Peltzer · Brooks

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GmbH-Gesetz

Synoptic Translation including
Comprehensive Introductory Comments on the Laws
Affecting the German GmbH

Synoptische Textausgabe
mit einer ausführlichen englischen Einführung
in das GmbH-Recht

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Synoptic Translation including Comprehensive Introductory Comments on the Laws Affecting the German GmbH

by

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von

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COMMENTS ON THE GERMAN GMBH-LAW

1. INTRODUCTION

a) The general concept of the law

The Law pertaining to Companies with Limited Liability[+)] dates back to 1892. At that time the joint stock company as well as general and limited partnerships had existed for a long time. The joint stock company, having its origins in the trading companies of the 17th century, came into fashion in the years of economic boom following the Franco-Prussian war of 1870/71. The partnership is probably the earliest form of business organization known.

What the German business community needed in the late 19th century was a form of business organization which limited the liability of the entrepreneur, was simple and typically designed for the smaller business. By contrast the joint stock corporation was typically the organizational form in which to amass large sums of capital contributed by very many shareholders without personal ties among themselves or to the company. Hence, for the joint stock corporation importance attached to the fungibility of the share and ease for the shareholder in joining and leaving the association at any time.

The shareholder of the newly created company with limited liability has by contrast to deal with a complicated procedure to acquire and sell a share, with in many cases the need for company approval (§ 15 para. 5). Typically, this company has only a few members who do not need representation in the form of a supervisory board who appoint and supervise management. This function can be properly performed by the shareholders' meeting which is itself easily convened and does not require notarization as is the case with the shareholders' meeting of a joint stock corporation.

Also, in the case of the newly created company with limited liability it seemed necessary to create the possibility to impose on shareholders further duties and obligations exceeding their original capital contributions which, however, should not result in unlimited liability. From this evolved the right of the shareholder to abandon his share where the liability for additional capital contributions is unlimited (§ 27 para. 1).

+) Section and paragraph references without further details are to the latest version of this law. The German for limited liability company "Gesellschaft mit beschränkter Haftung" is abbreviated "GmbH" so that it is usual to talk of this form of company as a GmbH. This German abbreviation is used frequently in the above text.

The resulting corporate form was a mongrel: it inherited the corporate entity and limited liability from the joint stock corporation but the type of relationship between shareholders and complicated procedure for joining and leaving the association from the partnership. It was nevertheless bound on the road to success. Ever since the law was enacted any German business venture would first think of organizing itself as a GmbH; it meant a clear cut solution, easy to plan and organize, the popularity of which further increased since the corporation profits tax reform of 1977 which in most cases significantly eased the burden of double taxation - at least for German residents - such that from then on the tax advantages of the partnership form (where the partners rather than the partnership are subject to income tax) have been considerably reduced.

b) The significance of the limited liability company in the German economy and business world

As of January 1, 1980, there existed some 225,000 companies with limited liability having a total share capital of DM 92.4 billion (the number of joint stock corporations at January 1, 1980 was 2,139 with total share capital of DM 88.6 billion). The number of companies with limited liability increases significantly each year whereas the number of joint stock corporations is gradually reducing. The company with limited liability is by far the widest spread and most popular form of company, the great advantages of which are that it is easy to organize, easy to handle, adaptable to many purposes and it requires only a comparatively small amount of initial share capital.

The GmbH is easy to organize because it required only two founders, one of whom was often an employee of the acting notary who transferred the one share he or she held in trust immediately to the principal shareholder upon registration of the company. The reform of the law has reacted to this perfectly legitimate practice and as from January 1, 1981, a sole founder suffices. By contrast it takes five founder members to establish a joint stock company.

The GmbH is easy to handle because the organizational structure can be reduced to a minimum. A shareholders' meeting can be convened without formalities (unless specified matters are to be dealt with), with the extra facility that all resolutions can be passed in writing (§ 48 para. 2) - compare the notarization requirement for each shareholders' meeting of a joint stock corporation. The running of the company can be entrusted to a sole managing director with no need for a supervisory board as is the case with the joint stock corporation.

The GmbH is adaptable to many purposes because it can be established for any legitimate purpose (§ 1), such purpose not necessarily being a business or commercial purpose at all. The articles of association need only include a small number of basic provisions (or they can be expanded to fill a small book).

It requires only a small amount of capital as even the increase in minimum capitalization brought about by the amendment of 1980 is comparatively modest and certainly only reflects a fraction of the loss in buying power the Mark has suffered in the nearly ninety years since the law was first enacted.

c) The amendments achieved by the reform of 1980

The present reform of the law has a long and varied history. Little has actually been changed since 1892 when the law first came into being. The government brought forward bills in the 1970's (compare Government printed papers VI/3088 and 7/253) which reflected a thoroughly considered concept but which would have totally changed the character of the GmbH and created a "small joint stock corporation" with all the rigidity of the latter. The bill VI/3088 comprised 300 sections and dealt with subjects such as relations to other companies of the same group, mergers and transfer of all assets and detailed provisions relating to the financial statements and accounting requirements, subjects which had so far only been dealt with in the Joint Stock Company Law. This concept of a major change did not achieve the necessary political backing and the government submitted a new bill in 1977 (printed matter 8/1347 of December 15, 1977). The scope of this bill was much more limited, leaving the bulk of the provisions of the old law unchanged and amending only certain parts. This bill was then further amended by the parliamentary legal committee (compare printed matter 8/3908) and finally became the new law which enters into force on January 1, 1981 (compare Federal Law Gazette I/1980 page 836 et seq.).

