


Recent reforms of the German GmbH

 EC law; Germany; Limited liability; Private companies

History and development of the law

Preliminary remarks

The German private limited liability company (Gesellschaft mit beschränkter Haftung or “GmbH”) owes its origin to a law enacted by the Reichstag on April 20, 1892 (the “GmbH Gesetz”). Its introduction owed much to the advocacy of the deputy *Oechelhauser*, who would have preferred a more personalistic structure to the one that was actually introduced. A further influence on its introduction was the law governing an entity which then existed in Germany, the miners’ union (*bergrechtlicher Gewerkschaft*). The public company had proved too complex an entity for the purposes of small and medium-sized enterprises, and the law of 1892 was designed to create an entity which could fulfil their needs. It was intended for small groups of shareholders with significant personal links, who did not wish for a simple mode of share transfer, but who wished to be able to depart from the statutory model to fulfil their needs.

Until fairly recently the law of 1892 did not undergo very significant reforms. The *Referentenentwurf* of 1969 and the *Regierungsentwurf* of 1971 proposed such reforms, but owing to the criticisms of academic writers and the vicissitudes of coalition politics, the government draft projects failed to be adopted. Significant changes were made to the law governing private companies relating to such matters as loans from shareholders and the giving of information to them by the *Novelle* of 1980.¹ GmbHs have been required to set up a supervisory board under paras 76 and 77 of the Works Councils Act 1952,² where they have 500–2,000 employees. One-third of the members of such a board must be employees’ representatives. The *Mitbestimmungsgesetz* of 1976 which provided for quasi-paritative co-determination in the *supervisory* boards of companies employing more than 2,000 persons was of significance to some large GmbHs.

Impact of certain Community Directives

The law governing the GmbH has undergone a number of changes owing to the enactment of Community Directives which have had to be transposed into German law. Thus the Fourth, Seventh and Eighth Company Law Directives which were respectively concerned with the annual accounts and group accounts of companies and with the qualifications of auditors were implemented in Germany, as also were the other Directives which affected private companies.

The amendments made in 2008

Significant changes have been made in German law governing private companies as the result of the passing of the Act to Modernise the Law Governing Private Companies and to combat Abuses³ (“*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbrauchen*” or “MoMiG”), which took effect on November 1, 2008. It appears that these changes may have been the most far reaching ones made to the 1892 *GmbH Gesetz* since its enactment. The objectives of the amendments include the acceleration and facilitation

of the processes of company formation, shareholder financing and mergers and acquisitions with a view to enhancing the GmbH as an effective vehicle for business, capable of competing on a level playing field with other corporate entities within the European Union, such as the English limited liability company.⁴

Changes made to facilitate the establishment of businesses

The MoMiG of 2008 differentiates between two alternative forms of the GmbH. In addition to its long-established form which requires a minimum capital of €25,000, para.5a of the *GmbH Gesetz*—which was incorporated therein by the amending MoMiG of 2008—provides for a new type of private company which will have no more than three members and a director, and will require a minimum capital of only €1 on formation. The so-called *Unternehmergesellschaft* (“UG”), literally “entrepreneurial company”, will be subject to restrictions on the distribution of profits (25 per cent of annual profits being required to be placed in a new capital reserve) which are intended to enable the UG to gradually acquire the minimum capital necessary to become a traditional private company.⁵ The restriction on the number of members may limit the usefulness of the new entity.

The MoMiG of 2008 attempts to speed up the registration process and to simplify the rules governing the formation of single member private companies.⁶ Thus, where a licence to trade was required to carry on certain businesses such as those of restaurants and property developers, it was formerly made necessary by para.8(1), no.6 of the *GmbH Gesetz* to submit the relevant licence with the application for entry on the register. This requirement has been abolished. There is now no need to provide any special security when a one person company is formed. The reforms mentioned in the present paragraphs are basically designed to further and accelerate the development of businesses.

Changes made to increase the attractiveness of the GmbH

One of the principal aims of the new MoMiG is to increase the attractiveness of the private company. Thus it is no longer necessary that the administrative centre of a German private company should coincide with the place where its registered office is situated; it appears this may be outside Germany. The new rule has probably been influenced by the European Court of Justice’s decisions in such important cases as *Überseering*⁷ and *Inspire Art.*⁸ These decisions make it clear that Community Law permits companies having their registered office in one Member State to conduct their operations in another member state and to establish branches there⁹. This simplification of German law is partially intended to enable German GmbHs to compete with UK (and other) private companies which carry on substantially all their business in Germany and other countries, and may encourage German companies to operate their foreign subsidiaries as German GmbHs.

