Expulsion and Valuation Clauses – Freedom of Contract vs. Legal Paternalism in German Partnership and Close Corporation Law

by

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The question of whether and when expulsion and valuation clauses in partnership agreements or the articles of close corporations are valid has occupied German courts as well as legal scholars for many decades. While the courts nowadays take a rather restrictive stance on the validity and enforceability of such clauses, a growing body of literature criticises the case law of the Federal Supreme Court as overreaching with regard to the members' freedom to arrange for the internal affairs of their own association. This article depicts the changeful case law of the German Federal Supreme Court on expulsion and valuation clauses as well as its echo in the scholarly debate. Subsequently, the analysis turns to the question whether and how this restriction of the partners' and shareholders' freedom of contract can be justified. It comes to the conclusion that limiting the members' private autonomy on the issues of expulsion and valuation of the exiting member's share in the association can, in principle, be justified as a manifestation of so-called libertarian paternalism. Applying this regulatory concept that builds on the insights of psychological and behavioural economic research to the Federal Supreme Court's case law shows, however, that the court's grip on the arrangements of the members of partnerships and close corporations is unjustifiably tight and has to be loosened in deference to the members' freedom of contract, thereby bringing it more in line with English and U.S. laws on closely held business associations.

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I. Introduction

In German partnership as well as close corporation law freedom of contract reigns with regard to the internal affairs of the respective association, i.e. insofar as the interests of creditors or other third parties are not involved. This is, however, only true in principle or – even less – as a starting point, since the courts as well as the academic literature have developed numerous doctrines and devices limiting the private autonomy of the (prospective) members and putting the partnership agreement or the articles of association, respectively, under judicial scrutiny.[1] Sleuthing what justifies these considerable restrictions of the members' private autonomy this article focusses on a more limited, but nevertheless prominent question being part of this greater issue, namely whether and when expulsion and valuation clauses in partnership agreements or the articles of close corporations are valid and/or enforceable. Even though this question has occupied German courts as well as legal scholars for many decades, its correct answer is still subject to considerable debate.

After unfolding the topic of this contribution in further detail (1. to 3.) and clarifying the reasons and motives of partners and shareholders to provide for expulsion and valuation clauses (II.) the article depicts the changeful case law of the German Federal Supreme Court on such clauses (III.) as well as the reactions in the legal literature (IV.). Subsequently, the analysis proposes an answer to the question whether, how and to what extent the court's restrictions of the partners' and shareholders' freedom of contract can be justified (V.). This is done by acknowledging that the presented case law constitutes legal

1 For an overview, also on Austrian law, suffice it to cite Hans-Georg Koppensteiner,' 'Über Grenzen der Vertragsfreiheit im Innenverhältnis von GmbH und O(H)G', [2009] GesRZ (Der Gesellschafter) 197; Wolfgang Zöllner in M Lutter et al (eds), Festschrift 100 Jahre GmbH-Gesetz (Dr Otto Schmidt 1992) 85.

paternalism. It is further claimed that this paternalist intervention is backed in part by evidence on human decision making gathered by behavioural economists and psychologists during the last decades, but only in part. Building on these findings the article advocates an approach that gives more room to the private autonomy of members of closely held associations, thereby bringing the overly restrictive German partnership and close corporation law more in line with its English and U.S. counterparts.

1. The starting point: freedom of contract with regard to the internal affairs of partnerships and close corporations

In principle, the members of a German partnership (*GbR*, *oHG*, *KG*)[2] or close corporation (*GmbH*)[3] are free to privately arrange for the internal affairs of their association. This freedom of contract with regard to the internal affairs of partnerships[4] and close corporations is explained and justified by the fact that the membership interests (shares) of these associations are not intended to be traded.[5] Notably, neither a partnership nor a *GmbH* can be listed on a stock exchange.[6] Therefore, no standardisation of their internal regime is needed for reasons of enhanced fungibility.[7]

2 By the term partnership the text refers to the civil partnership (*Gesellschaft bürgerlichen Rechts*, *GbR*), the (general) commercial partnership (*offene Handelsgesellschaft*, *oHG*), and the limited (commercial) partnership (*Kommanditgesellschaft*, *KG*).

3 The term close corporation refers to the German *Gesellschaft mit beschränkter Haftung* (*GmbH*), which is sometimes also referred to as the German LLC.

4 The principle of private autonomy and freedom of contract is considered as a hallmark of partnership law; suffice it to cite Michael Enzinger in K Schmidt (ed), *Münchener Kommentar zum HGB* (3rd edn, CH Beck 2011) Sec 109 marg no 1, with additional references.

5 The individual membership interest of a partnership is not transferable unless the partnership agreement provides otherwise or all partners assent; cf BGH NJW 1954, 1155 (*GbR*); BGHZ 77, 392, 395–96 (*KG*); Karsten Schmidt, Gesellschaftsrecht (4th edn, 2002) 1323, with further references. The transfer of a share in a *GmbH* (*Geschäftsanteil*) is – deliberately – impeded by certain formal requirements (cf Sec 15 *GmbHG*); for further details, suffice it to cite Frank Ebbing in L Michalski (ed), *GmbHG* (2 nd edn, CH Beck 2010) Sec 15 marg no 2–3.

6 With regard to the *GmbH*, cf, e.g., Thomas Raiser and Rüdiger Veil, Recht der Kapitalgesellschaften (5th edn, Vahlen 2010) § 24 marg no 11.

7 Cf, as to the arguments (purportedly) justifying Sec 23(5) German Stock Corporation Code (*Aktiengesetz*) which severely curbs the private autonomy of the shareholders of a German stock corporation (*Aktiengesellschaft*), Arnd Arnold in Wolfgang Zöllner und Ulrich Noack (eds), Kölner Kommentar zum Aktiengesetz, vol 1 (3rd edn, Carl Heymanns 2011) Sec 23 marg no 130 et seqq, with further references.

This view is confirmed by the German Civil and Commercial Code (*BGB*, *HGB*) as well as the Close Corporation Code (*GmbHG*)[8] being the statutory foundations of German partnership and close corporation law, respectively:

For the commercial partnership (*oHG*) Sec. 109 *HGB* expressly states that the legal relationship between the partners is governed by the provisions stipulated in the partnership agreement; the statutory provisions of Sec. 110 to 122 *HGB* only apply unless the partnership agreement says otherwise. Sec. 109 *HGB* also applies to the limited partnership (*KG*) by reference in Sec. 161(2) *HGB*. Principally the same holds for the civil partnership (*GbR*) which can be gathered from different provisions of the statutory law, such as Sec. 706(1), 709(2), 710 or 711 *BGB*.

This principle view is shared by the German Close Corporation Code: Sec. 3 *GmbHG* determines the necessary contents of the articles of association, while Sec. 45(1) *GmbHG* provides that "[t]he rights enjoyed by the members in the affairs of the company, in particular in relation to the management of the business operations, as well as the exercise of those rights, are determined according to the Articles of Association, insofar as no statutory provisions conflict." Sec. 45(2) *GmbHG* adds that only "[i]n the absence of specific provisions in the Articles of Association, the provisions of Sec. 46 to 51 apply."[9]

2. *Partnerships and close corporations as long-term contractual relationships*

Two characteristics of partnership agreements and the articles of association have to be kept in mind and taken account of, however, when applying the contractual paradigm:

Firstly, the subject matter of such agreements covers the typically (or at least intendedly) long lasting internal life of the respective association. Therefore, the contents of these contractual arrangements are necessarily incomplete, since it is outright impossible to provide for each and every future contingency possibly occurring.[10]

8 The abbreviations *BGB*, *HGB* and *GmbHG* refer to the German terms *Bürgerliches Gesetzbuch* (*BGB*), *Handelsgesetzbuch* (*HGB*), and *Gesetz betreffend Gesellschaften mit beschränkter Haftung (GmbHG)*, respectively.

9 The translation of the *GmbHG* provisions is borrowed from Carsten Jungmann and David Santoro, *German GmbH Law – Das deutsche GmbH-Recht* (CH Beck 2011). Aside from the articles of association the members of the *GmbH* are entitled to – and frequently use – contractual side-agreements (*schuldrechtliche Nebenabreden*) to deal with matters regarding the internal affairs of the corporation [cf id. 5].

10 See Holger Fleischer, 'Grundfragen der ökonomischen Theorie im gesellschafts- und Kapitalmarktrecht', [2001] ZGR (Zeitschrift für Gesellschafts- und Unternehmens-

Secondly, the contractual prerequisite of general consent is commonly attenuated by the *majority principle* imposed by statutory default provision (as is the case in *GmbH* law[11]) or by contractual arrangement (as is regularly the case in – commercial – partnership law) which applies to (midstream) decisions during the life of the association already in existence.[12] For a later amendment of the articles of association of a *GmbH* Sec. 53 *GmbHG* provides that "[t]he resolution [... amending the Articles] requires a majority of three-fourths of the votes cast."

Partnership agreements and the articles of a *GmbH*, thus, belong to the institutional category of – necessarily incomplete – *long-term contracts* also known as relational contracts[13]. Even more, associations with personal(ist) traits like partnerships and close corporations are said to be "quintessential relational contracts".[14] From an institutional economics perspective this is of considerable importance for the following analysis insofar as such contractual relationships (1) require considerable specific investments in the common endeavor being lost in case of exit or dissolution of the association, (2) are affected by substantial uncertainty, and (3) are continuous and long term in nature.[15] These traits, in turn, form a matrix that fosters ex post opportunism of the members in later stages of the association's life, which results in welfare losses.[16]

3. Expulsion and valuation clauses – definition and occurrence in practice

According to the principle of freedom of contract the members of a partnership or a *GmbH* are legally free to stipulate expulsion and valuation clauses in the partnership agreement or the articles of association, respectively.

recht) 1, 4–5; cf also Oliver E Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations', [1979] 22 J L & Econ 233, 237, 241.

11 Cf Sec 47(1) *GmbHG* provides.

12 See, e.g., Holger Fleischer, 'Gesetz und Vertrag als alternative Problemlösungsmodelle im Gesellschaftsrecht', [2004] 168 ZHR (Zeitschrift für das gesamte Handels- und Wirtschaftsrecht) 673, 683; cf also Herbert Wiedemann, *Gesellschaftsrecht* vol I (CH Beck 1980) 405 et seqq.

13 As to relational contract theory, see the classical work of Ian MacNeil, 'The Many Futures of Contracts', [1974] 47 S Cal L Rev 691; also id., 'Relational Contract Theory: Challenges and Queries', [2000] 94 Nw U L Rev 877.

14 Benjamin Means, 'A Contractual Approach to Shareholder Oppression Law', [2010] 79 Fordham L Rev 1161, 1195 et seqq, 1196, with regard to close corporations; cf also Donald J Smythe, 'Bounded Rationality, the Doctrine of Impracticability, and the Governance of Relational Contracts', [2004] 13 S Cal Interdisc LJ 227.

15 Williamson (n 10) 233 et seqq, 259; summarised by Smythe (n 14) 241.

16 See again Williamson (n 10) 233 et seqq, 254; summarised by Smythe (n 14) 242.

a) Expulsion clauses – definition and legal background

Statutory partnership law deals with the expulsion of a partner in Sec. 737 *BGB* (*GbR*) and Sec. 140 *HGB* (*oHG*). The latter provision also applies to the limited partnership (*KG*) by reference in Sec. 161(2) *HGB*.[17] Both, Sec. 737 *BGB* and Sec. 140 *HGB*, require good cause (*wichtiger Grund*) for expelling a partner (cf. Sec. 737(1)(2) *BGB* and Sec. 133 *HGB*), which must originate from the (conduct of the) partner intended to be expelled[18]. The two regimes merely differ insofar as (1) a civil partnership is not continued (but dissolved) in case of the exit of a partner unless the partnership agreement says otherwise, while a commercial partnership is continued de iure and (2) a civil partner is by default expelled by resolution[19], whereas a member of a commercial partnership has to be expelled by legal action.

Correspondingly, the courts recognise a de iure right of the *GmbH* to expel a member for good cause by legal action.[20] Furthermore, Sec. 34 *GmbHG* allows the redemption of a membership interest (share) insofar as it is permitted in the articles of association.[21] In the absence of the consent of the person entitled to the respective membership interest, the redemption may only take place if the requirements of the redemption were determined in the articles of association before the time at which the entitled person acquired the membership interest.[22] It is the prevailing opinion among scholars that these requirements must include a legitimate cause (*sachlicher Grund*) for the redemption which need not amount to "good" cause (*wichtiger Grund*) that entitles the GmbH to expel the respective member.[23]

17 The same is true for the *PartG* by the reference in Sec 9(1) *Partnerschaftsgesellschaftsgesetz* (*PartGG*).

18 Suffice it to cite Peter Ulmer and Carsten Schäfer in FJ Säcker and R Rixecker (eds), *Münchener Kommentar zum BGB*, vol 5 (5th edn, CH Beck 2009) Sec 737 marg no 8; Klaus J Hopt in Adolf Baumbach and K Hopt (eds), Handelsgesetzbuch (34th edn, CH Beck 2010) Sec 140 marg no 5.

