THE LEGAL REQUIREMENTS FOR A SHAREHOLDER'S EXCLUSION FROM A LIMITED LIABILITY COMPANY ACCORDING TO ARTICLE 420 PARA. 3 OF THE COMPANIES ACT WITH A SPECIAL REFERENCE TO ISSUES RELATED TO THE REIMBURSEMENT OF THE MARKET VALUE FOR THE SHARES HELD IN THE COMPANY

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UDK: 347.724(497.5)
347.72.034:347.724
DOI: 10.3935/zpfz.74.3.5
Izvorni znanstveni rad
Primljeno: veljača 2024.

*The Companies Act provides that a shareholder can be excluded from a limited liability company if there is an important reason for his exclusion. Besides the existence of an important reason, such exclusion must also be a measure of last resort (*ultima ratio*) and the excluded shareholder must be reimbursed for the market value of the share it held in the company. The paper analyses and elaborates on these requirements but also emphasizes some of the issues that the existing regulation inadvertently creates with the rules on share capital maintenance and share capital contributions. It will be demonstrated that these rules can hinder or even disable the exclusion of a troublesome shareholder from the company thus preventing the attainment of the purpose of the rules relating to the shareholder's exclusion. Therefore, specific* de lege lata *and* de lege ferenda *suggestions are provided to the Croatian legislator and the practitioners.*

Key words: limited liability company; shareholder's exclusion; share capital maintenance; share capital contributions

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1. INTRODUCTION

Relations between shareholders in a limited liability company are often much more personal than in a public limited company. That is because shareholders of a limited liability company usually personally know each other and have a trusting relationship, they are also regularly involved in the everyday operation of the company and its management. Furthermore, membership in a limited liability company is often closed to any interested third party while anyone can become a shareholder in a listed public limited company. Such close relations in a limited liability company can result in conflicting opinions which might ultimately degrade the trust established between the shareholders and even lead to their breakup. Besides adversely affecting their relationship, such personal conflicts can also seriously disrupt the everyday operations of the affected limited liability company. When this happens, the overall well-being of the company is at risk, which can also endanger its existence. In such situations, the company's well-being takes precedence over the relationships between its shareholders. In other words, when such a disruption can be attributed to one or more shareholders, the other shareholders may exclude them from the company.

Contrary to withdrawal, such exclusion is a measure aimed against a specific shareholder of the company who is unwilling to adjust in a manner that would be in line with the achievement of the company's purpose and goals. The rules on exclusion are expressly regulated in Croatian company law, in Articles 420 and 421 of the Companies Act.[1] The current regulation acknowledges two different paths for the exclusion of a shareholder. To be more specific, a shareholder can be excluded based on the special rules and procedures determined by the

[1] Companies Act, Official Gazette nos. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19, 34/22, 114/22, 18/23, 130/23. It should be noted that the legislative inspiration for the introduction of the rules on the exclusion of a shareholder from a limited liability company into the Croatian Companies Act can be found in German law, namely the *GmbH-Gesetz.* In this regard, the German rules on exclusion are almost identical to the rules found in the mentioned Article 420 and 421 of the Companies Act. Although the inspiration for many legal rules relating to the limited liability company established under Croatian law can be found in Austrian law, Austrian law does not have any rules on the exclusion of a shareholder from a limited liability company. Austrian case law only seems to allow for exclusion based on the company's articles of association and not due to the existence of an important reason. Therefore, it seems that the legislative role model for the introduction of rules on exclusion of a shareholder due to the existence of an important reason was German law. Consequently, this paper relies on the vast experience of German law and its legal literature in the elaboration of the arguments presented herein.

company's articles of association. Notwithstanding the existence of such special rules, the Companies Act also enables the exclusion of a shareholder based on the existence of an important reason. Therefore, the exclusion is generally available to every limited liability company, regardless of whether the shareholder holds a minority or majority stake in the company, regardless of whether the company is based mostly on the shareholder's contribution to the share capital or their contribution to the overall business operation of the company, whether it has a hundred, a dozen or only two shareholders.[2]

The topic of this paper is a critical assessment of the prescribed legal requirements for exclusion based on the existence of an important reason. Generally speaking, there are three general conditions for the exclusion of a shareholder of the company: 1) the existence of an important reason for the exclusion, 2) that such exclusion must be a measure of last resort for the resolution of the disruptive situation in the company, and 3) that the excluded shareholder is reimbursed for the market value of the share they held in the company.[3] The paper follows this simple structure but, besides analyzing each of these requirements, a special emphasis is placed on the assessment of some of the recognized issues relating to the reimbursement of the market value of the share to the excluded shareholder. The results of such assessment are some more and less specific *de lege lata* and *de lege ferenda* proposals. Finally, the paper also elaborates on the different stages of the company's life during which shareholder exclusion can take place.

2. EXISTENCE OF AN IMPORTANT REASON FOR A SHAREHOLDER'S EXCLUSION

According to Article 420 para. 3 of the Companies Act a shareholder of the company may be excluded from the company if there is an important reason justifying such an exclusion. The Companies Act further elaborates that such a reason exists when a shareholder's behavior prevents or significantly hinders the attainment of the company's purpose, and as a result, his continued membership

[2] In this direction from the position of comparable German law see Sosnitza in Michalski, L. (ed.), *GmbH-Gesetz, Band 1*, 4. Auflage, C.H. Beck, München, 2023, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 7; Kersting in Noack, U.; Servatius W.; Haas, U. (eds.), *GmbH-Gesetz*, 23. Auflage, C.H. Beck, München, 2022, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 2.

[3] In this direction from the position of comparable German law see Schindler in Ziemons, H.; Jaeger, C.; Pöschke, M. (eds.), *Beck Online Kommentar, GmbHG*, 51. Auflage, C.H. Beck, München, 2023, available at https://beck-online.beck.de, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 118.

in the company becomes intolerable for the company.[4] Although this provision only mentions the behavior of the shareholder, an important reason is not solely based on the shareholder's behavior towards the company, the other shareholders, or even third persons, but also on the circumstance that such reason originates in the person of the shareholder.

For example, reasons existing in a person are considered reasons that are tied to the characteristics of that person or circumstances directly related to that person.[5] For example, personal insolvency of a shareholder which could result in a hostile takeover of shares by the company's competitors, loss of the professional qualification (e.g. license) which was the reason for introducing that person into the company as a shareholder, loss of a family connection (e.g. due to divorce from a family member) which was the reason for receiving the shareholder status in a closed family company, a permanent or enduring illness that disables the shareholder from active involvement and cooperation with his other partners in the company when such involvement and cooperation is necessary for the achievement of the company's purpose.[6]

On the other hand, reason exists in the behavior of the excluding shareholder when such behavior relates to the shareholder's acts or omissions towards

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[4] This wording corresponds to the text of the § 207 para. 1 of the Proposal draft of the GmbHG from 1971/1973. However, under German law it is generally accepted that an important reason for exclusion exists if circumstances in the member or the member's behavior make the continuation of the company unlikely or at least seriously endanger the company and its interests. In that regard see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 119; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 5; Fleischer in Henssler, M; Strohn. L. (eds); *Gesselschaftsrecht*, 5. Auflage, C.H. Beck, München, 2021, GmbHG § 34 Einziehung von Geschäftsanteilen Rn. 24; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 1.

