case of *Chong Kok Ming v Richinn Technology Pte Ltd*, the Singapore High Court held that the shareholders' relationship had irretrievably broken down.²¹² The final order made was for the company to be wound up on the just and equitable ground unless the majority shareholder agreed within ten days of the order to purchase the minority shareholder's shares at fair value without discount to be assessed by an independent valuer.²¹³ Although the court saw fit to impose the majority shareholder with the financial liability of buying out the minority shareholder petitioner in this particular case, it retains the discretion to order, in a future case, that the company shall be the financially-liable party. In other words, the option of true non-fault withdrawal is open in Singapore.

Singapore's experience raises the possibility of incorporating non-fault withdrawal in the UK by amending the Insolvency Act's just and equitable winding up regime to grant the court express power to order a buyout in lieu of making a winding up order. While the creation of a 'just and equitable remedy' for the UK is admittedly no panacea to its close corporation problems, the immediate benefit of doing so would be to leave the statutory and conceptual structure of the existing UK unfair prejudice regime intact as an exemplar of the corrective model. In other words, rather than tamper with the existing corrective model-type regime by adding non-fault grounds to it, there may be practical advantages to establishing a separate quasi-insurance regime limited to non-fault grounds.

The resulting union of corrective and quasi-insurance models – a 'comprehensive' model of withdrawal – does present technical and practical challenges. Issues of arbitrage between the unfair prejudice and just and equitable remedies may well arise, but that is hardly a novel problem²¹⁴ and it is doubtful that the proposed reform would make things substantially worse. In any event, conflicts between the two withdrawal regimes can be reconciled later by a healthy dose of judicial

²¹¹For completeness, it should be noted that Singapore's withdrawal-in-lieu-of-winding up regime is not strictly limited to non-fault grounds as it also potentially covers a narrow subset of fault grounds in the form of director misconduct; see IRDA, ss 125(1)(f), 125(3).

²¹²*Chong Kok Ming v Richinn Technology Pte Ltd* [2020] SGHC 224 [122], [133]. For an analysis of this case, see Alan K Koh, Dan W Puchniak and Cheng Han Tan, 'Company Law' (2020) 21 SAL Ann Rev 224 paras 9.77–9.82 <<http://ssrn.com/abstract=3886068>>.

²¹³*Chong Kok Ming v Richinn Technology Pte Ltd* [2020] SGHC 224 [137]–[138], applying forerunners of IRDA, ss 125(1)(i), 125(3).

²¹⁴See PD 49B, para 1; Practice Direction – Insolvency Proceedings (IPD), para 22.

common sense and case management. While the UK's track record with withdrawal reform²¹⁵ is cause for pessimism, the pursuit of comprehensive shareholder protection through withdrawal is a timeless one – and hope never dies.

V. Conclusion

Intractable shareholder conflict is a perennial threat to close corporations. Withdrawal remedies are drastic, yet final and effective legal solutions to intractable shareholder conflict that also largely preserve close corporations as going concerns. Closer analysis of Germany's and the UK's withdrawal regimes using a functional comparative framework reveals critical differences. These differences reflect two contrasting models of withdrawal that encapsulate distinct visions of shareholder protection. Reforming UK law to address its current blind spot regarding non-fault withdrawal would be a worthwhile endeavour.

This Article is also a reminder of how domestically developed models and rules, even in an area of law as seemingly developed as unfair prejudice in the UK, are inherently limiting in perspective. National exceptionalism should have little place in close corporation law in the UK – or indeed, anywhere. Where it comes to tackling timeless problems faced by non-controlling shareholders in close corporations, there is always something to learn from – and be inspired by – foreign experiences.

Acknowledgements

I am grateful to Moritz Bälz, Tobias Tröger, Samantha Tang, Dan Puchniak, Curtis Milhaupt, Goto Gen, Kim Kon-Sik, Shishido Zenichi, and Wakita Masanori for their comments and advice on preparatory research leading up to this Article, to Shouyu Chong for research assistance, and to the anonymous reviewer whose suggestions helped to improve this Article significantly. I am also grateful to the attendees of the Corporate Law Teachers Association (CLTA) (since renamed Society of Corporate Law Academics) Annual Conference 2020 at Monash Business School for their comments on an earlier draft. All errors remain mine alone. An earlier draft of this Article was recognised at the CLTA conference as a highly commended article.

Disclosure statement

No potential conflict of interest was reported by the author(s).

²¹⁵The last round of reform took almost twenty years to go from proposal to enactment: Jenkins Committee, *Report of the Company Law Committee* (Cmd 1749, London, Stationery Office 1962) para 204; Companies Act 1980, s 75.

Funding

This research was supported by the Nanyang Technological University Start-Up Grant (04INS000773C300) and by the Ministry of Education, Singapore, under its Academic Research Fund Tier 1 (04MNP001989C300).

Notes on contributor

Alan K. Koh is Assistant Professor of Law, Division of Business Law, Nanyang Business School, Nanyang Technological University, Singapore.

ORCID

Alan K. Koh  <http://orcid.org/0000-0001-6305-2877>