

M e m o r a n d u m

From Dr. Ulrich Lohmann, LL.M. (Berkeley), Dr. Ulrich Block, LL.M. (Tulane),
 Dr. Nina Leonard

Date 6 November 2008

Re: Changes to German Corporate Law – the 2008 Reformation Act

On 1 November 2008, the Act Reforming the Law Governing Companies with Limited Liability and Suppressing Abuse (**Reformation Act**)¹ entered into force. The Reformation Act may make investments in German Companies with Limited Liability (**GmbH** or **Limited Liability Company**)² and stock corporations (**AG** or **Stock Corporation**)³, more attractive to foreign investors.

Some of the changes brought about by the Reformation Act are designed to make the Limited Liability Company more flexible:

- Generally, a Limited Liability Company requires, as before, a registered capital of € 25,000. The Reformation Act permits, however, the establishment of a Limited Liability Company with a smaller registered capital, which could be as small as € 1, subject to certain restrictions including the obligation to allocate a portion of future profits to the company's reserves until the equity is € 25,000.⁴ Earlier, it had been discussed to reduce the required registered capital to € 10,000 to ward off a tendency to avoid the registered capital requirement altogether by resorting to limited companies under English law; this tendency however appears to have abated.
- Limited Liability Companies may now be vested with authorized capital, which before was possible only with Stock Corporations. The nominal amount of such authorized capital is limited to one half of the nominal amount of the registered capital existing at the time when the authorized capital is registered.⁵

¹ in German: *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen*, short *MoMiG*

² in German: *Gesellschaften mit beschränkter Haftung*, short *GmbH*

³ in German: *Aktiengesellschaft*, short *AG*

⁴ § 5a of the Limited Companies Act, in German *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* or *GmbH-Gesetz*, hereafter **GmbH Act**, as amended by the Reformation Act. Such companies will have to use the ungainly title of *Unternehmergesellschaft (haftungsbeschränkt)*, which may be translated as *Entrepreneur Company (with limited liability)*.

⁵ § 55 a of the GmbH Act, as amended by the Reformation Act

- The capital of a Limited Liability Company is divided into interests⁶, each of which must have a specific nominal value assigned to it by the shareholders in the articles of association.⁷ Under the old law, a shareholder could hold only one interest in any given company. The minimum nominal value of such an interest was € 100 and had to be divisible by € 50. Now, a shareholder may hold more than one interest⁸ and the minimum nominal value of an interest has been reduced to € 1. This should make it easier to structure investments in Limited Liability Companies.
- The transfer of such interests is cumbersome, because the underlying contract, as well as the transfer itself, are valid only if they are recorded by a German notary.⁹ As a result, interests in Limited Liability Companies – as distinguished from shares in a Stock Corporation – cannot be traded publicly. Now, however, shareholders will be recognized by the management of the company only if they are registered in the shareholders' list deposited with the court of registration.¹⁰ If an individual or business entity has been registered in the shareholders' list for at least three years, the interests held by it can now be acquired *bona fide* even if such individual or business entity is not the owner of such interests, except *grosso modo* if the acquirer knows or should have known that the seller is not the owner, particularly if an objection by the true owner has been noted in the shareholders' list.¹¹ These new provisions are designed to facilitate the due diligence process and to reduce transaction costs.
- The rules regarding capital contributions have been relaxed to some extent: Under the old law, if a shareholder contributed cash to the capital to a Limited Liability Company and the company agreed to use the cash to acquire an asset from the shareholder, the entire process would have been void. Now, the capital contribution would be deemed validly made even though the cash does not stay with the company, if the shareholder either proves that the value of the asset is at least equal to the nominal amount of the cash contribution or pays the difference in cash.¹² Similarly, if the company uses the cash to make a loan to the shareholder, the capital contribution is deemed validly made if the company can rely on the loan being repaid¹³ at any time selected by the company.¹⁴

Other changes will be of particular interest to foreign investors:

⁶ in German: *Geschäftsanteile*

⁷ in German: *Gesellschaftsvertrag*

⁸ § 5 of the GmbH Act, as amended by the Reformation Act

⁹ § 15 (3) and (4) of the GmbH Act

¹⁰ in German: *Gesellschafterliste*, § 16 (1) of the GmbH Act

¹¹ § 16 (3) of the GmbH Act, as amended by the Reformation Act

¹² § 19 (4) of the GmbH Act, as amended by the Reformation Act

¹³ The German term is *vollwertig*, which implies that the value of the claim is not impaired.