[5] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 120; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 8.

[6] In this regard from the position of comparable German law see Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 10; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 2; Stefanink, R.; Punte, H.; M., *Der Ausschluss eines Gesellschafters aus der GmbH*, Gesellschafts- und Wirtschaftsrecht (GWR), *vol.* 10, Heft, 21, 2018, p. 405; Wicke, H., *GmbHG Kommentar*, 4. Auflage, C.H. Beck, München, 2020, Anh. § 34: Austritt und Ausschließung eines Gesellschafters Rn. 3.

the company, other shareholders, and even third persons.[7] For example, lying or defrauding the company or its shareholders to acquire membership in the company (e.g. about his professional qualifications, experience or knowledge), repeated severe breaches of the duty of loyalty to the company, total loss or destruction of the necessary trust towards the shareholder, causing damage to the public image of the company and its reputation, a severe violation of the binding non-competition clause in the company agreement, commission of criminal acts which could severely damage the public image of the company, abuse of the company's accounts for own private purposes, severe unethical conduct towards the company's employees resulting in damage to the company's interests, severe or repeated revealing of the company's trade secrets to company's competitors and even unwillingness to participate in the necessary restructuring of the company (e.g. when such restructuring is required by anti-competition rules and it is only the shareholder who stands in the way of an antitrust exemption).[8] This also includes the loss or violation of trust from other shareholders which ultimately leads to the disruption of the company's interests.[9]

Since such behavior and/or circumstances are related to a specific person, that means that the behavior and/or circumstances related to a previous shareholder generally cannot be attributed to the new shareholder.[10] In other words, the change of a troublesome shareholder also results in the loss of the legal ground for the exclusion of such new shareholder. However, that is not the case when the old shareholder acts as a puppet master over the new shareholder. In such a situation, the change in the person of a shareholder was only undertaken to avoid

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7 In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 121.

8 In this direction from the position of comparable German law see Thiessen in Bork, R.; Schäfer, C. (eds.), *GmbHG Kommentar*, 5. Auflage, RWS Verlag, Köln, 2022, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 60; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 2; Stefanink *et al., op. cit.* in fn. 6, p. 405; Wicke, *op. cit.* in fn. 6., Anh. § 34: Austritt und Ausschließung eines Gesellschafters Rn. 3.

9 In this regard from the position of comparable German law see Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 10.

10 In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 126; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 13; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 5.

exclusion and the loss of shares which would ultimately result in the loss of the initial shareholder's control over the company. The same reasoning should apply to cases where the new shareholder is seeking the exclusion of another shareholder when such exclusion would not be successful if attempted by the shareholder that preceded the new shareholder (e.g. due to the previous shareholder's equally contributory fault to the disruption of the company).[11] That is because such a change of a shareholder would disadvantage the remaining shareholder since he would be open to exclusion from the company compared to his position before the departure of the other shareholder when he was not open to such exclusion.[12] On the other hand, a specific person should also not be permitted to become a shareholder when, before the transfer of shares to that person, an important reason justifying the exclusion of that person already exists.[13]

Exclusion due to a reason in the behavior of the shareholder should not be permitted solely based on misconduct in the shareholder's private sphere, including his family or close friends, (e.g. marriage of a shareholder or his family member to the owner of the competing company). However, it should be noted that such misconduct could reach the public sphere and cause severe damage to the company's interests, in turn amounting to an important reason for the exclusion.[14] That risk is upon each and every shareholder. Similarly, failure to undertake business activities as a company director should normally not result

[11] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 126; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 13; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 5.

[12] For further elaboration on contributory negligence of other shareholders see below in this chapter.

[13] That may be the case when after the conclusion of the contract for the transfer of shares, but before the shares are transferred to the new shareholder, an important reason justifying the exclusion of that shareholder already exists. This means that the person to be excluded need not be a shareholder when such a reason comes into existence. Moreover, the company should also be enabled to temporarily prevent the transfer of shares until the conclusion of the court proceedings. There should be no reason to wait for the transfer of shares to the new shareholder. In this direction from the position of the comparable German law see Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 59.

[14] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 122; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 14; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 2.

in the shareholder's exclusion from the company.[15] In such a situation, the shareholder's activities should be assessed separately from his activities as a director of the company. In case the misconduct or behavior of the shareholder is solely related to his position as a member of the company's management, such misconduct could lead to his removal from that position. Removal from management is a lesser measure than the exclusion from the company which should always be the *ultima ratio* measure.[16] Furthermore, although an important reason is based on facts that originated in the past, such a reason must also disable the possibility of future cooperation with the affected shareholder.[17]

An important reason for exclusion from the company could be based on the exercise of shareholder rights (e.g. the right to be informed about the company's dealings and the right to seek annulment of the shareholder's assembly decisions), but only if the shareholder abuses such rights solely to harass other shareholders, the company and/or cause damage to the company's interest.[18] The mere exercise of such rights for any other reason (e.g. be it mere ignorance or genuine concern for the company's well-being) should not result in the shareholder's exclusion. Otherwise, orderly exercise of the shareholder's rights could be jeopardized or even abused against individual shareholders. This should also extend to the exercise of other legitimate rights against the company (e.g. asserting a claim

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[15] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 122; Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58.

[16] For more details on the *ultima ratio* nature of the exclusion see Chapter 3 (Shareholder's exclusion as the measure of last resort). However, that does not mean that the removal of a shareholder from the company management cannot lead to the exclusion of that shareholder from the company as well. Especially so if such a shareholder has severely breached the trust of the other shareholders that it cannot be reasonably expected from the other shareholder to cooperate with the shareholder who was part of the company management. In this direction see Jurić, D., *Isključenje člana iz društva s ograničenom odgovornošću*, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, *vol*. 44, br. 1, Pravni fakultet Sveučilišta u Rijeci, Rijeka, 2023, p. 280. In this direction from the position of comparable German law see Hoffmann, P.; Rüppell, P., *Ausschluss eines GmbH-Gesellschafters aus wichtigem Grund*, Betriebs Berater (BB), Heft 18, Deutscher Fachverlag GmbH, Frankfurt am Main, 2016, pp. 1026 – 1027.

[17] In this regard from the position of comparable German law see Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58.