19 Cf, e.g., Ulmer and Schäfer (n 18) Sec 737 marg no 1–3.

20 This right is construed by analogizing §§ 61 GmbHG, 117, 127, 133, 140 HGB. See, for further details, Olaf Sosnitza in L Michalski (ed), *GmbHG* (2nd edn, CH Beck 2010) Appendix to Sec 34 marg no 6–35.

21 Sec 34(1) *GmbHG*.

22 Sec 34(2) *GmbHG*.

23 Lutz Strohn in H Fleischer and W Goette (eds), *Münchener Kommentar zum GmbHG* (CH Beck 2010) vol 1, Sec 34 marg no 42; Olaf Sosnitza in L Michalski (ed), *Kommentar zum GmbHG* (CH Beck 2010) vol 1, Sec 34 marg no 37. It is a common view that – at least as a default rule – the expulsion of a member of the *GmbH* as well as the redemption of her share requires the payment of a compensation for the loss of her share in the company. As to the redemption of a member's share see, e.g., Strohn (n 23) Sec 34 marg no 117; as to the expulsion by judgment see BGHZ 9, 157; as to both see Markus

It is well settled that partners of a partnership as well as shareholders of a *GmbH* are entitled to facilitate the expulsion of one of its co-members in the partnership agreement or the articles of association in certain ways, as, for example, by abrogating the payment of compensation as a prerequisite for the legal effectiveness of the expulsion or by replacing the "good" – i.e. severe – cause (*wichtiger Grund*) required by law by a merely "legitimate" cause (*sachlicher Grund*) as a prerequisite for the expulsion of a member.[24]

By contrast, it is still an unsettled question and subject to ongoing debate, whether the partnership agreement or the articles of association may provide for a right to expel a member *without cause*, the exercise of which is at the discretion of a co-member or the association itself, viz. the majority of its members.[25] The term "expulsion clause" as used here refers only to this kind of problematic provisions.

b) Valuation clauses – definition and types occurring in practice

By law, i.e. as a default rule, the exiting member is entitled to a "full" compensation for the loss of its membership interest in the partnership or the close corporation.[26] According to the Federal Supreme Court[27] this usually means a compensation that amounts to the respective share of the capitalised earnings value of the company (*Ertragswert*).[28]

Gehrlein, 'Neue Tendenzen zum Verbot der freien Hinauskündigung eines Gesellschafters' [2005] NJW (Neue Juristische Wochenschrift) 1969.

24 See, e.g., BGHZ 105, 213, 216 et seqq. (*oHG*); BGH NJW 1983, 2880, 2881 (*GmbH*); BGHZ 112, 103, 108 (*GmbH*); also Gehrlein (n 23) 1970; Dirk Verse, 'Inhaltskontrolle von 'Hinauskündigungsklauseln' – eine korrekturbedürftige Rechtsprechung', [2007] DStR (Deutsches Steuerrecht) 1822.

25 The German literature refers to these expulsion clauses as '(freie) Hinauskündigungsklauseln'.

26 See Sec 738(1)(2) *BGB* which not only applies to civil partnerships (GbR) but also to the *oHG* and *KG* via Sec 105(3), 161(2) HGB as well as to the *GmbH* by analogy [cf Herbert Wiedemann, 'Das Abfindungsrecht – ein gesellschaftsrechtlicher Interessenausgleich', [1978] ZGR 477, 495; Götz Hueck and Lorenz Fastrich in A Baumbach and A Hueck (eds), GmbHG (19th edn, CH Beck 2010) Sec 34 marg no 22 with further references].

27 *Bundesgerichtshof* (*BGH*).

28 See for the standing case law, e.g., BGHZ 116, 359, 370–71 (*GmbH*); WM (Wertpapiermitteilungen) 1984, 1506 (*KG*); NJW 1993, 2101, 2103 (*oHG*). Most scholars approve this case law; see, e.g., Herbert Wiedemann, *Gesellschaftsrecht* (CH Beck 2004) vol 2, 242; Karsten Schmidt, *Gesellschaftsrecht* (4th edn, Heymanns 2002) 1477. The liquidation value (*Liquidationswert*) serves only exceptionally as a measure for a "full" compensation instead if it exceeds the capitalised earnings value in the case at hand [see BGH ZIP 2006, 851; for a different view with regard to the *GmbH* see Markus Lutter in M

The term "valuation clause" refers to a provision in the partnership agreement or the articles of the *GmbH* that deviates from this legal right to full compensation by applying a different measure or by other modifications that amount to a discount in relation to a "full" compensation or by excluding the right to compensation entirely. In practice, the founding members of German partnerships and close corporations provide quite often for such valuation clauses.[29] They come in different flavours[30]: It is, for example, not unusual to provide for a deferred payment of the compensation by instalments. The most prominent clause allots a compensation at book value (*Buchwertklausel*) to exiting members. This regularly comes with a discount on the compensation measured according to the capitalised earnings value due to depreciation and amortisation of corporate assets.[31]

In Germany, the legal validity and enforceability of such compensation discounts is subject to a long lasting and still not settled debate between the courts and legal scholars. As said, in the following the term "valuation clause" focusses on these problematic cases and therefore refers only to clauses that stipulate or imply such discounts on the compensation the leaving members were otherwise entitled to.

II. Reasons and Motives for Expulsion and Valuation Clauses

What are the reasons and motives that induce the members of a partnership or *GmbH* to provide for expulsion and/or valuation clauses?

Lutter and P Hommelhoff (eds), *GmbH-Gesetz* (17th edn, Dr Otto Schmidt 2009) Sec 34 marg no 70 with n 2] or the liquidation of the association takes actually place or is to be carried out in the imminant future [see, as to the *GmbH*, BGH FamRZ (*Zeitschrift für Familienrecht*) 1986, 776, 779]. Compare with *In re Bird Precision Ltd.* [1986] 1Ch. 658, where the court held that with regard to a buy-out order under s. 996 CA 2006 the minority member's interest is as a general rule valued on a pro rata basis and not at the discount rate at which the market normally values a minority interest.

29 Cf the – already older – empirical work of Roland Baumann, *Abfindungsregeln für ausscheidende Gesellschafter bei Personengesellschaften* (Stuttgart, Rer pol Diss 1987) 17 et seqq., 291; Gerhard K Balz [1983] GmbHR (GmbH-Rundschau) 185 et seqq.

30 Cf with regard to partnerships the lists provided by Henning Rasner,'Abfindungsklauseln in OHG- und KG-Verträgen', (1994) 148 ZHR 292, 294–5; Wiedemann, 'Rechte und Pflichten des Personengesellschafters', WM-Sonderbeilage 7/1992, 40; Hartwig Henze, 'Einschränkungen und Ausschluss des Abfindungsanspruchs des Personengesellschafters in der Rechtsprechung des BGH' in G Bitter et al (eds), Festschrift für Karsten Schmidt (Dr Otto Schmidt 2009) 619, 622.

31 Suffice it to cite K Schmidt (n 4) Sec 131 marg no 151.

1. Expulsion clauses

The provision of an expulsion clause in the aforementioned sense may be implemented first and foremost in order to guarantee a smooth, quick and cost-saving break-up of a shattered and dysfunctional relationship among the members of the association, which may – at the worst – lead to a dead lock leaving the partnership or corporation incapacitated.[32]

This is particularly true for a very severe disruption in the members' relationship that was caused by the contributions of several members. Because in this case the Federal Supreme Court negates the existence of a "good" cause justifying the expulsion of a single member de iure. Thus, without an expulsion clause – or a clause with (potentially) similar effects, like a call option, a Russian Roulette- or a Shoot Out-clause[33] – at hand the dissolution of the partnership or *GmbH* remains the only way of action to end the dead lock-situation.[34] This, however, is a way that often leads to the destruction of assets being tied to the survival of the venture such as the association's good will.[35]

2. Valuation clauses

Legal scholars as well as the courts identify two main reasons or motives for providing for valuation clauses in a partnership agreement or a *GmbH*'s articles of association:

On the one hand, such clauses are able to reduce the capital drain caused by the compensation payment the leaving member is otherwise entitled to. Thereby,

32 See with regard to 'Texas Shoot-out' clauses Holger Fleischer and Stephan Schneider, 'Zulässigkeit und Grenzen von Shoot-Out-Klauseln im Personengesellschafts- und GmbH-Recht', [2010] DB (Der Betrieb) 2713 et seqq.

33 As to these more 'modern' clauses cf, for example, Fleischer and Schneider (n 32).

34 See Matthias Kilian, 'Die Trennung vom "missliebigen" Personengesellschafter – Neue Ansätze in Sachen Ausschluss, Hinauskündigung und Kollektivaustritt?', [2006] WM 1567, 1568 refering to BGH WM 2003, 1084. The right to exit (*Austrittskündigung*), the member of a partnership (*GbR*, *oHG* or *KG*) is regularly entitled to by law (cf Sec 723, 724 *BGB* and Sec 132, 134 *HGB*) and which by agreement (*GbR*) or by law (*oHG*, *KG*; see Sec 131(3) no 3 *HGB*) does not lead to a dissolution of the partnership, is no alternative if – as usual – no faction of the quarrelling members wants to give way. The same holds true for buy-out clauses or put options [as to such provisions cf, from an English perspective, Geoffrey Morse et al, *Palmer's Limited Liability Partnership Law* (2nd ed, Sweet & Maxwell 2011) para A6–26 with regard to LLP law].

35 Cf also, from an English perspective, Geoffrey Morse et al (n 34) para A6–26, where a court order for the winding-up of a partnership, company or LLP on 'just and equitable grounds' according to s 35 Partnership Act 1890, s 122(1)(g) Insolvency Act 1986, 2001 LLP Regulations Reg. 5 and Sch. 3 is apostrophised as a 'total destruction scenario'.

the viability of the corporation can be preserved (*Bestandsschutz der Gesellschaft*).[36] This aim is not only furthered in case of a member's exit actually taking place, but also by the deterring and disciplining effect of such discounts on those members considering to exit the corporation (de facto exit barrier).[37]

On the other hand, such clauses – in particular "book value" clauses – aim at reducing the costs of measuring and executing the compensation payment as part of the exit process, since the calculation of the compensation amount the exiting member is entitled to is facilitated. This shall avert costly quarrels about the correct compensation amount.[38]

Economists have tried to render these thoughts more precisely: According to them, the preservation of the association's viability and continuing existence is no legitimate motive to curb the compensation of an exiting member per se. This is true, since the market guarantees that ressources and/or capital trend to the use that yields the highest return (given a certain risk).[39] Rather, one has to enrich the idea of preserving the business association by adding the consideration of preserving the specific investments in the partnership or corporation made by its members: At the time the association is founded the prospective members have certain expectations as to the life time of this investment project. The length of the association's life is in turn crucial for the founders' decision to make a specific investment in the common project, since the returns of this investment can typically only be recouped after a certain time period of prosperous operation of the partnership or *GmbH*.[40] In other words: The specific investment will pay for itself only after some time of successful operation has passed.[41]

36 Cf, e.g., BGHZ 65, 22, 27; BGHZ 116, 359, 368 (both with regard to the *GmbH*); furthermore Raiser and Veil (n 6) § 30 marg no 56; applying the courts' rulings to partnerships Werner Flume, '"Hinauskündigung" aus der Personengesellschaft und Abfindung', [1986] DB 629, 634; see also Rasner (n 30) 304; Walter Sigle, 'Gedanken zur Wirksamkeit von Abfindungsklauseln in Gesellschaftsverträgen', [1999] ZGR 659, 661–2; Wiedemann (n 30) 40; just referring Clemens Wangler, 'Abfindungsregelungen in Gesellschaftsverträgen: zum aktuellen Stand in Literatur, Rechtsprechung und Vertragspraxis', [2001] DB 1763, 1764 et seqq.

37 See Henze (n 30) 622.

38 Cf Wangler (n 36) 1764; Henze (n 30) 635.

39 See, e.g., Franz W Wagner, 'Unternehmensbemessung und vertragliche Abfindungsbemessung', [1994] BFuP (Betriebswirtschaftliche Forschung und Praxis) 477, 488–89; Wangler (n 36) 1764.

40 See, e.g., Wagner (n 39) 490 et seqq.; W Rainer Walz, *Privatautonomie oder rechtliche Intervention bei der Ausstattung und Änderung von Gesellschafterrechten*, Diskussionsbeiträge zu Recht und Ökonomie der Universität Hamburg Nr. 14 (1992), 17–18; also Wangler (n 36) 1764; Henze (n 30) 622–23.

