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Editorial

This issue of the *European Business Organization Law Review* is devoted to the most topical and important areas of company law reform, namely the revision of corporate forms and the introduction of unincorporated business entities such as partnerships and hybrid business forms.

Focusing on the United States, the increased emphasis on competition between jurisdictions led observers in the 1980s to call for the creation of a set of new types of business entity that were suitable for different types of businesses. Over the last two decades, we have witnessed the rise of the new unincorporated entities and the way they operate. The success of these new types of business associations is not accidental. Unsurprisingly, a large number of business parties have a preference for the new and more flexible types of entity, which have a perceived competitive advantage over corporations. Several factors contribute to the growth of these forms in recent years. First, States have responded to the need for business structures that are more flexible contractually, which has reduced reliance on or eliminated inefficient older forms. Second, the liberalisation of partnership law has been accompanied by the virtual elimination of the distinction between partnerships and corporations, accompanied by a move towards the recognition of partnerships as entities. Third, the increase in the choice of new contractual limited liability entities for business has resulted in the erosion of traditional restrictions on the internal structure of legal business forms.

In the Europe Union, the legal reform process has been advanced considerably by a recent wave of decisions by the European Court of Justice, which has stimulated the mobility of small businesses toward the United Kingdom, and hence the introduction of various legislative strategies to meet the needs of businesses that might be lured to more attractive jurisdictions. Naturally, the increased mobility of small companies has led some European jurisdictions to be responsive. The most obvious reaction by lawmakers has been to pursue improvements in the efficiency of their existing unincorporated business forms, while seeking to minimise the cost of regulation by lowering obligations. In this sense, lawmakers focus on modernisation and simplification strategies without regard to the introduction of new business entities.

The articles in this issue are grouped into two categories: the expansion of unincorporated business entities in the United States and the law reform process of limited liability forms in European jurisdictions.

In the first set of articles, McCahery, Vermeulen, Hisatake and Saito argue, in 'Traditional and Innovative Approaches to Legal Reform: The "New Company Law"', that the introduction of new legal entities is more likely to meet the contracting needs of professional firms, small and medium-sized businesses and entrepreneurs than simply making 'patch-up' reforms to existing company law

rules and structures. New entity types are designed to achieve best outcomes for companies by making available private ordering, fiscal transparency and limited liability. Even though these new forms are typically incomplete legally, their adaptability and responsiveness to economic change compensates for their deficiencies. They observe that, like the United States, a number of Asian countries have recently embarked on policy innovation through the introduction of new unincorporated business entities. Local officials in Singapore, aware of the need to create up-to-date business entities to compete for investment in China, introduced a limited liability partnership (LLP) in 2005, which should allow business parties to freely contract while offering sufficient legal protections for creditors and other investors. Likewise, Japan has expanded its line of business forms recently by introducing two new limited liability entities, a limited liability company (LLC) or *Godo Kaisha* and a limited liability partnership (LLP) or *Yugen Sekinin Jigyou Kumiai*. In the near future, India can also be expected to develop an LLP statute designed to attract new inward investment. Whilst there may be important differences in the new business entities and their underlying rationales, the authors contend that such innovations can be seen as a response to the costs of regulation and possibly an attempt to supply the legal rules most needed to attract inward investment.

In 'The New Business Entities in Evolutionary Perspective', Henry Hansmann, Reinier Kraakman and Richard Squire develop a law and economics analysis of the evolution of legal organisational forms with entity-based features necessary to facilitate commercial relationships with third parties. After examining how the principle of limited liability and entity shielding were key to the wealth creation associated with the rise of the modern corporation, they see the evolution of the new limited liability forms as different versions of the business corporation.

In 'Not "Like Sailors or Idiots or Infants": Social Welfare Based Limits on Private Ordering in Business Association Law', Allan Vestal challenges the orthodoxy associated with economic accounts of the success of the new unincorporated business entities, maintaining that there is a need to broaden the cost-benefit analysis by seeking to make an aggregate determination of the benefits and costs associated with the new contractual forms. The task should be to determine, as to each statutory provision, which level of private ordering is justified and in how many cases regulation may be required to correct the imbalance where private ordering is not warranted. As part of this expansive cost-benefit procedure, Vestal concludes that a determination of how many state-based variations of each business form is needed to justify their widespread use.

The second set of articles focuses on the private company law reforms underway in some European jurisdictions. In 'Close Corporations – Reforming Private Company Law: European and International Perspectives', Ulrich Seibert looks at the factors that have stimulated the reform of the German private limited company (*Gesellschaft mit beschränkter Haftung – GmbH*), noting that the primary

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motivation is the competitive pressure arising from the UK private limited company (Ltd). Evaluating the possible reform strategies available in a competitive market, he concludes that it is desirable to 'face the competition' by adopting provisions that are responsive to the inroads made by the United Kingdom's Ltd. Lawmakers seeking more incorporations have sought to introduce reforms designed to: (1) lower the minimum capital required (reduced to €10,000 rather than cut down to €1); (2) eliminate red tape involved in the transfer of shares and the entry of a limited company into the commercial register; (3) facilitate incorporations by introducing an electronic commercial register and electronic filing; (4) allow German companies the freedom of choice to move their seat of administration abroad; (5) increase the transparency of shares; (6) introduce *bona fide* acquisition of shares; (7) secure cash pooling; (8) deregulate rules on shareholder loans replacing equity capital; and (9) introduce tighter registration requirements to facilitate creditors claims and more demanding director disqualification provisions to limit abuse. Finally, Seibert does not believe that the approach taken by other regulators, which involves the introduction of new unincorporated business forms, is appropriate because it does not lead to improvements in the institutional environment.