[18] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 122; Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 60.

against the company as its creditor, even when the company is in financial difficulties).[19] Therefore, there is no important reason in situations where one shareholder refuses to subordinate his own legitimate interest to those of the company.

The assessment of whether there is an important reason for the shareholder's exclusions must be based on the objective consideration of all circumstances related to the case at hand.[20] First and foremost, it is important to determine the effect of such circumstances on the company's business operations and its purpose.[21] This means that other circumstances, those unrelated to the shareholder and/or his misconduct, should also be taken into consideration (e.g. whether the company in question is a company whose shareholders are closely connected partners or whether there is no such connection between the shareholders). In smaller companies, whose shareholders are personally and closely connected and more involved in the management of the company, circumstances related to a single shareholder or his behavior could more seriously affect the company's interests and thus amount sooner in the reason for his exclusion (e.g. in a company with two shareholders with an equal stake in the share capital, a serious quarrel between the shareholders could lead to the company's dissolution).[22] On the other hand, in companies with many shareholders contributing only to the share capital, there is presumably less chance that one shareholder could cause a serious disruption in the company's affairs and the attainment of the company's purpose. Special circumstances or the general state of the company can play an important role in such an assessment, as well. For example, when a company is in the process of liquidation, it should be determined whether the disruption caused by the shareholder affects the orderly liquidation of the

[19] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 122; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 11; Wicke, *op. cit.* in fn. 6., Anh. § 34: Austritt und Ausschließung eines Gesellschafters Rn. 3.

[20] In this regard see Jurić, *op. cit.* in fn. 16, pp. 279 – 280.

[21] In this regard from the position of comparable German law see Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 15.

[22] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 123; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 16; Hoffmann *et. al., op. cit.* in fn. 16, p. 1026.

company since this is the new purpose of the company.[23] On the other hand, past merits or contributions of the troublesome shareholder to the company's well-being should play no role in the overall assessment of the grounds for exclusion of that shareholder. That is because the current disruption to the company cannot be removed by such past events or past merits of the troublesome shareholder. Therefore, the assessment should consider only the present events and the effect of such events, as well as the effects of continued membership of the troublesome shareholder in the company, on the well-being of the company.[24]

It should also be noted that an important reason for exclusion could result from a single (severe) act or multiple acts of misconduct which individually cannot amount to such a reason for exclusion.[25] However, when assessing such cumulation of multiple acts one should also take into consideration the reaction of the company and its shareholders to such previous misconduct and/or circumstances related to the excluding shareholder. This means that if such a shareholder was not reprimanded or warned for committing such previous acts or if there was no reaction at all to such previous acts, they should hold no to little value in the assessment of the existence of an important reason for the shareholder's exclusion from the company.[26] In other words, with time the relevance of misconduct or incidents decreases in value, even more so if the shareholder was not reprimanded or warned in due time for such acts. Furthermore, the value of such incidents decreases if the company failed to act upon similar incidents in the past. Especially so when similar incidents were previously committed by other shareholders, as the company must treat all of its shareholders equally.[27] This does not apply to situations where the current incident is so much more severe than the previous ones that it had to trigger a reaction of the company or other shareholders.

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[23] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 123.

[24] In this direction from the position of comparable German law see Stefanink *et al., op. cit.* in fn. 6, p. 406.

[25] In this regard from the position of comparable German law see Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 15.

[26] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 123.

[27] In this regard from the position of comparable German law see Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 15; Stefanink *et al., op. cit.* in fn. 6, p. 406.

It should be noted that the affected shareholder does not need to be at fault for him to be excluded from the company. However, if such a fault exists and can be proven, it goes to the detriment of that shareholder when determining the seriousness of the disruption caused by his acts.[28] In other words, an important reason for exclusion normally exists when the shareholder acted deliberately or with gross negligence in disrupting the company and its well-being.[29] This also means that any contributory negligence of other shareholders to such a disruption may help alleviate the position of the affected shareholder. In such a situation one should consider which shareholder is predominantly at fault.[30] If multiple or all of the shareholders are equally at fault, one shareholder cannot be excluded from the company solely for his part in the disruption.[31] In such a situation, exclusion should affect all or none of the shareholders at fault. This is especially the case in companies with two shareholders where one shareholder intends to exclude the other.[32] However, in such a situation it is not possible to go through with the exclusion of both shareholders, but each shareholder could seek dissolution of the company based on Article 468 of the Companies

[28] In this regard from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 124; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 12, 17; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 3.

[29] In this regard see Jurić, *op. cit.* in fn. 16, p. 279. In this regard from the position of the comparable German law see Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 57.

[30] In this regard from the position of comparable German law see Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58. In this direction from the position of the comparable German law see Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 4; Stefanink *et al., op. cit.* in fn. 6, p. 406.

[31] In this direction see Jurić, *op. cit.* in fn. 16, p. 279. In this regard from the position of the comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 124; Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 12, 17.

[32] In this regard from the position of comparable German law see Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 17; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 4; Wicke, *op. cit.* in fn. 6., Anh. § 34: Austritt und Ausschließung eines Gesellschafters Rn. 3.

Act. This is a reflection of the principle of equal treatment of the shareholders in the company.

It is not uncommon that company shares are held on behalf of the shareholder by another authorized person (i.e. an agent). In those situations, an agent normally exercises shareholder rights on behalf of his principal, i.e. the actual shareholder. This means that the important reason for exclusion still relates to the shareholder since the agent is acting upon his instructions and because the agent's mistakes are fundamentally attributed to the shareholder as his principal. However, an agent may have very broad authority to exercise such rights on behalf of the shareholder. If the shareholder can prove that the authorized person acted on his own and without any specific instruction from the shareholder, i.e. that instruction which caused disruption is solely related to the behavior of the agent and that such disruption will not happen again because the shareholder will revoke the agent's authority of representation, the shareholder should not be excluded from the company. That is because in such a situation a less severe measure is taken, i.e. revocation of the agent's authority to represent the shareholder. This will normally be the case where the agent holds a timely indefinite authority to represent the shareholder before the company (e.g. as an asset manager).[33] This is even more so if the principal is contractually prohibited from giving any specific instructions to the agent. However, if the shareholder repeatedly or firmly refuses to revoke the agent's authority or cannot revoke such authority, this could lead to the shareholder's exclusion from the company.[34]

The existence of an important reason for the shareholder's exclusion should be determined based on the evidence presented during a hearing before the court. According to Article 284 para. 3 of the Civil Procedure Act the parties cannot present new facts and propose new evidence after the conclusion of the preparatory hearing (i.e. at the end of the preliminary hearing before the court).[35] However, according to Article 299 para. 2 of the Civil Procedure Act

[33] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 125; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 5; Stefanink *et al., op. cit.* in fn. 6, p. 405.

[34] In this direction from the position of comparable German law see Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 5.