41 For a numeric example see Wagner (n 39) 490–91.

The untimely exit of a member whose skills are crucial for the management and operation of the enterprise may disappoint these expectations. If an adequate surrogate member – as often – cannot be found, the expected returns on investment cannot be recouped in time. In the worst case the association has to be wound up, which generates its own costs.[42]

Against this background, the provision of valuation clauses curbing the compensation the members are entitled to in case of their exit can work as a commitment device making an exit (defection) rather unattractive and thereby tying the members together.[43] At the same time the compensation discount that remains in the association's funds functions as a (partial) insurance against the losses caused by a member's exit actually taking place.[44]

As to the second reason stated in favour of valuation clauses, namely the reduction of the costs for measuring and executing the compensation payment, its validity is not without doubt. It is true, indeed, that a "book value" clause makes it unnecessary to appoint and pay an appraiser, nevertheless quarrels can occur as to the correct assessment of certain items of the balance sheet. Even worse, "book value" clauses can create costs of their own by generating incentives for members planning to leave the partnership or corporation to act strategically: In order to receive a high compensation payment rational maximizers of their own utility will try to use their influence to hinder sensible, but book value reducing investments of the association (like research & development investments).[45]

III. Case Law limiting the Validity and Enforceability of Expulsion and Valuation Clauses

The question of whether and when expulsion and valuation clauses are valid and enforceable played a prominent role in den Federal Supreme Court's case law on partnerships and close corporations. Throughout the decades the court's position on this issue took some remarkable twists and turns. The following account firstly considers the case law on expulsion clauses (1.) before it turns to the Supreme Court's view on valuation clauses through the times (2.).

42 See for a concise account of the aforesaid Wangler (n 36) 1764.
43 Id.
44 Id.; stressing the latter effect Henze (n 30) 636.
45 Wagner (n 39) 487, 496; summarising Wangler (n 36) 1764–65; Henze (n 30) 623.

1. Expulsion clauses

a) Early cases – legal validity of expulsion clauses

Up to the first half of the 1970ies the Federal Supreme Court took the view that expulsion clauses are legally valid since they are within the realm of the members' freedom to privately order the internal affairs of their association.[46] Even if the valuation clause triggered by the expulsion should be invalid, this was not deemed to have repercussions on the validity of the expulsion clause itself.[47]

b) Current case law – unconscionability of expulsion clauses in principle

i. The principle

In the late 1970ies the Federal Supreme Court began to change its view on expulsion clauses.[48] In a decision from July 1981 the court held that a clause that entitles the members' majority to expel a member without cause is void due to the "innate limits of freedom of contract": Such clauses were deemed unconscionable and/or a breach of the fiduciary duties the members owe each other.[49] This new case law was at first applied to partnerships, but was subsequently extended to *GmbH* cases.[50] In later cases the court dropped its reference to a breach of fiduciary duties and focussed on the unconscionability standard[51].[52] At the core of its reasoning lies the argument that an expulsion clause may easily be abused as a means to intimidate opposing members. They – so the court says with reference to ancient greek mythology – live and act as members of the company under the "Sword of Damocles" – i.e. the constant threat – of being expelled if they do not act to the liking of the majority.[53] In the court's view this is also true if an adequate compensation is provided for in case of the member's exit, since such a compensation could only soften the threat but not eliminate it.[54]

46 BGHZ 34, 80 (*KG*); also BGH WM 1962, 462, 463; BGH WM 1968, 532, 533–34 (both dealing with a *KG*).

47 BGH NJW 1973, 1606, 1606–07 (*KG*).

48 This change was initiated by the court in BGHZ 68, 212 (*KG*).

49 BGHZ 81, 263 (*KG*).

50 BGHZ 112, 103 (*GmbH*).

51 This refers to the standard of *Sittenwidrigkeit*. The nullity of unconscionable contracts is laid down in Sec 138(1) *BGB*.

52 See BGH NJW 1985, 2421, 2422–23 (*KG*); also BGHZ 105, 216, 216–17 (*GmbH & Co. KG*).

53 BGHZ 81, 263, 268 with reference to Wiedemann, 'Rechtsethische Maßstäbe im Unternehmens- und Gesellschaftsrecht', [1980] ZGR 147, 153.

54 BGHZ 81, 263, 268.

ii. The exceptions

Expulsion clauses are, however, only regarded us null and void in principle. Over the years the Federal Supreme Court acknowledged numerous exceptions where an expulsion clause is deemed to be valid. Among these exceptional cases are most notably the following:

Trustee-like Character of the Membership: The trustee-like character of a membership granted by the owner of the enterprise because of a personal relationship justifies – in the court's view – the expulsion after the break-up of the personal relationship or the loss of trust in the respective member.[55]

Membership on Probation: A determinable expulsion clause is further deemed to be justified for the probation period of a new member joining a professional firm (law firm, medical practice).[56]

End of the Cooperation motivating the Membership: An expulsion clause is further justified if it stipulates the right to expel a member in case the cooperation ends that had been the reason for allowing the member to join the company in the first place. This exception applies for example to a manager who received a share in the company in order to incentivise him with regard to his managerial performance when his management term ends.[57]

Disposition by Testator: Lastly, the Federal Supreme Court held that a testator is allowed to pass on his enterprise on several heirs under the condition that one of them will be entitled to expel the others without cause.[58]

c) Judicial exercise control of valid expulsion clauses

If an expulsion clause is deemed valid, the court further reviews its exercise measuring it against the standard of good faith (*Treu und Glauben*).[59, 60] Due to the exceptional character of valid expulsion clauses this judicial control is – up to now – only of limited practical relevance.

55 BGHZ 112, 103.
56 Cf BGH ZIP 2004, 903, 905 (*GbR*); BGH ZIP 2007, 1309, 1311 (*GbR*).
57 BGHZ 164, 98 (*GmbH*); cf for a different example of this category BGH NJW 1983, 2880, 2881 (*GmbH*).
58 BGH ZIP 2007, 862, 863–4 para 10–12 (*KG*).
59 Sec 242 *BGB* forms the statutory basis of this standard.
60 BGH ZIP 2004, 903, 905–6.

2. Valuation clauses

The view of the Federal Supreme Court on the validity and enforceability of valuation clauses – and in particular on "book value" clauses – changed over time, too: In its early cases up to the early 1970ies valuation clauses were deemed unproblematic by and large and therefore passed judicial scrutiny as long as they did not affect the interests of the exiting member's creditors.[61]

a) The late 1970ies until 1993

This view changed in the late 1970ies and the following years when the Federal Supreme Court developed a two-pronged test for the validity of valuation clauses:

Unconscionability (First Prong): The Court firstly asked whether the valuation clause is unconscionable (and therefore void).[62] This should be the case when the discount on the "full" compensation is "out of all proportion" to the discount necessary (!) to preserve the ongoing economic and financial viability of the association.[63] Since a contractual clause is void because of unconscionability from the outset, but does not become unconscionable later on within the course of its existence, the relevant point in time for the assessment of this disproportionality is the time of the clause's stipulation – and not the time of the member's exit.[64] According to this test, the court rendered a clause void that reduced the compensation in case of a member's exit to one half of the book value of its membership interest or that provided for a deferred payment in 15 equal annual instalments. No importance was attributed to the fact that the membership interest was acquired gratuitously (as a gift) and that the member was expelled for (good) cause.[65]

Undue Exit Barrier (Second Prong): Secondly, the Federal Supreme Court tested whether the valuation clause violated Sec. 723(3) *BGB*, or at least con-

61 As to the nullity of valuation clauses designed to disadvantage the creditors of the exiting member see BGHZ 32, 151, 155–56; BGHZ 65, 22, 28–9; BGHZ 144, 365, 366 et seqq.

62 Cf Sec 138(1) *BGB*.

63 BGHZ 116, 359 (*GmbH*); cf also the earlier decision BGH WM 1978, 1044, 1045–46. In the later decision BGHZ 126, 226, 240–41, the court dropped this strict position and held instead that a valuation clause is not unconscionable and therefore void merely because the compensation discount provided for in the valuation clause is not strictly necessary to achieve legitimate goals, but that it needs a gross disproportionality between compensation amount and fair market value of the membership interest.

64 Id.

65 BGH ZIP 1989, 770, 771 et seqq (*GmbH & Co. KG*).

flicted with the basic rationale underlying this provision. Sec. 723(3) *BGB* – which is directly applicable only to partnerships[66] – provides that an agreement by which the right to leave the partnership[67] for (good) cause is excluded or limited is null and void. For the *GmbH* the court comes to the same result by developing a legal principle according to which the membership in the *GmbH* comes with an indispensable right to exit for (good) cause.[68] According to the Federal Supreme Court this principle renders a valuation clause void if the clause causes a "gross disproportionality" between the compensation it provides for and the fair market value of the membership interest. In the (former) court's view this was also true if the gross disproportionality occurred only after the clause was agreed upon (!). The crucial test question the court posed was whether a member being inclined to exit the association is typically held back from exiting by the valuation clause under scrutiny.[69] Had this question been answered in the affirmative the court replaced the void clause by so-called "supplementary interpretation" of the agreement (*ergänzende Vertragsauslegung*).[70] As a typical result the exiting member was adjudged a compensation payment that is higher than that provided for in the void clause but lower than a "full" compensation as provided for by law.[71]

b) The "turnaround" in 1993/1994

This case law has been heavily criticised by legal scholars. The main point of critique referred to the case of gross disproportionality of contractual and full compensation occurring *ex post*, i.e. in the course of time *after* the valuation clause was agreed upon: It was rightly pointed out that a clause cannot be valid in the beginning and become void later on due to changes in the external circumstances.[72] Furthermore, it was added that the right to exit has nothing

66 The provision is part of the law of the civil partnership (*GbR*) laid down in Sec 705 et seqq of the German Civil Code. It is applicable to the commercial partnership (*oHG*) and the limited partnership (*KG*) by reference in Sec 105(3) *HGB* and Sec 161(2) *HGB*, respectively.

67 The wording of the provision refers to the "right to terminate the partnership" which is due to the fact that as a default rule the civil partnership – as opposed to the commercial and limited partnership (cf Sec 131(3)(1) no 3 *HGB*) has to be liquidated if one of its partners exits by termination.

68 BGHZ 116, 359, 369.

69 BGH WM 1984, 1506 (*KG*); BGH ZIP 1989, 768 (*KG*); BGH ZIP 1989, 770, 771 et seqq. (*GmbH & Co. KG*); see also the obiter dictum in BGH NJW 1973, 651, 652 (*oHG*).

70 As to the (statutory) default rule see supra I.3.2.

71 BGHZ 116, 359, 369 et seqq; cf also BGH WM 1984, 1506.

72 See, notably, Rasner, 'Abfindungsklauseln in OHG- und KG-Verträgen', [1983] NJW 2905, 2908; Herrmann Büttner, 'Flexible Grenzen der Durchsetzbarkeit von Abfin-

to say to valuation clauses curbing the compensation in cases where the member is expelled and does not take his leave by his own initiative.[73]

The Federal Supreme Court reacted to this critique by changing its case law in a series of judgments in 1993 and 1994.[74] It thereby abandoned Sec. 723(3) *BGB* and the indispensable right to exit the company for cause, respectively, as a basis for the adjustment of the valuation clause in case of a gross disproportionality occurring in the course of time after the clause was agreed upon. In these cases the court asked instead whether (1) the later developments leading to the gross disproportionality were unforeseeable for the members at the time they agreed to include the valuation clause in the partnership agreement (or the articles of association) and (2) the gross disproportionality was so severe that it would be unfair to enforce the valuation clause upon the exiting member. This question – the Federal Supreme Court added – can only be answered with a view to the circumstances of each individual case.[75] If the enforcement of the valuation clause is deemed unfair the court would amend the agreement by tradingoff the interests of the exiting member and those of the members remaining in the association.[76]

c) The subsequent case law up to now

In its subsequent judgments dealing with the validity and enforceability of valuation clauses the Federal Supreme Court revitalized Sec. 723(3) *BGB* and the indispensable right to exit as a means to render valuation clauses void that due to their (foreseeable) negative financial consequences ab initio (!) were deemed to constitute de facto exit barriers.[77] A very impressive example of how far the court goes in curbing the freedom of contract is a case concerning the dissolution of a partnership founded by two brothers to operate a holiday camp.[78] The fair market value of the enterprise (holiday camp) was much lower

dungsbeschränkungen in Personengesellschaftsverträgen' in K Bruchhausen (ed), Festschrift für Rudolf Nirk (CH Beck 1992) 119, 124 et seqq; for a later endorsement see Peter Ulmer and Carsten Schäfer, 'Die rechtliche Beurteilung vertraglicher Abfingungsbeschränkungen bei nachträglich eintretendem groben Mißverhältnis', [1995] ZGR 134, 136 et seqq.

73 Büttner (n 72) 124.

74 The literature of that time characterised this change as a "turnaround" (*Wende*) of the court; see Barbara Dauner-Lieb, 'Angemessenheitskontrolle privatautonomer Selbstbindung des Gesellschafters? Die Rechtsprechung des BGH zu Abfindungsklauseln und Schutzgemeinschaftsverträgen', [1994] GmbHR 836, 837; Rasner (n 30) 297.