The main emphasis of the legislation amending the law lies in improved protection of creditors as well as of minorities and individual shareholders.

The most important changes can be summarized as follows:

1. The "one man GmbH" and the new minimum capitalization

From January 1, 1981 it is possible to establish a "one man GmbH", ie. a GmbH established by only one founder. The practice in Germany had previously been that a person who wanted to incorporate his business could do so only by establishing a company with a second founder - more often than not an employee of the acting notary. Immediately upon registration of the company the share of the second founder was transferred to the principal. It is now possible for one person alone to establish a GmbH.

The "one man GmbH" is, however, subject to special provisions. The minimum share capital of a GmbH is increased under the revised law from DM 20,000 to DM 50,000 (if one takes into consideration the fall in purchasing power between inception of the law in 1892 and 1981 the increased capital required of DM 50,000 is certainly not exaggerated). One quarter of this capital, but with a minimum of DM 25,000, must be paid up on formation so that where the minimum capitalization is chosen 50% must now be paid in, compared to the previously permitted 25% of DM 20,000.

The "one man GmbH" is subject to more stringent requirements. Here the sole shareholder must provide security for the balance of the cash contribution (the same one quarter with a minimum of DM 25,000 must be paid in) or pay in the full amount of the capital on formation. Identical rules apply if all the shares of a GmbH are concentrated in the hands of only one shareholder within three years of original registration (the act which brings a GmbH into existence). Again the remaining sole shareholder must pay up the capital in full or give surety.

A company registered prior to January 1, 1981 which does not meet the minimum share capital or paid-up capital requirements of the amended law, has five years until December 31, 1985 to comply with the new rules.

2. Formation of the GmbH and capital increase by contributions in kind

Contributions in kind with their inherent possibility of overvaluation are now subject to a more critical review by the registration judge than before. According to § 5, para. 4, the shareholders must explain in a special report the adequacy of the valuation of contributions in kind. If contributions are undervalued, the share subscribed for is still recorded at its nominal value and the assets are either stated at the same amount or at their market value with the difference recorded in free reserves. If contributions in kind are overvalued and do not reach the nominal amount of the share subscribed for, the contributor is liable to make up in cash the difference between the nominal amount of his share and the value of the contribution in kind. A capital increase by contributions in kind basically follows the same rules. § 56a et seq. governing these capital increases does not, however, refer to § 5, para. 4, so that the special report by the shareholders seems not to be mandatory if a contribution in kind is made at any time after registration of the GmbH. This could be an oversight when drafting the amendments to the law.

3. Inability of certain persons to serve as Managing Director (Geschäftsführer)

One of the typical forms of white collar crime is to establish a new GmbH which orders large quantities of merchandise (obviously with no intention to pay for them) or offers fantastic profit opportunities in the commodity market or other "unique" investment possibilities. Once victims alert the police or the public prosecutor, it is usually too late. The managing directors of such companies are usually "old acquaintances" of the public prosecutor. In order to reduce the possibilities of such a crime pattern in future, no person may be nominated or registered as managing director of a GmbH for five years after conviction of a bankruptcy crime or felony. Time actually served in prison is not counted in these five years. In order to achieve this limitation in practice, persons appointed must declare before registration that such a hindrance does not exist. Any false statement in this respect is punishable as a felony according to § 82.

4. Loans extended to the company by shareholders

The law has codified in § 32a and § 32b the essentials of existing case law. If a shareholder has extended loans to a company "at a time when shareholders acting a prudent businessmen" would have used the funds to increase the capital of the company, he may not demand repayment of the "loan" in case of bankruptcy. In simple terms, such a loan is considered to be a capital contribution.

If a third party has extended a loan at such point in time and the shareholder has provided security or a guarantee on the loan, the third party must first seek repayment of the loan out of the surety or guarantee and can claim repayment from the liquidator only for such portion of the original claim as has not been satisfied out of the surety or guarantee. The idea in this case is to protect the other creditors whose claims need only compete for (partial) repayment with the balance and not with the full claim of the creditor who received a guarantee or security from the shareholder. Because banks will very often ask the shareholders to guarantee loans to small and/or poorly capitalized companies with limited liability, this provision is of substantial practical significance for them.

If a shareholder loan is repaid to the shareholder during the year before the commencement of bankruptcy proceedings, the repayment as well as any security granted to the shareholder for the loan can be rescinded by the receiver (cf. the new § 32a of the Bankruptcy Code). If the loan has been extended by a third party but with a surety or guarantee from the shareholder and it is repaid within one year before bankruptcy proceedings commence, the shareholder shall refund the loan repayments to the company but only to the extent of the value of the surety or guarantee at the time of repayment. Alternatively he can hand the collateral to the company for its own satisfaction (§ 32b).