[35] Civil Procedure Act, Official Gazette nos. 53/91, 91/92, 58/93, 112/99, 88/01, 117/03, 88/05, 02/07, 84/08, 96/08, 123/08, 57/11, 148/11, 25/13, 89/14, 70/19, 80/22, 114/22, 155/23. The usually applicable rules on non-litigation procedure are

the parties may present new facts and propose new evidence only if they could not do so by no fault of their own before the conclusion of the preparatory hearing. This generally means that the relevant moment for the assessment of the existence of an important reason for the exclusion will be the moment when the preparatory hearing is concluded.[36] This also means that new evidence and new facts could be introduced into the proceeding after the conclusion of the preparatory hearing if such evidence and facts were unknown to the party wanting to introduce them by no fault of its own.

3. SHAREHOLDER'S EXCLUSION AS A MEASURE OF LAST RESORT

Exclusion leads to a loss of shares and thus a loss of shareholder rights in the company for the affected shareholder. To justify such a loss of shareholder rights, the shareholder's exclusion must be a measure of last resort for the resolution of a disruptive situation in the company. If there are other milder measures at hand that do not result in a loss of shareholder rights, such measures take precedence over the shareholder's exclusion from the company. In other words, exclusion is possible only when there are no other milder measures at hand to resolve the disruptive situation in the company, i.e. when the exclusion is the only *ultima ratio* measure at hand to resolve such a situation.[37] However, it should be noted that the submission of a claim under Article 468 Companies Act is not a milder measure since such a claim leads to the dissolution of the company and the loss of shareholder rights for every shareholder.[38] In other words, the exclusion of a

not clear on this issue but are supplemented by the rules on the Civil Procedure Act. In this regard see Article 2 Non-Litigation Procedure Act, Official Gazette nos. 59/23.

[36] According to German law, the relevant moment for the same assessment is the last oral hearing before the court. In that regard see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 128. For the same proposal in regard to Croatian law see Jurić, *op. cit.* in fn. 16, p. 279.

[37] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 129; Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 18; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 6.

[38] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 131; Strohn in Fleischer, H.; Goette, W. (eds.), *Münchener Kommentar GmbHG,*

single or several shareholders is a milder measure compared to the dissolution of the company since the company's continued existence always takes precedence.

Existence and type of milder measure depend on the facts of the case. For example, if a disruption is related solely to the shareholder's position as a member of the company's management, a milder measure could be his removal from the company's management.[39] Appointment of a substitute member of the management by the court in case the shareholder, as a member of the management, is unable to temporarily carry out his duties as a member of the company management (due to a prolonged illness) should also be considered a milder measure as opposed to his exclusion from the company. On the other hand, partial exclusion could also represent a milder measure in a situation where the shareholder is continuously abusing his voting rights to block necessary decisions in the shareholder's assembly (e.g. a decision on the capital share increase or decrease, or on the appointment of the management). This means that the shareholder will be excluded only in regard to the part of his shares that enables him to block such decisions.[40] Placing shares in the custody of a third person (e.g. to a broker or a financial institution) where the custodian is guided by the interests of the shareholders in general in the exercise of the affected shareholder's rights could also be a milder measure. However, since consent of the affected shareholder is necessary to transfer the shares to the custody of the third party, a refusal of the affected shareholder could pave the way for his exclusion from the company.[41] The same applies to cases where a shareholder's

Band 1, 4. Auflage, C.H. Beck, München, 2022, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 125.

[39] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 130; Thiessen in Bork *et al., op. cit.* in fn. 8, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 58; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 19.

[40] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 130; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 19; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 6.

[41] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 130; Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 6.

disruption of the company could be resolved with a change or removal of his dispositive rights in the company's articles of association.[42]

4. REIMBURSEMENT OF THE MARKET VALUE OF THE SHARES HELD IN THE COMPANY

According to Article 421 para. 2 of the Companies Act, an excluded shareholder has the right to be reimbursed for their shares at the market value of the share at the time of his exclusion. In other words, the shareholder's exclusion cannot be undertaken unless he is compensated for the shares he holds in the company. The debtor of this obligation is the company that issued the shares in question while the shareholder to be excluded is the creditor.

However, according to Article 407 para. 1 of the Companies Act such reimbursement may not be undertaken at the expense of the assets corresponding to the amount of the company's share capital. That is to say, because the reimbursement of the excluded shareholder is to be made from the company's assets, such reimbursement reduces the assets that form the liability fund to the company's creditors. The said provision of the Companies Act ensures that creditors are at least protected with the assets corresponding to the value of the share capital.[43] In other words, these provisions ensure that such value will not be affected by the reimbursement to the excluded shareholder. Otherwise, according to Article 407 para. 2 of the Companies Act the received payment should be returned to the company.

Therefore, Article 407 para. 1 of the Companies Act solely acts as a general mathematical tie-up of the company's assets and does not relate to any specific asset base. This is purely a numerical value based on the company's balance sheet at the moment the decision to exclude the shareholder is made.[44] The relevant share capital is the registered value of the company's share capital at the moment such reimbursement is to be made, but it is irrelevant whether the

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[42] In this regard from the position of comparable German law see Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 19.

[43] In that direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 121; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 20.

[44] In that direction from the position of comparable German law see Schmolke in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 30 Kapitalerhaltung Rn. 46, 58.

share capital has been paid in full or not. It should be noted that this provision does not protect the share capital itself, but the company's assets that correspond to the value of that share capital. In other words, a company cannot make payments to shareholders from the assets necessary to cover the value of its share capital.[45] This includes payments that would not only worsen the already negative balance but would also result in such an adverse balance for the company. Generally speaking, companies that are performing poorly and as a result are considered to be over-indebted will not be able to make payments to excluded shareholders for the shares they hold in the company.[46]

This means that exclusion cannot be undertaken if such payment will result in the breach of the aforementioned provision.[47] In theory, the reimbursement can only be made at the expense of the free assets of the company so as not to endanger the orderly functioning and the financial state of the company. This is an expression of the principle of share capital maintenance. However, one cannot but wonder about the effectiveness of such a prohibition since, at least under Croatian law, the minimal share capital is set at 2,500 euros for a limited liability company and at 1 euro for a simple limited liability company.[48] Such low minimal amounts of share capital are generally insufficient to represent any viable security for the company's creditors, especially if a company has more than one creditor, which is regularly the case. Therefore, the protection granted under Article 407 para. 1 of the Companies Act only makes sense in cases where a company has a much higher amount of share capital subscribed than the minimal one set out by the Companies Act. Since subscription of higher share capital is rarely the case in practice for unregulated limited liability companies, one cannot but wonder about the necessity of the aforementioned

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45 In that direction from the position of comparable German law see Schmolke in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 30 Kapitalerhaltung Rn. 57, 84; Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 121.