75 BGH ZIP 1993, 1160, 1161 (*oHG*).

76 BGH ZIP 1993, 1160, 1162; cf also BGHZ 123, 281 (*GmbH & Co. KG*).

77 See, for an early decision, BGHZ 126, 226 (*GbR*).

78 BGH ZIP 2006, 851.

than the value of the land the camp was built on. The partners knew that and therefore agreed to a valuation clause that referred to the market value of the enterprise in order to enable the remaining partner to continue the operation of the holiday camp. Despite these motives the court held the clause to be invalid as a de facto exit barrier because of the land value being 3.5 times higher than the value of the ongoing enterprise.[79]

On the other hand, the Federal Supreme Court recognised certain exceptions to the aforementioned standards: In cases where the member received the interest in the partnership or corporation as an incentive to perform well as a manager or employee of the enterprise, it is justified in the court's opinion to reduce the compensation being paid when the membership interest had to be returned due to the termination of the employment or the appointment as a manager to the amount the manager/employee had originally paid for it. Did the manager/employee receive the membership interest gratuitously, even the entire exclusion of any compensation is recognised by the court as valid.[80] The court comes to the same conclusion for cases where a member exits a nonprofit or charitable association.[81]

IV. The Accompanying Scholarly Debate

1. Expulsion clauses

The Federal Supreme Court's view on the legal validity of expulsion clauses has gained harsh criticism among legal scholars. The debate focusses on three interconnected questions: Does the Federal Supreme Court's case law on the principal nullity of expulsion clauses get it right? If so: Does a claim to full compensation of the membership interest in the case of expulsion change this result? What are the exceptional circumstances that justify a principally void expulsion clause?

a) Criticism of the Federal Supreme Court's case law on expulsion clauses

As to the criticism of the Federal Supreme Courts findings on the legal validity of expulsion clauses the following issues are stressed by those who see the court on the wrong track:

79 Id.; cf also BGH ZIP 2008, 1276 (*PartG*).
80 BGHZ 164, 98; 164, 107 (both concerning a *GmbH*).
81 BGHZ 135, 387 (*GbR*).

Inconsistency: To begin with, the Court's findings are criticised as inconsistent, since it doesn't stop finding ever new exceptions to the alleged principle of nullity. Rather, this ever growing body of exceptions is interpreted as indicating the incorrectness of the principle itself.[82] In addition, the "Sword of Damocles"-Argument is not seen as an argument backing the unconscionability of expulsion clauses.[83]

No justification by unequal bargaining power: Secondly, the limitation of the member's freedom and autonomy in organizing the internal affairs of their company is said to lack its justification. Since there is no situation of unequal bargaining power between the members of the company the members do not need any protection by the court (so the argument goes).[84]

No justification by disruptive effects on association: It is furthermore stated that the unconscionability of expulsion clauses cannot be explained by their destructive and dysfunctional effects on the operation of the partnership or corporation[85] which is one of the considerations underlying the "Sword of Damocles"-argument. This point of critique is backed by a threefold reasoning: Firstly, the "Sword of Damocles" -argument does not work with regard to

82 Martina Benecke, 'Inhaltskontrolle im Gesellschaftsrecht oder: "Hinauskündigung" und das Anstandsgefühl aller billig und gerecht Denkenden', [2005] ZIP (Zeitschrift für Wirtschaftsrecht) 1437, 1439; Henrik Drinkuth,'Hinauskündigungsregeln unter dem Damoklesschwert der Rechtsprechung', [2006] NJW 410, 411; Martin Peltzer, '"Hinauskündigungsklauseln", Privatautonomie, Sittenwidrigkeit und Folgerungen für die Praxis', [2006] ZGR 702, 713; Verse (n 24) 1824–25; cf also Matthias Kilian, 'Die Trennung vom "missliebigen" Personengesellschafter – Neue Ansätze in Sachen, Ausschluss, Hinauskündigung und Kollektivaustritt?', [2006] WM 1567, 1574. Even worse, the critics argue, the exceptions to the principle recognised by the court do not reveal any common rationale; cf Verse (n 24) 1824–25; also Peter Ulmer and Carsten Schäfer in FJ Säcker and R Rixecker (eds), *Münchener Kommentar zum BGB*, vol 5 (5th edn, CH Beck 2009) Sec 737 marg no 19; Carsten Schäfer in H Staub (founder), *Handelsgesetzbuch*, vol 3 (5th edn, de Gruyter 2009) Sec 140 marg no 63.

83 Cf Drinkuth (n 82) 411 referring to the origins of the "Sword of Damocles"-argument in Wolfgang Schilling, 'Zur Abfindung bei der Ausschließung ohne wichtigen Grund aus einer Personengesellschaft', [1979] ZGR 419, 426.

84 Drinkuth (n 82) 412; Kilian (n 82) 1569–70; Verse (n 24) 1825; differently, Wendt Nasall, 'Fort und Hinaus – Zur Zulässigkeit von Hinauskündigungsklauseln in Gesellschaftsverträgen von Personengesellschaften und Satzungen von GmbH', [2008] NZG 851, 854–55.

85 See as to this reasoning, e.g., BGHZ 81, 283, 166; this "functionality"-argument has been fleshed out by some scholars; cf Volker Behr, 'Der Ausschluß aus der Personengesellschaft im Spannungsverhältnis zwischen Vertrag und Status', [1985] ZGR 475, 493; Lorenz Fastrich, *Funktionales Rechtsdenken am Beispiel des Gesellschaftsrechts* (de Gruyter 2001) 8–9, 13–14; from the more recent literature, e.g., Sebastian Miesen, 'Gesellschaftsrechtliche Hinauskündigungsklauseln in der Rechtsprechung des Bundesgerichtshofs', [2006] RNotZ (Rheinische Notar-Zeitschrift) 522, 524, with additional references.

members holding only a minor interest in the company and therefore having only little, if any, influence on the association's fortunes (and, thus, on its proper functioning).[86] Secondly, the court does not take into account the benefits of such a clause, namely the cost-effective solution it provides for in case of an internal conflict.[87] Lastly, the introduction of an impersonal collective interest like the "functionality" of the association must not be used to limit the freedom of contract of the members in the absence of any third party effect.[88]

Ignorance of compensation: Yet another point of critique is the ignorance of the court with regard to a compensation provided for in case of an expulsion. The "Sword of Damocles"-argument is said to lose its persuasive power if the expelled member is entitled to an adequate compensation for the loss of his membership interest in the company. Speaking figuratively, it is said that in those cases the sword is tied not only to a single hair but to a whole horse-tail.[89]

Rigidity of sanction: In addition, the nullity sanction being the result of the unconscionability verdict is regarded as too harsh and rigid.[90] It would suffice – so the argument goes – to apply a control of the exercise of the expulsion clause to filter out abusive conduct.[91]

b) Comparison with U.S. and English partnership law

The critique of the Federal Supreme Court's position is further backed by a comparison with U.S. as well as English partnership law that both recognise the validity of expulsion clauses, but demand them to be exercised in good faith in each individual case[92]:

86 See Kilian (n 82) referring to BGHZ 164, 98, 103, where the Federal Supreme Court itself concedes this weak spot of its argument; with regard to this passage of the judgment see also Peltzer (n 82) 710.

87 See Verse (n 24) 1826.

88 Id.

89 Drinkuth (n 82) 411; Verse (n 24) 1826; similarly Ulrich Huber, 'Der Ausschluß des Personengesellschafters ohne wichtigen Grund', [1980] ZGR 177, 203; for a different view, Wiedemann (n 53) 153.

90 See, e.g., Karl-Georg Loritz,'Vertragsfreiheit und Individualschutz im Gesellschaftsrecht', [1986] JZ (JuristenZeitung) 1073, 1075, who put this in the now famous words that the "Damoclesian Sword of Expulsion" has been replaced by the "Guillotine of Nullity".

91 Suffice it to cite Benecke (n 82) 1439, with additional references; Verse (n 24) 1826.

92 The French law is, however, closer to the case law devised by the German Federal Supreme Court. Cf, e.g., Alexis Constatin, *Droit des sociétés* (4th edn, Dalloz 2010) 60.

With regard to the situation in the U.S. Sec. 601(3) of the Revised Uniform Partnership Act of 1997 (RUPA)[93] explicitly states that a partner is dissociated from a partnership due to his expulsion "pursuant to the partnership agreement". The official comment on Sec. 601 RUPA makes it clear that the expulsion can be "with or without cause".[94] Correspondingly, U.S. courts recognise the validity of (free) expulsion clauses which they deem justified due to the former consent of the member being expelled later.[95] According to Sec. 404(d) RUPA the courts, however, control whether the exercise of the clause complies in the individual case with the obligation of good faith and fair dealing.[96] For a breach of this obligation the courts regularly demand an "evil, malevolent, or predatory purpose"[97], while they do not hold an expulsion as being conducted in bad faith merely because it was caused and motivated by a "fundamental schism" among the members.[98]

Similarly, s. 25 of the English Partnership Act of 1890 allows for expulsion clauses in the partnership agreement without any specific qualification.[99] It is furthermore standing English case law that such expulsion clauses do not need to specify concrete causes or triggering events as a prerequisite of a legally valid expulsion.[100] However, alike their U.S. counterparts the English courts control the exercise of expulsion clauses applying the good faith-standard.[101] In view of these alternative solutions in other jurisdictions of the western world it has been rightly pointed out that expulsion clauses cannot be regarded as unconscionable in terms of being an offence against decency in the eyes of all just and fair minded people.[102, 103]

93 National Conference of Commissioners on Uniform State Laws (NCCUSL), Uniform Partnership Act (1997). Most of the state laws on partnerships are modeled on the RUPA.

94 See NCCUSL (n 93) Sec 601 comment 4.

95 See, e.g., *Holman v Coie*, 522 P2 d 515, 521–22 [4] (WashApp 1974); *Gelder Medical Group v Webber*, 41 NY2d 680, 683–84 (NY 1977); *Altebrando v Godziewski*, 831 NYS2d 351 (NYSuprCt 2006).; *Heller v Pillsbury Madison & Sutro*, 58 Cal Rptr2d 336, 346 [5] (CalApp 1996); implizit auch *Bohatch v Butler & Binion*, 977 SW2d 543, 545–46 (TexSuprCt 1998).

96 See references in n 95.

97 See, e.g., *Gelder Medical Group v Webber*, 41 NY2d 680, 684 (NY 1977); *Altebrando v Godziewski*, 831 NYS2d 351 (NYSuprCt 2006); cf, furthermore, *Holman v. Coie*, 522 P2d 515, 523 [5] (WashApp 1974).

98 *Bohatch v Butler & Binion*, 977 SW2d 543, 546–57 (TexSuprCt 1998). For an overview of the whole topic, see, e.g., Allan W Vestal,'Law Partner Expulsions', [1998] 55 Wash & Lee L Rev 1083; Jeff Schwartz, 'Good Faith in Partner Expulsions: Application of a Contract Law Paradigm', [2005] 9 Chapman L Rev 1.

99 S 25 Partnership Act 1890 provides: 'No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.'

100 This case law goes back to *Blisset v Daniel* [1853] 10 Hare 493, 504–505.

101 Id. For an overview of the topic see, e.g., Geoffrey Morse, *Partnership Law* (7th edn, OUP 2010) marg no 5.38–42; Roderick I'Anson Banks, *Lindley & Banks on Partnership*, (18th edn, Sweet & Maxwell 2002) marg no 10–110 et seqq, 10–120 et seqq.

102 *Verstoß gegen das Anstandsgefühl aller billig und gerecht Denkenden*. This is how unconscionability (*Sittenwidrigkeit*) in terms of Sec 138(1) *BGB* is traditionally defined.

103 Convincingly, Verse (n 24) 1827.

c) Alternative solutions offered by academics

Given this harsh criticism the academic community has developed certain alternative solutions with regard to handling the legal issues connected with expulsion clauses: Some commentators want the courts to take account of a compensation paid in case of the member's expulsion. Of those some regard the provision for an adequate compensation as a prerequisite for the validity of an exclusion clause[104], while others deem an expulsion clause providing for an adequate compensation to be regularly – if not generally – valid, but do not demand such a provision in each and every case[105]. A second camp gaining more and more support among legal scholars goes a step further by wanting to abandon the "unconscionable in principle"-thesis entirely and replace it by an exclusive good faith exercise control.[106]

2. Valuation clauses

The case law on valuation clauses obtained much more approval among academics than the Federal Supreme Court's findings on expulsion clauses. According to the analysis of legal scholars the legal setting of valuation clauses is as follows:

104 See, e.g., Barbara Grunewald, *Der Ausschluß aus Gesellschaft und Verein* (C Heymanns 1987) 221–22 (regarding associations with just a few members); Grunewald, 'Wer kann ohne besonderen Anlass seine Gesellschafterstellung verlieren?' in P Hommelhoff et al (eds), *Festschrift für Hans-Joachim Priester* (Dr Otto Schmidt 2007) 123, 131; cf already Huber (n 89) 203 er seqq; with regard to such cases where a professional loses his livelihood due to the expulsion Martin Henssler, 'Hinauskündigung und Austritt von Gesellschaftern in personalistisch strukturierten Gesellschaften' in B Dauner-Lieb et al (eds), *Festschrift für Horst Konzen* (Mohr Siebeck 2006) 267, 283.