Paragraph 16 of the amended *GmbH Gesetz* is designed to promote greater transparency in relation to the ownership of shares and to protect persons who acquire shares in good faith. In future, only persons entered in the list of shareholders maintained by the Commercial Register will be treated as shareholders in the company. This will make it easy for business partners to determine who has a

significant position in the company. Paragraph 16(3) of the amended GmbH Gesetz provides that where no objection has been made for at least three years, the contents of the list are to be treated as being correct in relation to a purchaser.¹⁰ The same rule is applicable where the list has contained an irregular entry for less than three years, if the error is attributable to the rightful shareholder. A purchaser will not be protected if he does not act in good faith.¹¹ A person is treated as not acting in good faith if he knew of the defective title, or was grossly negligent in failing to have such knowledge.

The new rules regarding cash pooling and the deregulation of the very complex legal rules on shareholder loans are also intended to increase the attractiveness of the GmbH. Cash pooling consists of the transfer of funds between different entities in groups, i.e. from subsidiaries to the parent company, for the purpose of centralised cash management. Such pooling often occurs in the context of international groups of companies. The subsidiaries acquire payment claims against the parent company. There has been some doubt as to whether such cash pooling is compatible with para.30(1) GmbH Gesetz as the result of a recent decision of the Federal Supreme Court.¹² It appears to be so under the revised text of this paragraph, which provides as follows:

“(1) The assets of the company which are necessary to maintain its capital must not be distributed to its shareholders. This rule is inapplicable to acts done which result from the existence of a control contract or profit transfer contract¹³ which are covered by a fully valid claim for counter performance or reimbursement against a shareholder. Sentence 1 is inapplicable to the return of a loan made by a shareholder, or to actions based upon claims arising out of legal transactions which correspond economically to such a loan.”

The complex rules governing share capital substitution by means of loans which formerly existed in paras 32a and 32b of the GmbH Gesetz have not been re-enacted. Loans from shareholders are now dealt with by insolvency law and the law governing the rescission of transactions (*Anfechtungsrecht*). The rules developed by the Supreme Court governing such transactions are no longer applicable.

An important rule is now contained in GmbH Gesetz, para.19(5), which—like para.30(1) GmbH Gesetz—is applicable to cash pooling arrangements. The former text provides that if, prior to a cash contribution, a transaction with a shareholder is agreed upon which corresponds economically to the repayment of the contribution and does not consist of a disguised contribution in kind, it only releases the shareholder from his liability to make the cash contribution when the company's claim for reimbursement is for full value, and at any given time it is immediately repayable, or it is possible to demand reimbursement by termination of the agreement by the company without giving notice. It will be frequently difficult for a shareholder to meet these conditions, and in some cases perhaps for him to show that the transaction did not involve a disguised contribution in kind. The directors of the company may need to check periodically on the financial position of the relevant shareholder to protect themselves from negligence claims by the company.

Disguised contributions in kind (*verdeckte* or *verschleierte Sacheinlagen*) are dealt with in para.19(4) GmbH Gesetz. There have been considerable doctrinal disputes about such contributions in the past.¹⁴ They occur, for example, if the funds contributed to the company for the shares are

returned to the contributor as the purchase price for a particular asset from him, or in order to discharge a loan made, or to be made by him. Such contributions have been used in the past to evade the strict German rules governing the audit of contributions in kind, and the provision of particulars thereof in the company's articles. Paragraph 19(4) provides that if the cash contribution (*Geldeinlage*) of a shareholder has—in the light of economic considerations and on the basis of an agreement made in connection with the cash consideration—to consist entirely or partly of a disguised contribution in kind; it does not release the shareholder from his duty to make a cash contribution. However the contract concerning the contribution in kind and the legal transactions governing its execution are not ineffective. The value of the assets transferred to the company at the time of the application for registration, or subsequently in the case of a later transfer, has to be set off against the requirement of a monetary contribution, which remains in existence. This may not take place before the registration of the company, and the shareholder bears the burden of proving that the asset has maintained its value.

Measures intended to combat abuse

The amending MoMiG provided for a number of measures intended to combat abuse of the private limited company form. In order to facilitate the bringing of legal actions against German private companies, the business address of such companies will have to be situated in Germany and will be contained in the commercial register.¹⁵ If service of documents at this address is impossible, it will be possible to effect such service by public notice.

Article 9 of the MoMiG of 2008 provides for the amendment of para.15(1) of the Insolvency Law (*Inzolvvenzordnung*) so as to provide that if a juristic person has no director, any shareholder may petition for insolvency. This provision is designed to prevent such a duty from being evaded because the director has absconded.¹⁶ Furthermore, the prohibition on payments when the company is insolvent in para.64 of the GmbH Gesetz has been extended by the addition of a further sentence, which imposes liability on directors for payments to shareholders which must lead to the insolvency of the company, unless this outcome was not apparent to a person exercising the degree of care of a careful businessman. It may, in fact, be very difficult for a director to determine whether a payment is likely to lead to insolvency.