46 In this regard from the position of comparable German law see Conradi, P., *Wann ist der Ausschluss aus der GmbH wirksam?*, Neue Zeitschrift für Gesselschaftsrecht (NZG), Heft 34, C.H. Beck, München, 2021, p. 1550.

47 In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 132.

48 For Croatian law see Article 389 para. 2 and Article 390.a para. 3 Companies Act. Comparably, the minimal share capital of the German limited liability company is set at 25,000 euros and 35,000 euros for the Austrian limited liability company. Such minimal share capital rules provide for a much higher level of creditor protection than the Croatian minimal share capital requirements.

provision of the Companies Act. It would be much more logical to *de lege ferenda* associate such protection with a fixed value dependent on the average underlying company's assets in one business year (e.g. 25,000 euros) and not the share capital unless the share capital surpasses such a fixed value. Another, even more logical solution, would be to associate such protection with an adaptable value that is dependent on the amount of the company's debts, and not the value of the company's share capital. Otherwise, one should even consider *de lege ferenda* the actual necessity of a prohibition set up under Article 407 para. 1 of the Companies Act.

Going back to the existing legal regulation under Article 407 para. 1 of the Companies Act, to lower the protective threshold under such provision it might be possible to undertake a share capital reduction in accordance with the Companies Act if the share capital is higher than the minimal share capital of 2,500 euros (e.g. 100,000 euros or more). This might in turn enable the reimbursement of the excluded shareholder. However, if at the moment when the decision to exclude the shareholder is made it is clear that the company will not be able to reimburse the shareholder for his shares when such payment is foreseeably due, the decision to exclude the shareholder is void.[49] The decision should not be considered *de lege lata* void if other shareholders or a third person or third persons are willing to reimburse the excluded shareholder and take over his shares in the company instead of the company.[50] Even though this is not a possibility expressly provided for under Article 420 para. 3 of the Companies Act, which mentions only the obligation of the company to reimburse the shareholder, such a possibility should be permitted. That is because it is primarily in the interest of the company for the troublesome shareholder to be removed from the company as soon as possible to reestablish its orderly operation. In such a situation, the court should request from the other shareholders or the third person or persons to provide appropriate security to the excluded shareholder for the reimbursement of its shares in the company to deny the claim to declare the company's decision void. However, if this is not an option and the decision

[49] In that direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 132; Conradi, *op. cit.* in fn. 46, p. 1548; Hoffmann *et. al., op. cit.* in fn. 16, p. 1029.

[50] In this regard see Jurić, *op. cit.* in fn. 16, p. 282. In this direction from the position of comparable German law see Kersting in Noack *et al., op. cit.* in fn. 2, Anhang nach § 34 Ausschluss und Austritt von Gesellschaftern Rn. 11; Conradi, *op. cit.* in fn. 46, p. 1550.

is ultimately declared void, the only possibility left might be to dissolve the whole company according to Article 468 of the Companies Act.[51]

The current Companies Act regulation creates even further practical problems. According to Article 398 para. 3 of the Companies Act the company cannot release the shareholder from his obligation to make payments for the shares held in the company and thus to make contributions to the company's share capital.[52] On the other hand, Article 421 para. 2 of the Companies Act provides that the reimbursement for the shares held by the excluded shareholder cannot be undertaken before the company's claim towards such shareholder is settled. In other words, if the share contribution for the shares held by the excluded shareholder is not fully paid into the share capital, it seems that the exclusion cannot proceed. The same applies to situations where a company has any other outstanding claims towards the excluded shareholder (e.g. additional payments under Article 391 of the Companies Act).[53] This effectively prevents or in the best case delays the removal of the shareholder from the company until its claim is settled which can prove to be detrimental for the company. Just to remind the reader, the reason for the exclusion of a shareholder lies in the shareholder's behavior which prevents or significantly hinders the attainment of the company's purpose, and as a result, his continued membership in the company becomes intolerable for the company.[54] Keeping in mind the provisions of Article 421 paras. 1 and 3 of the Companies Act, according to which the excluded shareholder can lose his membership in the company only after he is reimbursed for the shares held in the company, one cannot but see an issue with such a solution.[55] In other words, until all the company's claims towards the "troublesome shareholder" are settled such shareholder is granted free reign in the company, i.e. is allowed to cause even further trouble to the company. Not only is such a conclusion counterproductive, but it also hinders the purpose of the rules on the exclusion of a shareholder of the company.

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[51] In that direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 121.

[52] The only other possibility would be to initiate a share capital reduction or to find another shareholder or a third person willing to take over such share and make the necessary payment into the share capital instead of the current shareholder.

[53] In this direction see Jurić, *op. cit.* in fn. 16, p. 282.

[54] For more on the important reason for the exclusion of a shareholder see Chapter 2 (The existence of an important reason for the shareholder's exclusion).

[55] In this regard concerning the cessation of the excluded shareholder's rights see Barbić, J., *Pravo društava, Knjiga druga, Društva Kapitala, Svezak II., Društvo s ograničenom odgovornošću*, 7. izdanje, Organizator, Zagreb, 2020, p. 185.

Presumably, the purpose of Article 421 para. 2 of the Companies Act is generally to prevent any payments by the company to the excluded shareholder if the company has any outstanding claims toward that shareholder. On the other hand, by being excluded the shareholder acquires a claim of its own towards the company which amounts to the market value of the shares held by him. This means that both the company and the shareholder hold claims against each other. If all the legal requirements are met, nothing should prevent the company and the excluded shareholder from setting off one claim against the other.[56] However, concerning the prohibition set out in Article 421 para. 2 of the Companies Act, nothing should also prevent the company from setting off all such claims against the troublesome shareholder once he has been removed from the company. Otherwise, the exclusion of a troublesome shareholder could be impeded by the mere existence of a company's claim against such a shareholder. Such an outcome, which conditions the shareholder's exclusion with the settlement of all outstanding debts toward the company, is unreasonable since the company's interest in removing the troublesome shareholder may even outweigh its interest in settling all such claims toward that shareholder. In any case, a choice of whether to exclude the shareholder and settle claims later or settle claims first and exclude the shareholder later should be *de lege ferenda* left to the company. This should depend on the company's discretionary assessment of its prevailing legal interest in the matter at hand, whether it is the settlement of the company's claims towards the shareholder or the shareholder's exclusion from the company.

However, Article 398 para. 3 of the Companies Act expressly provides that the company's claim relating to the shareholder's share capital contribution expressly cannot be a subject of such a setoff. As an expression of a principle of share capital contribution, it provides that the shareholder is under obligation to make such a contribution to the company's share capital regardless of his outstanding claims against the company. That is because such contribution adds to the company's share capital which enjoys special protection under company law rules.[57] However, this does not mean that the company cannot

[56] For set-off requirements see Articles 195 to 202 Obligations Act, Official Gazette nos. 35/05, 41/08, 125/11, 78/15, 29/18, 126/21, 114/22, 156/22, 155/23.