105 See, e.g., Verse (n 24) 1829, with reference to BGHZ 164, 98 and BGHZ 164, 107; cf also Benecke (n 82).

106 See, e.g., Benecke (n 82) 1441 et seqq; Drinkuth (n 82) 412; Grunewald, 'Ausschluss aus Freiberuflersozietäten und Mitunternehmergesellschaften ohne besonderen Anlass', [2004] DStR 1750, 1751; Felix Hey, *Freie Gestaltung in Gesellschaftsverträgen und ihre Schranken* (CH Beck 2004), 214 et seqq; Friedrich Kübler, 'Familiengesellschaften zwischen Institution und Vertrag' in P Hommelhoff et al (eds), *Festschrift für Walter Sigle* (Dr Otto Schmidt 2000) 183, notably 197 et seqq; Hans-Joachim Priester, 'Drag along- und Call-Option-Klauseln in der GmbH-Satzung' in Stefan Grundmann et al (eds), *Festschrift für Klaus J Hopt*, Vol 1 (de Gruyter 2010) 1139, 1146; Verse (n 24) 1827 et seqq. For an overview of the controversy on the right measure and intensity of a judicial exercise control suffice it to cite Verse (n 24) 1828, with additional references.

a) Unconscionability, Sec. 138(1) BGB

"Valuation Clauses" that provide for a preclusion of any compensation for the exiting member are deemed to be unconscionable and, thus, void except for certain particular cases.[107] Among these are the manager-/employee-cases already referred to[108]. Also, with regard to nonprofit or even charitable associations the exclusion of any compensation for the leaving member is widely accepted.[109] Furthermore, the compensation-free redemption of a membership interest in case of death is deemed legally valid.[110] According to some scholars the same shall be true where the preclusion of any compensation is a (contractual) penalty for exceptionally grave breaches of a member's duties.[111]

Besides a complete exclusion of any compensation a valuation clause is deemed unconscionable if the compensation provided for is – at the time of its stipulation – grossly disproportionate in relation to the fair value of the member's share in the association.[112] In the majority's view it is without legal significance whether the membership interest was received gratuitously or not.[113] That said, some scholars stress that the term of "gross disproportionality" has to be applied cautiously as not to degenerate the unconscionability standard to a mere standard of proportionality.[114]

107 For the prevailing view, suffice it to cite Ulmer and Schäfer (n 18) Sec 738 marg no 45; Strohn (n 23) Sec 34 marg no 227 et seq.

108 See supra III.2.3, also III.1.2.2.

109 See, e.g., BGHZ 135, 387, 390 (*GbR*); Ulmer and Schäfer (n 18) Sec 738 marg no 62; Strohn (n 23) Sec 34 marg no 228; Sosnitza (n 23) Sec 34 marg no 66.

110 See Ulmer and Schäfer (n 18) Sec 738 marg no 61; Hueck and Fastrich (n 26) Sec 34 marg no 34; Sosnitza (n 23) Sec 34 marg no 68; K Schmidt (n 4) Sec 131 marg no 161 et seqq; Strohn (n 23) Sec 34 marg no 228 and 246 et seqq.

111 Ulmer and Schäfer (n 18) Sec 738 marg no 61; Sosnitza (n 23) Sec 34 marg no 66; Strohn (n 23) Sec 34 marg no 228; for a different view, see Hueck and Fastrich (n 26) Sec 34 marg no 34; K Schmidt (n 4) Sec 131 marg no 180.

112 Suffice it to cite Strohn (n 23) Sec 34 marg no 227, with further references. The courts as well as most legal scholars refrain from applying certain percentages, because they are regarded as too rigid as to suit the particularities of each individual case; cf, e.g., OLG Oldenburg GmbHR 1997, 503, 505; K Schmidt (n 4) Sec 131 marg no 168; Hueck and Fastrich (n 26) Sec 34 marg no 27; Strohn (n 23) Sec 34 marg no 227; but cf also Ulmer and Schäfer (n 72) 152 et seqq; similarly Markus Geißler, 'Rechtsgrundsätze und Bewertungsfragen zur angemessenen Abfindung des ausscheidenden GmbH-Gesellschafters', [2006] GmbHR 1173, 1180–81.

113 Cf K Schmidt (n 4) Sec 131 marg no 179 referring to BGH ZIP 1989, 770.

114 Cf Dauner-Lieb, 'Abfindungsklauseln bei Personengesellschaften', [1994] 158 ZHR 271, 288 (restricting the unconscionability verdict to evident cases); id. (n 74) 839; Walter Sigle, 'Gedanken zur Wirksamkeit von Abfindungsklauseln in Gesellschaftsverträgen', [1999] ZGR 659, 666–67. The courts and the literature supporting their decisions try to avoid this degeneration by demanding a relation between compensa-

Measured by these standards "book value" clauses are considered as justifiable and therefore valid in principle[115], whereas valuation clauses providing for a compensation amounting only to one half of the book value of the share in the association are considered unconscionable[116]. Whether smaller discounts on the book value are legally valid is still an open question.[117] On top of that, "book value" clauses are considered unconscionable if they are also applicable in cases where the affected member terminates his membership for (good) cause[118] or is expelled without cause[119]. In case of a void valuation clause, the statutory default rule applies, i.e. the member is entitled to full compensation.[120]

b) The valuation clause as de facto exit barrier

The Federal Supreme Court not only holds a valuation clause void if it is unconscionable, but also if it is foreseeable at the time of its stipulation[121] that the clause is associated with such severe disadvantages for the exiting member that he "reasonably refrains from exiting despite his formal right to leave the company".[122] According to a prominent view among legal scholars, however, the exit deterring effect of such clauses may not be considered as an independent reason for their invalidity, but as one factor to be traded off within the

tion and fair value that is "completely out of proportion" (*vollkommen außer Verhältnis*); cf, e.g., BGHZ 116, 359 in headnote c) (*GmbH*); BGH NJW 1989, 2685, 2686 (*KG*); BGHZ 126, 226, 239–40 (*GbR*); from the literature Strohn (n 23) Sec 34 marg no 227; Hueck and Fastrich (n 26) Sec 34 marg no 27; Raiser and Veil (n 6) § 30 marg no 57.

115 See Ulmer and Schäfer (n 18) Sec 738 marg no 64; K Schmidt (n 4) Sec 131 marg no 168; Strohn (n 23) Sec 34 marg no 257; Sosnitza (n 23) Sec 34 marg no 70, all with additional references.

116 See BGH ZIP 1989, 770; also K Schmidt (n 4) Sec 131 marg no 168; Sosnitza (n 23) Sec 34 marg no 70, with additional references.

117 Cf BGH ZIP 1989, 770.

118 OLG Naumburg NZG 2001, 685; Sosnitza (n 23) Sec 34 marg no 70.

119 See BGH NJW 1979, 104; OLG Naumburg NZG (*Neue Zeitschrift für Gesellschaftsrecht*) 2001, 658; Sosnitza (n 23) Sec 34 marg no 70; cf also Ulmer and Schäfer (n 18) Sec 738 marg no 64; for an undispensible right to a "full" compensation in these cases U Huber (n 89) 204–05; Wolfgang Schilling, 'Zur Abfindung bei der Ausschließung ohne wichtigen Grund aus einer Personengesellschaft', [1979] ZGR 419, 429.

120 Undisputed; suffice it to cite Lutter (n 28) Sec 34 marg no 86.

121 As to the changes the Federal Supreme Court's rulings underwent with regard to the relevant point in time for controlling whether the valuation clause constitutes a void de facto exit barrier see supra III.2.1 and 2.2.

122 See BGH ZIP 2006, 851, 851 et seq. and supra III.2.3.

framework of the judicial control for the unconscionability of a valuation clause.[123]

c) Enforcement limitations of legally valid valuation clauses

If the court holds the valuation clause to be legally valid, the judicial review is not at its end: According to the courts and the vast majority of academics it further has to be considered whether the exercise of the clause in the case at hand is conducted abusively or in bad faith.[124] The details of this "exercise control" are, however, subject to debate:

i. The judicial "exercise control": doctrinal foundations

As this judicial exercise control was devised to capture cases where developments taking place *after* the stipulation of the valuation clause led to a gross disproportionality between the provided for compensation amount and the fair market value of the membership interest, the question arises whether these cases can be remedied by a supplementary "gap filling" interpretation of the partnership agreement or the articles of association. While the Federal Supreme Court has shown to be very quick at recognising such a gap to be filled by the court itself[125], it is the dominant view among scholars that a significant disproportionality is not enough to conclude that the members did not consider this possibility at the time the valuation clause was stipulated. Such clauses – so the argument goes – typically aspire to insulate the association from the unforeseeable future developments affecting the value of the membership interests. As a consequence of this position, the prerequisites for a gap filling interpretation of the agreement or the articles by the court are only met in (highly) exceptional cases.[126]

123 Convincingly, K Schmidt (n 4) Sec 131 marg no 156; albeit, more than just a few scholars ascribe little practical relevance to this cause of nullity in addition to unconscionability as laid down in Sec 138(1) *BGB*; see, e.g., Strohn (n 23) Sec 34 marg no 232; Hueck and Fastrich (n 26) Sec 34 marg no 27; similarly, Ulmer and Schäfer (n 18) Sec 738 marg no 49; see also OLG Köln NZG 1998, 779, 780.

124 See from the literature, e.g., Ulmer and Schäfer (n 72) 134 et seqq; id. (n 18) Sec 738 marg no 54–55; K Schmidt (n 4) Sec 131 marg no 176 et seqq.

125 Cf, e.g., BGHZ 123, 281; BGH WM 1993, 1412.

126 See, e.g., Rasner (n 30) 298; Dauner-Lieb (n 114) 283; id. (n 74) 840; Ulmer and Schäfer (n 72) 143; Michael Volmer, 'Vertragspaternalismus im Gesellschaftsrecht? – Neues zu Abfindungsklauseln', [1998] DB 2507, 2510, all with further references; for a detailed account see also Bernd Richter, *Die Abfindung ausscheidender Gesellschafter unter Beschränkung auf den Buchwert* (CH Beck 2002) 95–114; for a different view, see Joachim Schulze-Osterloh, [1993] JZ 45, 46 (note to BGH, judgment of 16 December 1991 – II ZR 58/91).

The legal standard employed within the frame of the judicial "exercise control" of valuation clauses is Sec. 242 *BGB*, i.e. the standard of good faith.[127] It is applied to control for unfair consequences of generally unsuspicious valuation clauses due to the particular circumstances of the individual case. A gross disproportionality between the compensation provided for in the clause and the fair market value of the membership interest is regarded as an "unfair consequence" in this sense.[128] Probably the most difficult and controversial issue with regard to this "good faith exercise and enforceability control" of valuation clauses is the question which factors have to be taken into account to distinguish between a still reasonable valuation clause and a clause already resulting in unbearable consequences for the exiting member. Whereas it is clear and undisputed that the unenforceability of a per se valid clause has to be restricted to exceptional and atypical cases,[129] it is the common view that no bright line rule exists to distinguish the enforceable from the unenforceable valuation clause.[130] Instead, a multifactor test is applied. Among the relevant factors are said to be[131]: (1) the cause for the exit;[132] (2) the duration of the membership;[133] (3) the contribution to the buildup and success of the enterprise;[134] (4) the economic and financial situation of the partnership or company

127 See, e.g., the references cited in n 124.

128 Suffice it to cite Richter (n 126) 160 et seqq, with additional references. The same is true if a member is more or less "pressed" to exit the company by illegal or bad faith conduct of the other members, e.g. by means of an accumulation strategy leaving the member with no or at least no significant dividend payments; see, e.g., OLG Köln NZG 1999, 1222, 1224; cf also OLG Naumburg NZG 2001, 658; from the literature, e.g., Rasner (n 72) 2909–10; Richter (n 126) 162–63; for a different view Dirk Mecklenbrauck, *Abfindung zum Buchwert bei Ausscheiden eines Gesellschafters* (Josef Eul 2000) 154 et seqq.

129 Suffice it to cite Richter (n 126) 161 referring to Lorenz Fastrich, *Richterliche Inhaltskontrolle im Privatrecht* (CH Beck 1992) 25.

130 Suffice it to cite Ulmer and Schäfer (n 18) Sec 738 marg no 55, 57, with additional references.

131 Cf also the detailed listings in Richter (n 126) 166 et seqq; Mecklenbrauck (n 128) 169 et seqq.

132 See, e.g., Rasner (n 30) 305; K Schmidt (n 4) Sec 131 marg no 180, with further references.

133 BGH WM 1993, 1412, 1413; BGHZ 123, 281, 286; OLGR Hamm 1992, 202; OLG Naumburg NZG 2000, 698, 700; from the literature, e.g., Büttner (n 72) 133; Rasner (n 30) 305; Richter (n 126) 168; critically or outright dissenting Torsten Schöne, 'Wirksamkeits- und Angemessenheitskontrolle von Abfindungsklauseln bei Personen(handels)gesellschaften und GmbH' in C Armbrüster et al (eds), *Privatautonomie und Ungleichgewichtslagen* (Boorberg 1995) 117, 141; Mecklenbrauck, 'Abfindungsbeschränkungen in Gesellschaftsverträgen', [2000] BB (*Betriebsberater*) 2001, 2005; id. (n 128) 182–83; Lutter (n 28) Sec 34 marg no 90.

