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German Law ALERT

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The New German Limited Liability Company Act

The new "Act aimed at modernizing the Limited Liability Company Act (GmbHG) and combating abuses" came into force on November 1, 2008 and modernizes the old GmbH law in the following key areas:

- The GmbH establishment procedure has been modified to (a) simplify the processes of share division, merging and transfer and (b) facilitate the easy provision of share capital. Furthermore, modernization of the registration system will accelerate the registration process at the commercial register *(Handelsregister).*
- In stark contrast to the old law, the new law permits a GmbH to locate its headquarters outside Germany. It assists the acquisition process by requiring greater transparency in relation to share ownership and codifies rules relating to group financing. This new legal footing will enable the GmbH to wholly participate in cash pooling systems that are common in other countries.
- The new law tackles the issue of deceptive and fraudulent business practices in a number of ways. It simplifies the procedure for filing legal claims, removes the possibility of artificial and vexatious delays in insolvency proceedings and imposes higher standards on those able to become managing directors of companies.

The government's aim is to strengthen the GmbH as a corporate form in Europe through the simplification of GmbH founding and administration procedures, in the following manner.

Formation

The new law allows for a totally new type of legal GmbH to be formed, with a minimum nominal share value of only €1. This new variant of German GmbH has to be named *Unternehmergesellschaft (haftungsbeschränkt),* and this (or the abbreviation "UG") must form part of the company name until the general minimum nominal share capital of €25,000 is achieved. In addition, the UG must

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place 25 percent of its annual profit into a new capital reserve until this minimum nominal share capital is reached. This reserve can be used only for increasing nominal share capital or for balancing losses or loss-carry-forwards of the UG. Unlike the still traditional type of GmbH, a UG may not make contributions in kind during formation or as part of later capital increases.

Cash Pooling

German law relating to capital contribution and maintenance (derived mainly from case law of Germany's Federal Court of Justice (BGH)) is currently obstructive in the context of GmbH participation in internationally recognized and authorized cash pooling structures for group financing. The capital contributions made by a shareholder to the GmbH, when paid directly into a group account under a cash pooling structure, are considered invalid under principles of German case law, which deems that these payments do not fall under the direct control of the GmbH. However, the new law codifies and modifies such BGH case law by making these payments valid upon satisfaction of the condition that an adequate repayment claim is guaranteed. Upstream loans in cash pooling structures are permitted and available under the new law, even to companies experiencing negative equity. Problems remain, however, as the burden of determining the adequacy of the repayment claim falls upon the managing director, who may be personally accountable for damages suffered by the company or its creditors. What is legally adequate in terms of a repayment claim has yet to be clearly defined.

Transfer of Shares

The new law differs from the old (in particular with respect to the transfer and acquisition of shares) in that it places greater importance on the list of existing shareholders filed with the commercial register *(Handelsregister).* The acquisition of any shares from an individual or corporate entity listed as a shareholder at the commercial register shall be judged to be effective even in circumstances for which the seller had no authority to make the disposal. Therefore, in relation to the shareholder list, the Act allows, in contrast to the old law, the acquisition *bona fide* of GmbH shares. The statutory assumption of ownership outlined above is, however, subject to a number of conditions. The assumption will not apply if (a) the share(s) do not exist, (b) the buyer was aware of any defect in title or (c) the seller has been listed on the shareholder list for less than three years. Under the new law, the need to perform due diligence investigations and verification exercises and to obtain seller's warranties as to ownership of shares will be reduced.

Authorized Share Capital

The GmbH has been afforded greater flexibility in raising capital. The new law enables the GmbH to have authorized capital, similar to that enjoyed by the German stock corporation *(Aktiengesellschaft).* The benefit is that, for a period of up to five years, the shareholders can authorize the managing directors to increase the stated share capital against contributions.

Capital Maintenance Rules

Unlike the old law, the new law relating to capital maintenance *(Eigenkapitalersatzrecht)* is comprehensive and digestible. As previously outlined, the commercial practice of cash pooling has been facilitated through the removal of the assumption that loans to shareholders are a prohibited repayment of stated share capital as long as certain conditions are met (a fully recoverable payment claim and only an accounting exchange on the asset side of the balance sheet). Furthermore, capital maintenance law now forms a part of insolvency law, and loans to shareholders are now in all circumstances subordinate to the claims of other creditors.

Extended Management Liability

The regulations regarding management liability have been modified and tightened in a significant manner. The focus of liability has shifted away from the shareholders to fall on the managing directors of a GmbH. The new regime legislates that a managing director must accept personal liability for the payment of dividends to shareholders if those payments result in the insolvency of the GmbH (this remains the case even if he or she acted on shareholder instruction). Managing directors also are personally liable for any losses incurred as a result of erroneous information contained in the shareholder list, as they are responsible for the accuracy of this list. The extent of such personal liability also covers issues relating to capital maintenance. Furthermore, managing directors are personally liable if, in connection with cash pooling arrangements, they fail to negotiate an adequate termination option and the failure results in unacceptable levels of indebtedness or insolvency. In this regard, they have a duty to make assumptions necessary to determine whether the repayment claim of the company for loans to the cash pool remains at full value, and as a consequence they are personally liable for any losses resulting from these assumptions.

The modifications to the GmbH law offer easier access to this corporate status, and time will tell whether the new status will be more common used in Europe.

For more information on the new German Limited Liability Company Act, please contact Squire Sanders European partner Dr. Andreas Fillmann or your principal Squire Sanders lawyer.