[57] For example, the share capital always has to be paid by the company's shareholders since the share capital also, among other, serves to provide some comfort to the company's creditors that they will be able to settle their claims against the company. However, this is not a guarantee of such protection even in companies with high amounts of share capital since registered share capital does not mean that the company has such value in assets available at hand.

remove the troublesome shareholder from the company when he has not paid his share capital contribution in full. In this situation, the only prohibition is the one relating to Article 418 para. 1 of the Companies Act which disables the company to take over such shares as its own. This does not mean *de lege lata* that a company cannot exclude the troublesome shareholder while adhering to the principle of share capital contribution enshrined in Article 398 para. 2 of the Companies Act. This is accomplished by the taking over of such shares by the company, but on behalf and for the benefit of the future holder of such shares, and not for the company's own account.[58] Consequently, the company may decide at a later date to transfer such shares to another shareholder or a third person willing to make the necessary share capital contribution, but can also attempt to reduce the total amount of the share capital and thus, if possible, eliminate the missing share capital contribution.[59] Doing so ensures the observance of the principle of share capital contribution.[60] However, if none of these options are viable, the company should be enabled *de lege lata* to find recourse in the solution enshrined within Article 403 of the Companies Act.[61]

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[58] In this direction from the position of Croatian company law concerning the shareholder's exclusion for the failure to make the share capital contribution see Barbić, *op. cit.* in fn. 55, p. 229. In this direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 123, 128; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 20.

[59] It should be noted that the situation where the share capital is not paid in full relates solely to monetary contributions and not to contributions made in items or rights since such contributions have to be made in advance of the acquisition of the share in the company. Based on Article 398 para. 6 of the Companies Act, the share capital reduction could release the shareholder from his obligation to pay the missing share capital contributions. This is only possible if the nominal value of the share is set at a higher nominal value than the minimal value of 10 euro as determined by Article 390 para. 1 of the Companies Act.

[60] In this direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 128.

[61] According to Article 403 of the Companies Act when the company cannot get the missing share capital contributions from the excluded shareholder or his legal predecessors, nor can it raise the necessary funds for this by selling such share, the missing contribution shall be paid by other shareholders in proportion to their share capital stake in the company. Please note that this provision relates to the shareholder's exclusion from the company in case of the shareholder's failure to make the necessary share capital contribution. However, there should be no obstacle to the use of this rule in case of the shareholder's exclusion for an important reason justifying such an exclusion.

However, if other shareholders refuse to take over the shares and participate proportionately in the compensation of the excluded shareholder, they should nevertheless be held liable to the excluded shareholder for violation of trust.[62] This is only one example of the issues generated by the blind observance of the share capital contribution and share capital maintenance rules. However, one cannot but wonder whether such principles should play a smaller role in a limited liability company than in a public limited company. Especially since the minimal share capital in a limited liability company is set at such a low value which can hardly serve as any meaningful measure of protection for the company creditors.[63] These deliberations do not disregard the fact that according to Article 400 of the Companies Act, a shareholder could be excluded from the company because he failed to make his share capital contribution. However, such exclusion does not occur when shareholder makes such contributions in due time. Moreover, a shareholder may even challenge such a claim before the court and prolong his exclusion from the company (e.g. because the claim to pay the missing share capital contributions was not made equally against other shareholders with missing share capital contributions). In other words, it is very likely that in such a situation exclusion of a troublesome shareholder from the company will be delayed during which time the shareholder will be able to maintain his shareholder status and continue with the disruption of the company.

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[62] In other words, since the decision to exclude a specific shareholder from the company is based on the decision of the shareholder's assembly, i.e. based on the decision of the shareholders themselves, the other shareholders should not be enabled to escape their liability towards the excluded shareholder for failing to take over his shares. The trust relates to the ability of the company to compensate the excluded shareholder that was created by the shareholder's decision to exclude that shareholder. However, such liability should be proportionate to the share capital they hold in the company pursuant to Article 403 para. 1 of the Companies Act.
For a similar proposal from the position of comparable German law see Conradi, *op. cit.* in fn. 46, p. 1550; Hoffmann *et. al., op. cit.* in fn. 16, p. 1029. Contrary to this see Wicke, *op. cit.* in fn. 6., Anh. § 34: Austritt und Ausschließung eines Gesellschafters Rn. 4.

[63] Share capital only tells the company's stakeholders that it had at some moment in time assets that correspond to the value of the share capital available for use. However, share capital is a fixed value and does not reflect the actual value of the company's assets which can be used to settle its debts towards its creditors. Nonetheless, the Croatian national legislator ties the share capital value to various schemes aimed at ensuring that the company accumulates and holds assets that at least correspond in part to that value and that aim to protect the company's solvency and its creditors. The critique of these principles is not the topic of this paper and will be left to some other examination.

According to Article 421 para. 2 of the Companies Act, the excluded shareholder is entitled to the payment of the market value for his shares in the company at the moment the shareholder is excluded from the company. Such payment is not intended to be punitive or damnifying in nature.[64] The market value represents the value such shares could achieve on the regular market if they were to be sold to a third person. Such valuation is oriented toward the valuation of the whole company with special regard to its future prospects since the company continues to operate (e.g. the prospects of additional income in the foreseeable future increases the market value of the company) and because the buyer usually does not buy a specific company because of its past successes, but because of the company's prospects to earn him a profit in the future.[65] Once the company's market value is determined, the market value of the affected share can be easily determined with regard to its part in the overall share capital.[66] The company's articles of association can specify the exact assessment method to be used for the determination of the affected share's market value.[67] Since such valuation methods are normally aimed at determining the future value of the company, the methods mostly used are the capitalized earnings and the discontinued cash flow method.[68]

It seems that Croatian courts consider that only that method of assessment may be used to determine the market value of the share.[69] In other words, the

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64 In this direction from the position of the comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 156. In regard to non-punitive character from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 130.

65 In this regard see Barbić, *op. cit.* in fn. 55, p. 173. In this direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 156.

66 For example, if the market value of the whole company is determined to be 10 million euros and the share belonging to the affected shareholder amounts to 20 percent of the overall share capital, the market value of such shares should generally amount to 2 million euros. Naturally, such market value of the share can be affected by special rights, additional obligations, or restrictions relating to the exercise of shareholder's rights tied to such share.