134 BGH WM 1993, 1412, 1413; BGHZ 123, 281, 286; OLG Oldenburg GmbHR 1997,

at the time of the exit;[135] (5) the financial and personal situation of the exiting member.[136, 137]

ii. The legal consequence: judicial adjustment of the clause

If the court holds that the disputed valuation clause cannot be exercised in good faith under the circumstances of the case at hand it is called to adjust the clause. While this consequence is undisputed in principle, it is subject to debate which measure the court has to apply when adjusting the clause: The Federal Supreme Court as well as some scholars supporting its position want to conduct yet another comprehensive weighing of interests.[138] The goal of this weighing process is to grant the exiting member a "fair" compensation[139] with a view to the conflicting interests.[140] A growing body of literature, however, advocates mimicking the arrangement the members would have struck had they known that their actual bargain is unenforceable under the circumstances at hand.[141] As a result, the exiting member is only granted a compensation that – on the basis of the actual clause – just meets the requirements of reasonableness.[142]

V. Legal Restrictions on Expulsion and Valuation Clauses as a Manifestation of Libertarian Paternalism

The judicial review of expulsion and valuation clauses in German partnership and close corporation (*GmbH*) law constitutes a far-reaching interference with the freedom of the members to regulate the internal affairs of their

503, 505; OLG Naumburg NZG 2000, 698, 700; from the literature, e.g., Rasner (30) 305; for a different view Lutter (n 28) Sec 34 marg no 90.

135 OLGR Hamm 1992, 202; OLG Oldenburg GmbHR 1997, 503, 505–06; from the literature, e.g., Carsten T Ebenroth and Andreas Müller, 'Die Abfindungsklausel im Recht der Personengesellschaften und der GmbH – Grenzen privatautonomer Gestaltung', [1993] BB 1153, 1157; Detlev J Piltz, 'Rechtspraktische Überlegungen zu Abfindungsklauseln in Gesellschaftsverträgen', [1994] BB 1021, 1024.

136 BGHZ 123, 281, 287–88; cf also OLG Dresden DB 2000, 1221, 1222.

137 While the factors (4) and (5) are considered by the courts, most legal scholars deny their relevance; cf Schöne (n 133) 140–41; Mecklenbrauck (n 128) 179–80, 185; Rasner (n 30) 306; Richter (n 126) 169–70; Ulmer and Schäfer (n 72) 150.

138 See, e.g., BGHZ 123, 281, 289 within its "gap filling interpretation" of the respective clause; and the earlier decision BGHZ 116, 359, 371; from the supporting literature, see, e.g., Hueck and Fastrich (n 26) Sec 34 marg no 28.

139 This refers to the German term "*angemessene Abfindung*".

140 Cf BGHZ 116, 359, 371; BGHZ 123, 281, 289.

141 Ulmer and Schäfer (n 72) 152; Schäfer (n 82) Sec 131 marg no 131; Richter (n 126) 173.

142 Richter (n 126) 173.

association autonomously. The question arises why the courts find it necessary to do so and whether they are justified to intervene as they do.

1. Case law on expulsion and valuation clauses as legal paternalism

Since the reference to the abstract, free-floating "functionality" of the association is unconvincing[143] and third party interests, namely those of the association's creditors, are not affected, what remains as a possible justification for the restriction of the members' freedom of contract is the protection of these very members' interests. Assuming that all members consented to the stipulation of the respective expulsion and/or valuation clause in the partnership agreement or the articles of association the Federal Supreme Court's case law turns out to be a means intended to protect the members from themselves. In other words: The court's case law on expulsion and valuation clauses constitutes legal paternalism.[144]

2. Why paternalism with regard to the members of a (quasi-)partnership?

This insight leads directly to the next question: Why are members, especially founding members of partnerships and close corporations in such a need of protection? Why can't they look after themselves? An answer to these questions may be found in the empirical evidence behavioural economists have gathered over the last decades:

a) Legal paternalism from a behavioural economics perspective

Throughout the previous decades experimental economists and psychologists gathered evidence which lead to the conclusion that real people do not act like *homines oeconomici*[145], that they are not completely rational in their choices, but that they use "rules of thumb" (heuristics)[146] and are influenced by biases

143 Cf supra IV.1.1.

144 See, in detail, Klaus U Schmolke, *Grenzen der Selbstbindung im Privatrecht* (forthcoming 2012) § 8, notably sub IV.5 and V.

145 As to this traditional economic concept of human behaviour see, e.g., Gebhard Kirchgässner, *Homo Oeconomicus* (3rd edn, Mohr Siebeck 2008); also Joseph Persky, 'Retrospectives: The Ethology of Homo Economicus', [1995] 9(2) J Econ Persp 221; it is largely concordant with the 'Resourceful, Evaluating, Maximizing Man' designed by Karl Brunner and William H Meckling, 'The Perception of Man and the Conception of Government' [1977] 3 J Money, Credit and Banking 70, 71–72.

146 As to the use of heuristics as a means of human decision making cf, e.g., Gerd Giger-

which result in systematically distorted choices.[147] Well-established phenomena (socalled anomalies[148]) are, for example, overconfidence and overoptimism of decision makers when making choices under uncertainty[149], framing effects[150], anchoring effects[151] and so forth.[152]

Facing this evidence *Cass Sunstein*, *Richard Thaler* and others concluded that a paternalistic intervention of courts and policy makers is justified and enhances freedom of choice insofar as it addresses these biases and heuristics aiming at "nudging" decision makers to a more rational decision (so-called "libertarian paternalism").[153] What they stress, is that the measure for the intervention is what the decision makers *themselves* want to do (but fail to accomplish). Or, in

enzer, 'Heuristics' in Gigerenzer and Christoph Engel (eds), Heuristics and the law (MIT Press 2006) 17; id., *Gut Feelings* (Viking 2007).

147 The pioneers of behavioural economic research and discoverers of many heuristics and biases in human decision making were the psychologists Daniel Kahneman and Amos Tversky; as to their research cf the selftestimony of the Nobel laureate Kahneman given in his prize lecture 'Maps of Bounded Rationality: A Perspective on Intuitive Judgment and Choice' which has been published in [2003] 93 Am Econ Rev 1449.

148 This term is used to indicate the deviation from the paradigm of *homo oecomicus*.

149 See, for two classic studies Neil D Weinstein, 'Unrealistic Optimism About Future Life Events', [1980] 39 J Personality &Soc Psychol 806; Ola Svenson, 'Are we all less risky and more skillful than our fellow drivers?', [1981] 47 Acta Psychologica 143; for a more recent survey of the psychological research on self-assessment see David Dunning, Chip Heath and Jerry M Suls, 'Flawed Self-Assessment', [2004] 5 Psychol Sci Pub Int 69.

150 See, e.g., the classic study by Tversky and Kahneman, 'The Framing of Decisions and the Psychology of Choice', [1981] 211 Science 453; cf also Nicholas Barberis, Ming Huang and Richard H Thaler, 'Individual Preferences, Monetary Gambles, and Stock Market Participation: A Case for Narrow Framing', [2006] 96 Am Econ Rev 1069; Matthew Rabin and Georg Weizsäcker, 'Narrow Bracketing and Dominated Choices', [2009] 99 Am Econ Rev 1508.

151 See, e.g., Edward J Joyce and Gary C Biddle, 'Anchoring and Adjustment in Probabilistic Inference in Auditing', [1981] 19 J Accounting Res 120.

152 See, for an excellent overview of recent research in the field of behavioural economics, Stefano DellaVigna, 'Psychology and Economics: Evidence from the Field', [2006] 96 J Econ Lit 315; furthermore Colin F. Camerer, 'Behavioral Economics' in R Blundell et al (eds), Advances in Economics and Econometrics, vol 2 (Cambr UP 2006) 181; Camerer and George Loewenstein, 'Behavioral Economics: Past, Present, Future' in CF Camerer et al (eds), Advances in Behavioral Economics (Princeton UP 2004) 3.

153 See Cass Sunstein and Richard H Thaler, 'Libertarian Paternalism is Not an Oxymoron', [2003] 70 U Chi L Rev 2259; Thaler and Sunstein, 'Libertarian Paternalism', [2003] 93 Am Econ Rev 175; id., *Nudge: improving decisions about health wealth, and happiness* (Yale UP 2008); similar concepts were devised by Christine Jolls and Sunstein, 'Debiasing through Law', [2006] 35 J Legal Stud 199; Camerer et al, 'Regulation for Conservatives: Behavioral economics and the Case for "Asymmetric Paternalism"', [2003] 151 U Pa L Rev 1211; Anne van Aaken, 'Begrenzte Rationalität und Paternalismusgefahr: Das Prinzip des schonendsten Paternalismus' in M Anderheiden et al (eds), *Paternalismus und Recht* (Mohr Siebeck 2006) 109.

the own words of *Thaler* and *Sunstein*: "In our understanding, a policy is 'paternalistic' if it tries to influence choices in a way that will make choosers better off, *as judged by themselves*."[154] Thus, they advocate forms of soft paternalism.[155]

Since individuals normally are better informed as to their own "real" preferences than policy makers or judges are[156], paternalistic strategies have to be used with caution and only in cases and situations where it is sufficiently likely that an individual decision maker's choice will be distorted by biases or heuristics unless the paternalist intervenes.[157]

Therefore, libertarian paternalists like *Sunstein* and *Thaler* prefer to use so-called *debiasing* strategies where the regulatory addressees are free to make the choice they want, but are assisted by the law in overcoming their systematic errors and making their choice according to their own preferences.[158] Examples for such debiasing techniques are form requirements, disclosure rules or cooling off periods.[159] Since these "little helpers" are not costless, it is justified to speak of paternalistic devices albeit very cautious ones.[160]

154 Thaler and Sunstein (n 153) 5 (emphasis in the original).

155 Soft (also referred to as weak) paternalism aims at protecting the adressee of the paternalistic measure from "involuntary" harming himself, i.e. acting against his own preferences, while hard (strong) paternalism does not take account of the preferences of the adressee to be protected. The hard paternalist, therefore, deems himself justified in protecting people from the perceivedly harmful consequences even of their fully voluntary (rational) choices; see, e.g., Joel Feinberg, 'Legal Paternalism' in Rolf Sartorius (ed), *Paternalism* (U Minn P 1983) 3; John Kleinig, *Paternalism* (Rowman & Allanheld 1984) 8 et seqq.

156 As to this so-called 'knowledge problem' of paternalism see already John S Mill, *On Liberty* (Parker & Son 1859) 137: "[W]ith respect to his own feelings and circumstances, the most ordinary man or woman has means of knowledge immeasurably surpassing those that can be possessed by anyone else."; in detail, Mario J Rizzo and Douglas Glen Whitman, 'The Knowledge Problem of New Paternalism', [2009] BYU L Rev 905.

157 See, e.g., the calculus provided by Camerer et al (n 153) 1211, 1219 et seqq; Eyal Zamir, 'The Efficiency of Paternalism', [1998] 84 Va L Rev 229, 256 et seqq; in detail, also Schmolke (n 144) at § 4 III.3 and § 5 V.5.

158 Cf the references in n 153; recently also Cass Sunstein, 'Empirically Informed Regulation', [2011] U Chi L Rev 1349.

159 Id.; furthermore Gregory Mitchell, 'Libertarian Paternalism is not an Oxymoron', [2005] 99 Nw U L Rev 1245, 1260–61; with regard to the paternalistic protection of shareholders of close corporations, see also Judd F Sneirson, 'Soft Paternalism for Close Corporations: Helping Shareholders Help Themselves', [2008] Wis L Rev 899, 918 et seqq; Michael K Molitor, 'Eat Your Vegetables (or at least Undersrtand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses?', [2009] 14 Fordham J Corp & Fin 491, 568 et seqq.

160 See the references in n 153; Mitchell (n 159) 1260–61; furthermore, cf already Mill (n 156) 180: "Every increase in cost is a prohibition, to those whose means do not

The alternative *insulating* strategy does not meddle with the decision making process of the regulatory addressee itself but merely protects him from the consequences of his (probably) flawed decision.[161] This strategy obviously cuts deeper into the freedom of contract since it denies the legal recognition of certain contractual contents *in advance* or – by way of judicial review – controls for the validity and/or enforceability of a choice made *ex post*. Being the more intensive measure insulating strategies are only justified where debiasing strategies cannot grant a sufficiently certain protection.[162]

The advantage of *ex post* insulating measures, i.e. the judicial review of contract clauses, is that the concrete consequences of the clause in each individual case can be taken into account to ascertain whether this contractual result complies with the preferences of the parties at the time the respective clause was agreed upon. Thus, the concrete consequences of the clause serve as an indicator whether the decision making process of the parties was flawed or not.[163]

b) The specific vulnerability of (founding) members of (quasi-)partnerships

Given the aforesaid, the question arises why the courts review partnership agreements and the articles of close corporations as closely as they do with regard to expulsion and evaluation clauses. The danger of *ex post* opportunism especially by the members' majority and the oppression of the minority is real[164] and should be taken account of in advance by the prospective members when bargaining over the contents of the partnership agreement or the articles of association.[165] Thus, *rational* actors being in the situation of prospective members intending to join a partnership or close corporation would anticipate

come up to the augmented price; and to those who do, it is a penalty laid on them for gratifying a particular taste."