¹⁴ § 19 (5) of the GmbH Act, as amended by the Reformation Act

- The statutory domicile of any a Limited Liability Company or Stock Corporation (collectively **Corporations**) must be in Germany, as before, and each Corporation must at all times have an office address in Germany registered by the court.¹⁵ However, the law would now permit the relocation of the principal place of management of the company to another country.¹⁶
- The entire assets of a Limited Liability Company, including the assets making up the registered capital (**Non-Distributable Assets**), may now be used to make loans to the shareholders and as collateral for debt incurred by the shareholders.¹⁷ Such transactions are now pronounced valid, to the extent they involve Non-Distributable Assets, if either the company can rely on the loan being repaid when due¹⁸ or the company and the shareholder have entered into a profit-and-loss-pooling agreement. Before, it was unclear whether such transactions were lawful to the extent they involved Non-Distributable Assets.¹⁹ This uncertainty made leveraged transactions as well as cash pools difficult. While the new law is designed to do away with such uncertainty, it still leaves ample room for legal battles, in particular as to what it takes for a company to be able to rely on a loan being repaid when due. In addition, every transaction between a company and its shareholder must be reviewed to make sure that it does not violate fiduciary duties, the principle of equal treatment of shareholders or other tenets of corporate law or constitutes a tort to the detriment of the company's creditors.²⁰
- The same rules apply to Stock Corporations,²¹ except that these may not provide financial assistance to a shareholder for the purchase of their own shares unless they have entered into a profit-and-loss-pooling agreement with the shareholder concerned.²²
- The management of a Corporation has a duty to institute insolvency proceedings, *grosso modo*, if the company's net assets have become negative or if the company is unable to pay its bills as they fall due. This duty is subject to severe sanctions, including criminal prosecution. Under the old law, shareholders were occasionally tempted to remove the management without replacing it, rather than injecting the cash needed to avoid the insolvency filing. Now, if there is no

¹⁵ § 8 (4) of the GmbH Act and § 37 (3) of the Stock Corporation Act, in German: *Aktiengesetz*, short *AktG*, each as amended by the Reformation Act

¹⁶ § 4a of the GmbH Act

¹⁷ § 30 (1) of the GmbH Act, as amended by the Reformation Act

¹⁸ The German term is *vollwertig*, which implies that the value of the claim is not impaired.

¹⁹ i.e. if the remaining net assets are lower than the registered capital, *see* the decision of the Federal Court of Justice (BGH) dated 24 November 2003, BB 2004, 293, which said that the loan granted by a company to its shareholder was unlawful arguing that the company's repayment claim was worth less than the cash making up the registered capital.

²⁰ A shareholder would be liable in tort to the company's creditors if it interfered with the company's business in such a way that the company becomes insolvent.

²¹ § 57 (1) of the Stock Corporation Act, as amended by the Reformation Act

²² § 71 a of the Stock Corporation Act, as amended by the Reformation Act

management, the duty to institute insolvency proceedings and the associated risks will fall on the shareholders.²³

- Repayments of principal of shareholder loans may now be clawed back by the receiver, in the event of insolvency of a Corporation, if such repayments were made after the insolvency filing or within one year before, and collateral granted for such claims may be clawed back if granted after the insolvency filing or within ten years before.²⁴

This memorandum provides only a general overview. It should not be relied upon as legal advice.

v. Boetticher Hasse Lohmann - Partnerschaft von Rechtsanwälten

²³ § 15 a (3) of the Insolvency Act (*Insolvenzordnung* or *InsO*), as amended by the Reformation Act

²⁴ § 135 of the Insolvency Act, as amended by the Reformation Act