67 In this direction see Barbić, *op. cit.* in fn. 55, p. 184 – 185.

68 In this direction from the position of the comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 83.

69 For example, in the High Commercial Court's decision Pž-1912/99 dated 18th June 1999, the Court determined that a company's articles of association could not

company's articles of association cannot determine any other manner of compensation than to compensate the excluded shareholder with the market value for his shares. Therefore, it seems that the court is of the position that such a rule, included in Article 421 para. 2 of the Companies Act, is mandatory. However, one cannot but wonder where the overreaching legal interest is that requires such protection of the legislator. To be specific, there is no overreaching public interest requiring protection here (e.g. the obligation to submit annual financial statements), nor is this a matter involving a third person requiring such protection (e.g. a company's creditor). This is purely a matter between the company and its shareholders. Therefore, the shareholders should be *de lege lata* enabled to deviate from Article 421 para. 2 of the Companies Act in regard to the compensation of the market value for the company's shares (e.g. through a provision in the company's articles of association). This could, for example, result in the determination of a lower fixed value of compensation or a value that does not correspond to the market value of the affected shares, be it directly or indirectly by way of a value-fixing method.[70] This is supported by the regular inclusion of buyback option clauses in articles of association where one specific shareholder can buy back the shares of another shareholder in case he decides to leave the company for a fixed price determined in advance (e.g. for 1 euro). This is acceptable since every shareholder can oppose such reduction of his rights in the articles of association as opposed to the rights provided under the Companies Act (i.e. the right to be compensated the market value of the shares held in the company when excluded from the company).[71] Later on, by becoming a shareholder any other person agrees to such reduction of shareholder rights in the articles of association. However, Article 420 para. 4 of the Companies Act provides that it is not possible to deprive the excluded shareholder of his rights to seek compensation from the company completely. In other words, such

determine that the shareholder that is withdrawing from the company is entitled to compensation other than the one corresponding to the market value of such a share. The rules on the shareholder's withdrawal apply in the same way to the exclusion of shareholders from the company. This decision is published in *Zbornik Visokog trgovačkog suda Republike Hrvatske 1994. – 2004.,* Visoki trgovački sud Republike Hrvatske, Zagreb, 2004, p. 269.

70 In this direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 156.

71 In this direction see Article 455 para. 3 of the Companies Act where it is stated that when shareholder rights are being reduced in the articles of association, every affected shareholder must give his consent to such reduction. Otherwise, the change is considered to be invalid.

an article of association clause would be null and void.[72] However, exclusion without payment of such compensation to the excluded shareholder is possible under exceptional circumstances, i.e. when the company has no economic value at the moment the claim is filed before the court.[73] This will usually occur in insolvent companies, just before the insolvency proceedings have commenced.

The relevant moment for the determination of the share's market value is the moment of the shareholder's exclusion. This is regularly the moment when the company or all other shareholders file a claim before the court under Article 420 para. 3 of the Companies Act.[74] This ensures that the determination of the market value is fixed to a specific moment which ensures that the parties will not delay the proceedings with the intent to use the additional time to diminish or increase the company's value and thus increase or decrease the excluded shareholder's compensation.[75] The right to compensation comes into existence with the finality of the court's decision or exceptionally at a later date set out in the court's decision based on the request of the parties involved (e.g. because the company suggested a somewhat later date required to acquire liquid assets for the payment of the shareholder's compensation). The relevant moment can also be the moment the shareholder's assembly decision on the exclusion of the shareholder is reached.[76] This is only possible when the company's articles of association expressly allow for the exclusion of the shareholder according to Article 420 para. 1 of the Companies Act, i.e. without the need to file a claim before a court.[77]

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[72] In this direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 156.

[73] In this direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 157.

[74] In this regard see Barbić, *op. cit.* in fn. 55, p. 184.

[75] In this direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 158.

[76] In this regard see Barbić, *op. cit.* in fn. 55, p. 184.

[77] In this direction from the position of comparable German law see Schindler in Ziemons *et al., op. cit.* in fn. 3, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 158.

5. EXCLUSION OF A SHAREHOLDER IN DIFFERENT STAGES OF THE COMPANY'S LIFE

The exclusion of a shareholder is generally possible in all stages of the company's life. This includes both the stage when the company is still not registered with the court register (the pre-company stage) and the cessation stage of the company when it is still under liquidation based on the shareholder's decision (company liquidation stage).[78] The exclusion of a shareholder is irrelevant during the insolvency proceedings since shareholders in such a capacity alone cannot affect the insolvency proceedings once they have been initiated.[79]

In the pre-company stage, the limited liability company still lacks its legal personality and as a consequence, it demonstrates some of the features of a partnership instead of a corporation (e.g. concerning the ownership of the company's assets and liability for the company's debts). However, internally it acts as a full-fledged limited liability company with a legal personality.[80] This means that since the issue of exclusion of a shareholder is an internal company matter the rules applicable to the exclusion of a shareholder from a limited liability company with legal personality apply (i.e. Article 420 of the Companies Act).[81] On the other hand, there is no place for the application of rules relating to the exclusion of a partner from a partnership (e.g. Article 653 of the Obligations Act).[82] However, since shares in a limited liability company come into existence

[78] In this direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 126; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 7.

[79] The bodies responsible for handling insolvency proceedings are the court, the insolvency administrator, the creditor's assembly, and the committee of creditors. See in this regard Article 75 et al. Insolvency Act, Official Gazette nos. 71/15, 104/17, 36/22.

[80] See in this regard Article 6 para. 1 Companies Act. For a more elaborate explanation see fn. 82.

[81] In this direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 126.

[82] This argument is based on the idea that although a limited liability company lacks the legal personality in the pre-company stage, for all other purposes it is and should be treated as a fully-fledged limited liability company. According to Article 6 para. 1 of the Companies Act the rules determined in the company's articles of association apply to the relationship between the founders in the pre-company stage. However, such rules cannot cover all the possible situations that could arise in the pre-company stage. In such a situation, it would be prudent to reach out for

once the company is registered with the court register, the excluded shareholder in a pre-company has not yet been issued any shares and there is no need to take away any shares from him.[83] If the excluded shareholder has made any share capital contributions based on such shares, such contributions should be reimbursed to him. Such reimbursement should normally meet the requirements of Article 421 para. 2 of the Companies Act concerning the reimbursement of the market value of the share at the time of his exclusion. However, if this is not the case, a higher or lower value than the value of his contribution should be reimbursed.[84] On the other hand, since the excluded shareholder's obligation to contribute to the company's share capital is made part of the articles of association, the other shareholders will have to make the necessary changes to the articles of association to remove such obligation of the excluded shareholder.[85] This might impose an obligation of further contributions by other shareholders or a new shareholder if such exclusion results in the share capital falling below the minimal amount determined by applicable law (e.g. 2,500 euros).[86] Otherwise, the court will refuse to register the company into the court register.