161 See for a description of paternalistic insulating measures, e.g., Jolls and Sunstein (n 153) 200, 207–08, 226; Sean Hannon Williams, 'Sticky Expectations: Responses to Persistent Over-Optimism in Marriage, Employment Contracts, and Credit Card Use', [2009] 84 Notre Dame L Rev 733, 741.

162 See, e.g., Jeffrey J Rachlinski, 'The Uncertain Psychological Case For Paternalism', [2003] 97 Nw U L Rev 1165, 1168, 1224–25; van Aaken (n 153) 137–38.

163 Schmolke (n 144) § 5 VI.5.5.4.1, § 7 VI.2.3.3.2.5 and § 8 V.2.3.4.4

164 Cf already supra I.2.

165 Cf Stephen M Bainbridge, *Corporation Law and Economics* (Foundation Press 2002) 830: "[P]arties who want liberal dissolution rights may bargain for them [...] before investing." ; this argument has also been summarised by Means (n 14) 1162: "According to standard law and economics, minority shareholders in closely held corporations must bargain against opportunism by controlling shareholders before investing. [...] Put simply, you made your bed, now you must lie in it."

the dangers of opportunistic conduct and protect themselves accordingly.[166] If they dispense with a certain means or level of protection this would be part of their rational bargain.[167] Therefore, no judicial review of expulsion or valuation clauses is warranted in order to protect rational members of a partnership or a close corporation.[168] Against this background, the Federal Supreme Court's case law on expulsion and valuation clauses can only be justified if the assumption of rational behaviour does not hold. Evidence from behavioural economic research suggests just that[169]:

Especially the founders of small firms being personally involved in the operation of the enterprise (socalled "Mom and Pop businesses") – which describes not only the paradigm of the partnership[170] but also the vast majority of the German close corporations (*GmbH*) in existence[171] – suffer from a variety of

166 For effective contractual safeguards against the oppression of the shareholder minority by the majority cf the examples given by Sneirson (n 159) 915–16; Douglas K Moll, 'Minority Oppression & The Limited Liability Company: Learning (or not) from Close Corporation History', [2005] 40 Wake Forest L Rev 883, 9811 et seqq.

167 Cf Smythe (n 14) 245; Robert C Illig, 'Minority Investor Prtotections as Default Rules: Using Price to Illuminate the Deal in Close Corporations', [2006] 56 Am U L Rev 275, 323; Paula J Dalley, 'The Misguided Doctrine of Stockholder Fiduciary Duties', [2004] 33 Hofstra L Rev 175, 221, stating that minority protection by judicial intervention would "rewrite the contract and provide a windfall to the minority"; also Larry E Ribstein, 'The Closely Held Firm: A View from the United States', [1994] 19 Melb U L Rev 950. 955.

168 Schmolke (n 144) § 8 IV.5; cf also the so-called "contractarians" cited in n 165 and 166; for a slightly different view Means (n 14) 1185 et seqq; but see also Clayton P Gilette, 'Commercial Rationality and the Duty to Adjust Long-Term Contracts', [1985] 69 Minn L Rev 521, 581.

169 For a detailed account of the following, see Schmolke (n 144) § 8 V.1.

170 For the German partnership law suffice it to cite Herbert Wiedemann, *Gesellschaftsrecht*, vol II: *Recht der Personengesellschaften* (CH Beck 2004) 15 et seq.; for the English law cf Geoffrey Morse, *Partnership Law* (7th edn, 2010) marg no 1.19 et seqq with 1.31 and 5.01; cf for US-American partnership law, e.g., Bainbridge, *Agency, Partnerships & LLCs* (Foundation Press 2004) 4 with regard to the general partnership.

171 As to the factual background of the *GmbH*, cf the empirical data presented by Holger Fleischer in H Fleischer and W Goette (eds), *Münchener Kommentar zum GmbHG*, vol 1 (CH Beck 2010) Introduction marg no 198 et seqq. Close corporations with such personalistic elements have been dubbed quasi-partnerships. This colorful term has been developed in English case law and according to Lord Wilberforce in *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, 379 decribes a company characterised by one or more of three typical elements, namely "(i) an association formed or continued on the basis of personal relationship, involving mutual confidence [...]; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company – so that if confidence is lost,

closely interconnected biases and systematic errors when drafting their partnership agreement or the company's articles of association.[172] Among the most important biases and anomalies are (1) the interplay of overconfidence, above average-effect and self-serving bias usually summarised by the term "overoptimism".[173] This phenomenon intensifies itself by a kind of self-excitation process due to the representativeness heuristic (so-called confirmatory bias).[174] (2) The overoptimistic confidence and trust in the persistence of an amicable cooperation among the (founding) members is further increased by the availability heuristic[175]; the present situation is overestimated insofar as it answers as an indicator for the future situation (projection error).[176] (3) Likewise, the excessive discounting of future utility results in an underestimation of potential future conflicts.[177] On top of that, the (seemingly) small probability of future conflicts is (4) often completely disregarded.[178]

Some typical characteristics of the founding situation foster and exacerbate these biases and decision making errors[179]: (1) The foundation of a business is typically conducted in a stock of optimistic atmosphere.[180] Additionally, the

or one member is removed from management, he cannot take out his stake and go elsewhere."; cf also *In re Bird Precision Bellows Ltd* [1984] 1 Ch 419, 430.

172 See, e.g., Melvin A Eisenberg, 'The Limits of Cognition and the Limits of Contract', [1995] Stan L Rev 211, 251 et seqq.; Means (n 14) 1174 et seqq.

173 See, e.g., Eisenberg (n 172) 249, 251–52; Means (n 14) 1174–75, 1176 et seqq, both recognising unduly optimism as a typical characteristic of the founders of close corporations. As to the different aspects of the overoptimism phenomenon, suffice it to cite Williams (n 161) 742–747.

174 Means (n 14) 1175: "[A]lthough a rational actor would gather the optimal amount of information before making a final decision, optimism may cause the investor to look for information that reinforces their belief."; also Eisenberg (n 172) 249; in general, Jon Elster, *Explaining Social Behavior* (Cambr UP 2007) 158: "The agent initially forms an emotionbased bias, and the urgency of emotion then prevents her from gathering the information that might have corrected the bias."

175 As to the availability heuristic in general, see the detailed account of Tversky and Kahneman, 'Availability: A heuristic for judging frequency and probability', in D Kahneman et al (eds), *Judgment under unvertainty: Heuristics and biases* (Cambr UP 1982) 163.

176 See Eisenberg (n 172) 252.

177 Eisenberg (n 172) 249, 252; Means (n 14) 1175; in general, Elster (n 174) 224–25, defining the "inability to project" as "the lack of ability to imagine what oneself or others would have reasons to believe, or incentives to do, in future situations that depend on one's present choice."

178 See, recently, Kevin M Stack and Michael P Vandenbergh, 'The One Percent Problem', [2011] 111 Colum L Rev 1385, with regard to ensuing regulatory problems.

179 As to the following, see also Holger Fleischer, 'Gesellschafterkonflikte in geschlossenen Kapitalgesellschaften', in G Bachmann et al (eds), Prinzipien der geschlossenen Kapitalgesellschaft in Europa (de Gruyter 2012 forthcoming) III.2. b) aa).

180 Cf Means (n 14) 1163: "[F]ounding a business is an inherently hopeful act."; also F

common project often gains a psychological "momentum" that induces the participating parties to avoid potential causes of conflict in order not to endanger the intended business agreement.[181] (2) The founders of a partnership or close corporation are typically embedded in personal relationships.[182] This "embeddedness" leads to an atmosphere of overtrustfulness.[183] At the same time the founders back away from bargaining over prospective conflicts fearing they might otherwise damage this trustful and cooperative atmosphere being crucial for the quality of their personal relationship.[184] (3) The long-term time frame of the project makes it even more difficult to measure the probability and impact of future contingent events.[185] Furthermore, the founders are often (4) inexperienced[186] and (5) lack the resources to take professional (legal)

Hodge O'Neil, 'Oppression of Minority Shareholders: Protecting Minority Rights', [1987] 35 Clev St L Rev 121, 124: "Unfortunately the atmosphere of optimism and goodwill which prevails during the initial stages of a business undertaking usually obscures the possibility of future [...] conflicts [...]."

181 See Brian R Cheffins, *Company Law* (OUP 1997), 273–74: "Investors in smaller businesses will usually prefer to avoid bringing up potentially contentious matters since doing so might engender feelings of mistrust and thereby jeopardize the survival of the business relationship."; JAC Hetherington and Michael P Dooley, 'Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem' [1977] 63 Va L Rev 1, 36–37: "[T]he minority investor may be hesitant to raise too many reservations for fear of demonstrating too little confidence in the majority and thereby queering the deal. Introducing the subject of future dissension may produce present discontent and prevent the firm from being organized."

182 Illig (n 167) 318: "Shareholders in close corporations are also involved in an intimate, ongoing relationship, which in many cases overlaps with significant familial and other bonds."; Fleischer (n 179) III.2. b) aa); Means (n 14) 1176; Moll (n 166) 912, with additional references in n 102.

183 Cf Moll (n 166) 912: "There is often an initial atmosphere of mutual trust that diminishes the sense that contractual protection is needed."; also Means (n 14) 1176, with an impressive example from the US-American case law.

184 See, again, Moll (n 166) 914: "Effective contracting for protection is particularly challenging in such a setting, as the parties usually seek to avoid harming their relationship during the contracting process."

185 Cf Eisenberg (n 172) 252; "Long duration accentuates all these problems."; also Fleischer (n 179) III.2. b) at n 110: "[S]chließlich verhindert der langfristige Zeithorizont von Gesellschaftsverträgen, dass die Gründergesellschafter alle wichtigen Bestandteile ihrer Vereinbarung im Vorhinein auf wohldefinierte Verpflichtungen reduzieren: Sie können nicht alle denkbaren Kontigenzen voraussehen und sind aufgrund ihrer unzureichenden teleskopischen Fähigkeiten oft nicht in der Lage, Zustände der Gegenwart und Zukunft sachgerecht miteinander zu vergleichen."

186 Cf with regard to the founders of US-American close corporations and LLCs Moll (n 166) 912: "[C]lose corporation owners are often unsophisticated in business and legal matters such that the need for contractual protection is rarely recognized." and 952, with further references; David Charny, 'Hypothetical Bargains: The Normative Structure of Contract Interpretation', [1991] 89 Mich L Rev 1815, 1872; also O'Neil (n 180) 124:

advice[187]. Later, i.e. midstream, adjustments of the partnership agreement or the articles of association fail to take place due to cognitive dissonance and related phenomena.[188]

As a result, especially founders of a partnership or close corporation are particularly prone to the risk of underinsurance against ex post opportunistic behaviour (oppression of minority).[189] The later loss of bargaining power due to the emergence of a stable majority faction is only a consequence of this underprotection.[190]

3. The case law on expulsion and valuation clauses as an example of excessive legal paternalism

The judicial review of expulsion and valuation clauses conducted by the German Federal Supreme Court turns out to be a paternalistic insulating device.[191] The insights of behavioural economic and psychological research support this case law insofar as a specific risk of members, especially founders, of small business associations to underinsure against the risk of ex post opportunism by a majority faction (oppression of minority) could be substantiated as a potential justification for paternalistic intervention by the courts.[192]

"[E]ven if the participants foresee the possibility of future dissension, they are reluctant to call in and pay the costs of legal counsel to provide against contingencies."

187 See, e.g., with regard to the situation in the USA Sneirson (n 159) 916; Charny (n 186) 1872.

188 See, already, Schmolke (n 144) § 8 V.1.3; as to the phenomen of cognitive dissonance in general, see Leon Festinger, *A Theory of Cognitive Dissonance* (Stanford UP 1957). For an illustrative example see the famous US-American case *Wilkes v Springside Nursing Home, Inc* 353 NE2d 657 (Mass 1976), where the seed of the disruption of the members into two hostile factions was sown two years before the underlying conflict escalated.

189 Schmolke (n 144) § 8 V.2.1.1; cf also, e.g., Means (n 14) 1166: "Like the rest of us, shareholders in close corporations are imperfectly rational and tend to underestimate the likelihood of future strife."; Eisenberg (n 172) 249 with regard to the abdication of fiduciary duties.

190 Cf, with further references, Moll (n 166) 911: "The oppression problem would be far less acute if minority investors were likely to contract for protection before committing their capital to a close corporation."

191 As to the distinction between debiasing and insulating measures as a paternalistic device cf supra 2.1.

192 See, e.g., also Moll (n 166) 916: "This systematic failure to 'selfprotect' exacerbates the oppression problem and underscores the need for a judicial response."; Sneirson (n 159) 920: "Paternalism, generally speaking, seeks to prevent these sorts of poor decisions and encourage good ones through coercion or influence."

Against this background, the question arises whether and when it is sufficiently likely that the expulsion clause and/or valuation clause in question is the result of a flawed decision making process of the founders/members to justify the restriction of their freedom of contract by judicial review.

a) Debiasing as a less restrictive alternative?