In future a conflict between the new provisions and prior case law may arise. The supreme court has ruled that the point in time when prudent businessmen would increase the capital base of the company not only encompasses the situation when the loan was originally extended but also critical situations arising during the lifetime of the loan. It is an open question whether this will continue after the new law comes into effect or whether § 32a is so specific ("... instead grants a loan") that the interpretation of the Supreme Court can no longer apply.

5. Inspection rights of individual shareholders

A main theme of the GmbH-Law amendment relates not only to protection for creditors but also for minority shareholders. According to the new § 51a, the managers shall, upon request of any shareholder, provide information pertaining to the matters of the company and allow for inspection of records and accounts. This right of the individual shareholder is extremely far

reaching and provides him - as one well-known scholar of German corporate law has formulated it - with rights equal to the supervisory board of a joint stock corporation or a GmbH. Any company considering a change of its legal form into that of a GmbH will certainly have to take this new provision into account.

The information demanded by the individual shareholder can be refused by management based only on the very narrow grounds laid down in para. 2, namely if it is feared that the shareholder will use information obtained for purposes contrary to the company's interests and thereby inflict a not insignificant disadvantage on the company or an affiliated enterprise. Furthermore, the refusal must be endorsed by a resolution of the shareholders.

6. Loans extended to managing directors, holders of general signing powers and authorized signatories

Loans may in future only be granted to managing directors, holders of general signing powers (Prokuristen) and authorized signatories out of assets not required to preserve the nominal capital of the company. In the negative sense this means that the group of persons mentioned in § 43a may not receive loans unless the capital is fully paid up and the company's net equity position exceeds the stated share capital by at least the amount of the proposed loans.

7. Mergers and transformations

The Joint Stock Company Law contains in § 339 et seq. extensive provisions regarding the merger of companies, the transfer of assets and the transformation of companies to another legal form. The provisions of the new GmbH law, which are not incorporated into the GmbH law but rather in the Law on Capitalization of Reserves (Kapitalerhöhungsgesetz) are closely modelled on the comparable provisions of the Joint Stock Company Law. As in § 399 of the Joint Stock Company Law, two forms of merger are possible: firstly the transfer of all the assets of one company (the transferor company) to another company (the transferee company) in exchange for shares in the latter company; secondly formation of a new company with limited liability into which all assets of each of the companies to be combined are transferred in exchange for shares in the new company. The first alternative is by far the most common.

Under this method the shareholders of the transferor company receive shares in the transferee company which reissues its own shares held or creates new shares by means of a capital increase. The capital increase is governed by the rules relating to an increase by contributions in kind. The shareholders of each of the participating GmbH's must approve the merger by resolution with a majority of at least 75 per cent.

The creation of the "one man GmbH" now makes possible the transformation of a sole proprietorship into a GmbH. Nearly all other types of transformation had already been regulated: the transformation of a GmbH into a joint stock corporation and vice versa, the transformation of a GmbH into a partnership or vice versa as well as the transformation of a sole proprietorship into a joint stock corporation. The transformation of a sole proprietorship into a company with limited liability was the only missing link. The new provisions added to the Transformation Law contain the new legal possibility and the procedure to be followed: a notarized declaration from the sole proprietor and his special report on the adequacy of amounts attributed to contributions in kind according to § 5 para. 4 and on the current state of business and the position of the enterprise. The transformation becomes valid upon registration of the new company with limited liability in the commercial register. Upon registration the entire assets and liabilities of the sole proprietorship pass with legal effect to the new GmbH.

2. FORMATION

The formation of the company requires a contract between the shareholders to be, called the articles of association or by-laws (§ 2). Obviously, in the case of a sole founder this is not a contract but a unilateral declaration. The articles of association must be notarized (§ 2 para. 1). For practical purposes the shareholders should at the same time hold a meeting to appoint the managing directors or director because the latter must act for the company in commercial register matters, including applications for registration of the company to the local court (Amtsgericht).

The shareholders need not appear in person before the acting notary. They can delegate their powers to representatives whose proxies must be notarized or whose signatures must at least be authenticated (§ 2 para. 2). The application for registration is submitted by the managing directors designate, who will have to prove their authority (§ 8 para. 1 No. 2) either from their appointment in the articles of association - which is impractical - or by submitting the minutes of a meeting of the shareholders - or their proxies - appointing them to their new office.

The first meeting can be held without any difficulty immediately after the notarization of the articles of association. If more than one shareholder is represented by the same representatives the proxy should contain exemption from the restrictions of § 181 of the German Civil Code (prohibition of dealing with oneself or as proxy of two different principals, in order to avoid conflicts of interest). In the application for registration, the signatures of the managing director(s) must be authenticated which in practice is done by the notary who notarizes the articles of association and who also prepares the application for registration and the necessary documentation. Obviously the articles of association themselves must be attached (§ 8 para. 1 No. 1) because they are the basis for the registration.