Exclusion of a shareholder is also possible during the company liquidation stage. However, an important reason for exclusion from the company must then

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the rules relating to a limited liability company with a legal personality. This means that all the internal decisions in such pre-company stage are made based on the rules on the limited liability company and not based on rules on partnership from the Obligation Act. Companies Act rules are more appropriate for the needs of a limited liability company in the pre-company stage than the rules on partnership. Moreover, the company's founders expect to apply such rules once the company is registered with the court register so it would be illogical to apply different rules in the pre-company stage. The general rules on partnership from the Obligation Act apply subordinately to companies that are not qualified as corporations only when specific Companies Act rules do not provide for a rule in a specific situation (e.g. see Article 69 Companies Act). Therefore, Companies Act rules relating to specific company types should take precedence over general the Obligation Act rules on partnerships. In this direction see Barbić, J., *Pravo društava, Knjiga prva, Opći dio*, 3. izdanje, Organizator, Zagreb, 2008., pp. 181 – 182.

83 For when shares come into existence in a limited liability company see Barbić, *op. cit.* in fn. 55, pp. 98 – 99.

84 For more on the determination of the market value of the share see Chapter 4 (Reimbursement of the market value of the shares held in the company).

85 Concerning such content of the articles of association see Article 388 para. 1 pt. 3 Companies Act.

86 For the minimal share capital see Article 389 para. 2 Companies Act.

closely relate to the company's liquidation.[87] In other words, the shareholder's behavior must be such to prevent or significantly hinder the liquidation of the company so that his continued membership in the company for the remainder of the liquidation becomes intolerable for the company. This is because once liquidation is carried out, all shareholder membership rights and obligations are also extinguished since the company ceases to exist. However, if other shareholders are seriously contemplating the continuation of the company and cannot proceed due to the behavior of a specific shareholder, the important reason for the exclusion of such a shareholder should relate to the stage after the cessation of the company's liquidation (i.e. as if the company was not in liquidation at all).[88] Other shareholders, however, should not be permitted to abuse the right to exclude a shareholder (e.g. on false ground of continuation of a company).

6. CONCLUSION

The paper elaborates upon the three legal requirements for the exclusion of a shareholder due to the existence of an important reason for such exclusion from the company according to Article 420 para. 2 of the Companies Act. This is 1) the existence of an important reason for the exclusion, 2) that such exclusion must be a measure of last resort, and 3) that the shareholder is reimbursed for the market value of the share it held in the company.

In doing so, the paper especially focuses on the issues related to the reimbursement of the market value for the shares held in the company. Generally, the paper emphasizes that the applicable rules on share capital maintenance and share capital contributions should not necessarily compromise the exclusion of a shareholder from the company. In this regard, Article 407 para. 1 of the Companies Act operates as a safeguard mostly for the company's creditors. The paper argues that such protection which relates to a mathematical tie-up of assets relating to the company's share capital is regularly ineffective due to low minimal share capital requirements in the limited liability company. Therefore, the paper provides some *de lege ferenda* suggestions that would actually provide some viable protection to the company's creditors. The paper also emphasizes that in

[87] In this direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 127; Sosnitza in Michalski *et al., op. cit.* in fn. 2, Anhang § 34 Ausschluss und Austritt von Gesellschaftern Rn. 7.

[88] In this direction from the position of comparable German law see Strohn in Fleischer *et al., op. cit.* in fn. 38, GmbHG § 34 Enziehung von Geschäftsanteilen Rn. 127.

situations when the company is unable to reimburse the excluded shareholder, the decision to exclude a shareholder should not be deemed void *ab initio* if other shareholders or third persons are willing to reimburse the excluded shareholder.

Further issues are generated by Article 398 para. 2 of the Companies Act on the inability of the company to release the shareholder from his obligation to make contributions to the company's share capital and Article 421 para. 2 of the Companies Act, according to which the reimbursement to the excluded shareholder cannot be undertaken before any company claims towards such shareholder are settled. In other words, the existence of any company claim toward the troublesome shareholder seems to effectively prevent or at least delay his exclusion from the company.

In case of the company's claim relating to the excluded shareholder's contribution to the share capital, the company should still be *de lege lata* able to exclude the troublesome shareholder from the company while still adhering to the principle of share capital contribution enshrined in Article 398. para 2 of the Companies Act. This can be undertaken by taking over such shares by the company, not for its own account, but for the benefit of the future holder of such shares. That other person will make the missing share capital contribution to the company. If this is not an option, the company should be *de lege lata* enabled to find recourse in the solution enshrined in Article 403 of the Companies Act according to which the missing share capital shall be paid by other shareholders in proportion to their share capital stake in the company. In case of exclusion and the existence of any other company's claim against the excluded shareholder, both the company and the excluded shareholder hold claims against each other. Therefore, nothing should prevent them from setting off such claims against each other. In any case, in such a situation a choice should be *de lege ferenda* left to the company on whether to exclude the shareholder and settle the claims later or settle the claims first and exclude later.

The paper also touches upon the determination of the market value of the shares held by the excluded shareholder. Among others, the paper *de lege lata* proposes and elaborates that the shareholders should even be enabled to fix in advance the value of such reimbursement contrary to the position of Croatian case law.

In doing so, the paper examines the various legal complexities surrounding the exclusion of a shareholder, shedding light on potential challenges and proposing elaborated considerations for refining the regulatory framework to better align with practical scenarios in the business environment.

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Sažetak

Tomislav Jakšić*

UVJETI ZA ISKLJUČENJE ČLANA IZ DRUŠTVA S OGRANIČENOM ODGOVORNOŠĆU PREMA ČL. 420. ST. 3. ZAKONA O TRGOVAČKIM DRUŠTVIMA S POSEBNIM OSVRTOM NA PROBLEME VEZANE UZ NAKNAĐIVANJE TRŽIŠNE VRIJEDNOSTI ZA POSLOVNE UDJELE U DRUŠTVU

*Zakon o trgovačkim društvima određuje da se član može isključiti iz društva s ograničenom odgovornošću ako za to postoji važan razlog. Osim postojanja važnog razloga, takvo isključenje mora biti i sredstvo krajnje mjere (*ultima ratio*), a isključenom se članu društva mora nadoknaditi i tržišna vrijednost udjela u društvu. U radu se analiziraju i razrađuju navedeni uvjeti za isključenje pri čemu se analiziraju i određeni problemi koji su nesvjesno nastali djelovanjem postojećih pravila o održavanju temeljnog kapitala i obvezi uplate uloga u temeljni kapital. U radu se će obrazložiti kako navedena pravila mogu spriječiti ili čak onemogućiti isključenje problematičnog člana iz društva, čime se sprječava postizanje svrhe pravila koja se odnose na isključenje tog člana. Stoga se hrvatskom zakonodavcu i praktičarima daju konkretni prijedlozi* de lege lata *i* de lege ferenda.

Ključne riječi: društvo s ograničenom odgovornošću, isključenje člana društva, održavanje temeljnog kapitala, uplata uloga u temeljni kapital

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