Beforehand, however, another question has to be addressed. Since debiasing strategies, as a general rule, inflict lesser costs in terms of the frustration of autonomous choices on the addressees of the paternalistic intervention[193], it has to be clarified whether such strategies exist that create a level of protection being equivalent to the protective standard granted by the judicial review imposed by the German courts. Is this question to be answered in the affirmative the principle of proportionality demands to apply the less restrictive measure giving more room to freedom of contract.[194]

Such debiasing strategies that help the (founding) members of an association to protect themselves from the opportunistic behaviour of their co-members in case of a later conflict have, indeed, already been put forward by academics. Scholars from the U.S., for example, have suggested to systematically inform and educate prospective owners of closely held businesses about the dangers of such an endeavor, namely the danger of oppression by the majority,[195] or to force the (founding) members to actively choose about how to protect themselves by requiring them to file a mandatory foundation or incorporation form that addresses the relevant issues[196]. In German *GmbH* law the articles of association have to be notarised.[197] This form requirement does not only grant legal and evidentiary certainty, but also serves to warn the founding members about the dangers and consequences that accompany the foundation of a *GmbH* and thereby to keep them from rash decisions. To meet this protective purpose effectively, the form requirement goes along with the notary public's obligation to inform and educate the prospective members about the consequences of the transaction intended.[198] Since the foundation of a partnership comes along with similar, if not greater risks, it has been proposed to extend

193 Cf supra 2.1.

194 See, in greater detail, Schmolke (n 144) § 8 V.2.3.1. As to the regulatory strategy of abstaining from any regulation, cf the (overly) pointed remark by Means (n 14) 1176.

195 See Molitor (n 159) 574 et seqq.

196 See Sneirson (n 159) 933 et seqq.

197 Sec 2(1) and (1 a) *GmbHG*.

198 Cf Sec 17 *BeurkG*.

these debiasing measures to the foundation of a partnership which up to now does not require a specific form under German law.[199]

However, apart from the fact that also the costs of debiasing are not negligible there are considerable doubts as to whether certain biases are amenable to debiasing techniques at all. This is especially true for certain aspects of overoptimism[200] which is a major source of a flawed decision making process leading to the underinsurance of business founders against opportunistic behavior of their co-founders[201].[202] Thus, it can be contended with regard to the question put forward here, namely the justification of the judicial review of expulsion and valuation clauses as exerted by the German Federal Supreme Court that it does not become obsolete due to equally effective, but less restrictive debiasing measures readily available.[203]

b) Judicial review of expulsion clauses

Confronting the case law on expulsion clauses with the question posed above, namely whether it can be justified as a means of libertarian paternalism[204], the professed unconscionability of these clauses "in principle" turns out to be an example of excessive legal paternalism by the courts.[205] This case law amounts to a far-reaching interference with the members' autonomy, which can only be justified if the probability of the clause being the result of a distorted choice is proportionately high. This, however, is not the case.[206] As shown, the stipulation of an expulsion clause can be a very reasonable measure.[207] This is not only acknowledged by the less restrictive English and U.S. law on expulsion

199 See Koppensteiner (n 1) 203.

200 Cf with regard to the so called above average effect and the selfserving bias Williams (n 161) 748 et seqq, 761–62 with further references.

201 See supra 2.

202 Due to these shortcomings of a pure debiasing strategy corporate law scholars in the US who are inspired by the insights of behavioural economic research deem (accompanying) insulating measures necessary as a fallback position or safety net; cf Molitor (n 159) 575: "Because no system for addressing the problem of minority owner oppression can be perfect, however, the following also considers some shortcomings of this approach and argues that fiduciaryduty analysis and oppression statutes must remain in place."; also Means (n 14) 1184–85 against Sneirson (n 159) 899.

203 For further details, see, again, Schmolke (n 144) § 8 V.2.3.4.1.

204 See supra 3. pr.

205 Similarly, e.g., Benecke (n 82) 1441; Drinkuth (n 82) 412; Priester (n 106) 1146; Verse (n 24) 1827 et seqq.

206 Schmolke (n 144) § 8 V.2.4.2.1; as to the critique of the case law from the literature, see supra IV.1.1.

207 See supra II.1.

clauses[208], but also backed by the Federal Supreme Court itself when it recognises numerous situations and cases where an expulsion clause is deemed to be justified and therefore held valid.[209] Expulsion clauses are not regularly "dysfunctional" (a propos "Sword of Damocles")[210] – thereby indicating a flawed choice of the members – but serve to further a smooth and cost-efficient execution of a member's exit in case of severe conflicts among the members.

As a means of adequate protection for the member affected by the expulsion clause, it is necessary, but also sufficient to provide for an ex post judicial review of the – generally unobjectionable – exercise of the expulsion clause.[211] Thereby, abusive and opportunistic conduct of the majority (or the member entitled to exercise the clause) can be fended off; the burden of proof is shifted back to the expelled member claiming that the clause is unenforceable as exercised in the respective case.[212] Freedom of contract is the default rule again.[213] For a proper exercise of the expulsion clause in good faith it should suffice that a legitimate cause (*sachlicher Grund*) is underlying the expulsion in question.[214] Such a legitimate cause is namely given, when there is a fundamental schism among the members.[215] Furthermore, a "full" compensation for the consequential loss of the membership interest is no *condicio sine qua non* for a fair and reasonable exercise of an expulsion clause. For the coocurrence of an expulsion clause and a valuation clause, i.e. a compensation discount[216], *alone* does not indicate with sufficient probability that the expelled member's decision making process leading to his assent to the expulsion clause was flawed. The rational assent to such a regime is, for example, plausible where the respective member acquired her membership interest gratuitiously. Therefore, the manager-/employee-cases are correctly decided by the Federal Supreme Court.[217] Conversely, a "full" compensation for the loss of the membership interest in the association may not always suffice to render the expulsion of a member fair and, thus, enforceable. In such cases where a member is actively involved in running the business

208 See supra IV.1.1.
209 See supra III.1.2.2.
210 As to the legitimate critique from the literature see supra IV.1.1.
211 See the references in n 106.
212 As to the burden of proof, cf, e.g., Kübler (n 106) 199.
213 Differently, but unconvincingly Gehrlein (n 23) 1972.
214 Cf, e.g., Verse (n 24) 1828; in detail, Schmolke (n 144) § 8 V.2.4.2.3. Differently, Benecke (n 82) 1440 et seqq; Henssler (n 104) 282–83, both demanding a comprehensive weighing of the interests concerned with a view to the fiduciary duties the members of the association owe each other.
215 Similarily, Verse (n 24) 1822; cf also the US case *Bohatch v Butler & Binion*, 977 SW2d 543, 545–547 (Texas SupCt 1998).
216 As to the definition of valuation clauses see supra I.3.2.
217 See supra III.1.2.2 at n 80.

of the association and thereby earns her livelihood the compensation of the firm's assets represented by her share in the association may not be enough.[218]

c) Judicial review of valuation clauses

In light of the concept of libertarian paternalism as depicted above[219] the judicial review of valuation clauses as practiced by the German Federal Supreme Court can indeed be rationalised by and large. Nevertheless, it shows also tendencies to overreach with regard to the restriction of the members' freedom of contract: As far as the Federal Supreme Court refers to the indispensable right to exit a close corporation to hold a valuation clause null and void it ignores the legitimate interests of the remaining members.[220] The deterring effect on members willing to exit can be taken into account within the control for the unconscionability of the clause (Sec. 138(1) *BGB*).[221]

In contrast, the court's case law on the unconscionability of valuation clauses providing for a compensation that is grossly disproportionate in relation to the fair market value of the membership interest[222] can be justified as an appropriate means of paternalistic protection of members against their own irrationality. For it can plausibly be presumed that such clauses are the result of a flawed decision making process.[223] This presumption may, however, be rebutted by showing that in the case at hand the valuation clause is the result of rational and reasonable considerations.[224] The courts assumed such reasonable

218 Cf the Federal Supreme Court's case law on valuation and compensation clauses with regard to exiting members of professional firms, e.g. BGH ZIP 2008, 410, 411. The occurrence of such cases, however, does not amount to an argument against the validity of expulsion clauses per se and in favour of winding up the association instead [cf. *Ebrahimi v Westbourne Galleries Ltd* [1973] A.C. 360 on English company law demanding bad faith conduct in the concrete case], since winding up the partnership or company would not leave the respective member in charge. Even as a means of forcing the quarrelling members into negotiations on a "fair" compensation of the leaving member its aptitude is not without doubt, since bad blood among the members may lead to spiteful behaviour which frustrates an objectively desirable agreement and leads to a value destructing dissolution of the association.

219 See supra 2.

220 As to these interests see supra II.2.

221 Similarly, K Schmidt (n 4) Sec 131 marg no 156; cf already supra IV.2.2.

222 Cf supra III.2 and IV.2.1.

223 Cf supra 2; cf, in this context, also BGH DB 2011, 2765, 2766 para 14, whereby a valuation clause has to be interpreted in cases of doubt as to be intended to lead to a "reasonable", i.e. rational and sensible, result.

224 See, in detail Schmolke (n 144) § 8 V.2.4.3.3

considerations when upholding valuation clauses that were part of a manager incentive scheme.[225]

As to a gross disproportionality developing *ex post*, i.e. after the stipulation of the valuation clause, the judicial exercise control applying the good faith standard (§ 242 *BGB*) is the appropriate legal answer in the vast majority of cases. Whereas it is true that a gap filling contract interpretation takes precedence over such an exercise control, the requirements of the former will rarely be met.[226] This is true, because in most cases the valuation clause is intended by the parties to provide for a predictable and calculable solution against the background of uncertain future events. In other words: the members provided for the risk of a gross disproportionality occurring, i.e. there is no gap in the agreements or articles to be filled by the court, but they (merely) underestimated the probability of its occurrence.

If an exercise control shows that the enforcement of the valuation clause leads to unacceptable results, the court is called to adjust the clause.[227] The aim of this adjustment is not to replace the original clause by a "reasonable" or "fair" one, but to grant the exiting member a compensation that just meets the requirements to pass the judicial control.[228] This alone would honour the members' intentions at the time they crafted the clause.

VI. Conclusion

1. As in many other jurisdictions freedom of contract rules in principle with regard to the internal affairs ofGerman partnerships and closely held corporations. In German partnership and *GmbH* law this principle is, however, subject to numerous exceptions. To that effect, the German Federal Supreme Court puts expulsion and valuation clauses in partnership agreements and the articles of close corporations, respectively, under close scrutiny.

2. Despite the fact that there are reasonable motives for stipulating expulsion and valuation clauses, namely guaranteeing a smooth and cost-saving breakup of a shattered relationship among the members and protecting specific invest-

225 BGHZ 164, 107, 116; see also BGHZ 135, 387, 390–91; cf supra III.2.3.

226 See also the references in n 126; as to the respective debate supra IV.2.3.1.

227 Cf supra IV.2.3.2.

228 Richter (n 126) 173; see also Omri Ben-Shahar, 'Fixing Unfair Contracts', [2011] 63 Stan L Rev 869 calls this the "principle of minimally tolerable terms"; cf id., at 906: "The [courts…] should mimic the bargain that the parties would have struck, even if that bargain favors one of the parties."; but see also Eisenberg (n 172) 253: "The solution to the problems […] is […] to allow either party the right to easy exit on fair terms […]."

ments in the common business the judicial review of such clauses can be justified in principle as a means of libertarian paternalism. This paternalistic concept builds on the insights of behavioural economic and psychological research on human decision making. The evidence gathered by this line of research suggests that human agents are subject to systematic errors when making decisions due to biases and the employment of heuristics. It could be shown that especially the founders of closely held businesses and firms are prone to these biases and heuristics, notably to being overly optimistic with regard to the future understanding of the members thereby underinsuring against opportunistic behaviour of their co-members in cases of conflict.

3. However, the limitations on private autonomy the Federal Supreme Court inflicts upon the (prospective) members of partnerships and close corporations by its case law on expulsion and valuation clauses are overly restrictive. In contrast to this case law, but in line with the principle of freedom of contract, expulsion clauses should not be held void, but legally valid as a default rule. As a means of adequate protection for the member affected by the expulsion clause, it is necessary, but also sufficient to provide for an ex post judicial review of the exercise of the expulsion clause in the individual case. The exercise of the clause should pass this review if a legitimate cause is underlying the expulsion in question.

4. In contrast, the case law on valuation clauses is more considerate of the members' private autonomy. Nevertheless, by classifying a valuation clause as a de facto exit barrier infringing the indispensable right to exit the association the court neglects legitimate interests of the remaining members. The deterring effect on members willing to exit can be taken account of within the control for the unconscionability of the clause. With regard to cases of a gross disproportionality between the compensation amount provided for in the valuation clause and the fair value of the membership interest developing in the course of time *after* the stipulation of the clause, the Federal Supreme Court should refrain from assuming a gap in the members' agreement too lightly. More often than not, there will be no such gap, and the court should therefore resort to an exercise control applying the (objective) good faith standard (§ 242 BGB). If this control shows that the enforcement of the valuation clause leads to unacceptable results, the valuation clause should be adjusted by granting the exiting member a compensation that just meets the requirements to pass the judicial control.