Finally, the grounds for exclusion from appointment as a company director contained in para.6(2), sentence 3 of the GmbH Gesetz and s.76(3), sentence 3 of the German Stock Corporation Act (*Aktiengesetz*) have been extended to include convictions for delay in presenting an insolvency petition, for making false statements and misrepresenting facts. The extension also applies to certain criminal offences in relation to business activity which are included in paras 263–264a and paras 265b–266a of the Penal Code. The prohibitions are made applicable by para.6(2) of the GmbH Gesetz and para.76(3), sentence 2–4 of the *Aktiengesetz* to similar offences committed abroad. In addition, para.6(5) of the GmbH Gesetz now provides that shareholders who deliberately, or acting with gross negligence, permit a person who is not qualified to be a director to carry on the conduct of business transactions are jointly and severally liable for damage or loss caused to the company by the violation of that persons obligations thereto.

Concluding Remarks

There is probably a good deal to welcome in the above-mentioned amendments to the *GmbH Gesetz*. It is not clear how much use will be made of the new type of private company, the UG. It may well be that creditors will require personal guarantees when conducting transactions with it and persons choosing to use this form may well require legal advice. The new provisions contained in paras 19(5) and 30(1) *GmbH Gesetz* would seem to put cash pooling on a sounder basis than it formerly enjoyed, and thus to comply with the needs of groups. The expansion of the disqualifications from appointment as directors would seem to be justified. The relaxation of the rules governing the maintenance of capital may impose increased duties of care on the directors. They may thus incur liability under para.43(3) if they repay loans from shareholders out of assets required to maintain the company's capital. According to para.64 of the *GmbH Gesetz* as recently amended, they will also incur liability if they make such payments after the company has become insolvent or excessively indebted. The former rules governing loans which were a substitute for capital were complex and difficult to understand fully. The repeal of these rules—and the treatment of loans from shareholders as being governed exclusively by insolvency law—has been contended by many commentators to lead to greater security.¹⁷

Dr Frank Wooldridge and Liam Davies Solicitor, CA Legal

¹ BGBL (1980)1.836.

² BGBL (1952)1.681. This Act was replaced by a similar Act of 2004, Drittelbeteiligungsgesetz, BGBL (2004)1.974.

³ See Press Release by the Federal Ministry of Justice: "The new Law governing private companies" p.1.

⁴ German businesses would often register as English limited liability companies to avoid the higher minimal capital requirements and longer registration procedure under the *GmbH Gesetz*.

⁵ The amending MoMiG of 2008 contains a model protocol both for the formation of single member private companies and the new form of private company.

⁶ See Press Release by the Federal Ministry of Justice, p.2.

⁷ *Überseering BV v Nordic Construction Co Baumanagement GmbH (NCC)* (C-208/00) [2000] E.C.R. I-9919.

⁸ *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* (C-167/01) [2003] E.C.R. I-10155.

⁹ Although the *R. v HM Treasury Ex p. Daily Mail* (81/87) [1988] E.C.R. 5483 judgment of the European Court of Justice was upheld in the Court's recent decision in *Cartesio Oktato es Szolgaltato bt* (C-210/06) [2009] 1 C.M.L.R. 50, it would not appear to affect the Court's judgments in *Überseering* and *Inspire Art*. In *Cartesio* the ECJ upheld a Hungarian law which prohibited the transfer of the operational headquarters of a Hungarian limited partnership abroad. No such prohibition now appears to exist under German law.

¹⁰ However, the new statutory presumption does not apply if the relevant shares do not exist and so neither obviates the requirement for due diligence investigations nor vendor's warranties.

¹¹ Such protection was first available in May 2009: see para.3(3) of the Transitional Provisions (*Übergangsvorschriften*) to the 2008 MoMiG. It is only so available if the inaccuracy was present before November 1, 2008, and can be attributed to a person entitled to the shares. If it cannot be so attributed, protection is available as from November 1, 2011.

¹² BGHZ 157 72.

¹³ Any payments made under such contracts do not appear to be required to have come from the parties thereto only.

¹⁴ It has been disputed in the literature whether an agreement between the management of the company and the shareholder concerning the return of the funds contributed is necessary, or whether a mere temporal and factual connection between the making of the contribution and the return of the funds is enough.

¹⁵ See paras 4a and 10 of the *GmbH Gesetz*, as amended.

¹⁶ It may be questionable in a particular case whether a company has a director.

¹⁷ See Habersack ZIP 2007 2145, 2153 and Kallmeyer DB2007 2755, 2758. See also the helpful article by Dr. J Lips, T Randel and Dr C Werwig. *Das neue GmbH-Recht-Ein Überblick*—in the same sense.

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