In 'The Austrian *GmbH & Co. KG*', Susanne Kalss observes that, until recently, fiscal reasons explained why business parties would create a *GmbH & Co. KG*. However, the fiscal advantage of this business form has been eroded in recent years due to legislative changes that have been beneficial to the *GmbH*. Lawmakers have continued to erode the competitive advantage of the *GmbH & Co. KG* by also allowing corporations the possibility of netting the company's profits and losses against the shareholders' other income. Thus, since it is unlikely that the *GmbH & Co. KG* currently provides sufficient regulatory arbitrage advantages to justify parties switching to the form, the decline of the *GmbH& Co. KG* is inevitable.

In 'Private Ordering and Buy-Out Remedies Within Private Company Law: Towards a New Balance Between Fairness and Welfare?', Harm-Jan de Kluiver provides an overview of the report of the expert group appointed by the Dutch government in 2003 to advise on the review of private company law and the draft legislation which subsequently emerged. As a starting point for analysing private company law, De Kluiver notes that there are three main concerns: (1) the accessibility of the private company for a wide range of business parties; (2) the internal structure of the company; and (3) the protection of third parties. Against this background, the Dutch expert group noted that the freedom of contract should to a large extent govern the internal governance structure of the private (close) company (*Besloten Vennootschap* or *BV*). When it comes to the introduction of new types of entities, De Kluiver acknowledges that these developments should be able to exist alongside more traditional legal business forms. But, rather than endorse the adoption of a new hybrid business entity, the expert group proposed a number of changes to make the private company more flexible. In this context,

De Kluiver explores several possible explanations of why making the private law of companies more flexible can lead to positive results.

In 'Flexibility and Function of Private Company Statutes', Maarten Kroeze observes, against the background of the Dutch reform process, that the objective of a debate on private company law statutes is indeed to provide insights for dealing with some of the far-reaching challenges involved in the reform of private company law. In this context, he notes that there are two types of rules in private company law: rules linked to promoting welfare and other rules that promote fairness. Having shown that the private company has characteristics of both a partnership and corporation, Kroeze goes on to propose a number of amendments to the current reform proposal, including: (1) shares without voting rights should be allowed; (2) the valuation of the share value by an expert should not be mandatory if there is prior shareholder agreement or no basis for a valuation due to misconduct, fraud, etc.; (3) a private company without a formal board of directors and shareholders as governing body should be permitted; (4) an default rule should be introduced on the restriction of the transfer of shares introducing a pre-emption right for other shareholders unless stated otherwise in the articles of association; (5) the duty of stating a purpose in the articles of association should be non-mandatory; and (6) shares with no par value should be introduced for practical reasons.

In her article, 'Directors' and Shareholders' Liability as a Means of Protecting Creditors of the *BV*', Loes Lennarts observes that a number of commentators have observed that the Dutch capital maintenance regime is ineffective and creates obstacles for private parties in the operation of their affairs. Against this background, she argues that the Dutch reform process should attempt to strike a proper balance between welfare and fairness. This task, however, is complicated by the presence of the three parties involved, which makes it difficult to locate a unique equilibrium. In her overview of the Dutch reform programme, Lennarts argues that the proposals in the area of distributions, which assign responsibility to the board and liability rules for directors for reviewing the distributions, are for the most part appropriate. She goes on to consider the proposed obligation for shareholders to return any distribution which was made to them within one year prior to bankruptcy. While the idea has some advantages – it will efficiently protect creditors and take pressure off directors – she cautions that the automatic pay-back provision could create a climate of fear prompting large shareholders either to avoid investment in a Dutch *BV* or to exploit loopholes in the law to avoid triggering the provision.

Finally, this issue concludes with two articles concerning company law reform at European level.

In 'European Company Law Beyond the 2003 Action Plan', Theodor Baums describes the current state of implementation of the European Commission's 2003 Action Plan on Modernising Company Law and Enhancing Corporate Governance, as well as how the new Commission revisited and adjusted the Action Plan

after it entered office in November 2004. In addition, he sketches the outlook for the future development of European company law and corporate governance. He discusses the methods and goals of the Commission and, insofar as possible, describes the contours of the concrete measures that are in the works.

In 'Is a Directive on Corporate Mobility Needed?', Eddy Wymeersch claims that corporate mobility remains a real political issue. To clarify matters, he distinguishes between a formal seat transfer, being the choice of a different legal regime, and a *de facto* seat transfer that would not affect the applicable company law, the host State not being entitled to apply its company law rules. He argues that a future directive should be based on this distinction, prescribing the formalities for the former and stating clearly the consequences of the latter, thereby also defining the limits within which the 'general good' can be invoked.

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