RECENT DEVELOPMENTS IN THE PRACTICAL APPLICATION OF THE ACT TO MODERNIZE THE LAW GOVERNING PRIVATE LIMITED COMPANIES AND TO COMBAT ABUSES (GENERALLY KNOWN AS THE MOMIG)

Barely a year and a half after the enactment of the MoMiG and the corresponding changes in the Private Limited Companies Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG), application of the provisions in question has repeatedly given rise to uncertainty as to how to interpret this legislation. For example, the issues that have arisen have included questions revolving about the recorded list of shareholders and the provisions of law that make it easier to establish a private limited company under German law (GmbH). This article addresses two aspects that are currently the subject of considerable controversy – the acquisition in good faith of shares by a third party in the case of shares that have already been sold subject to a condition precedent and the redemption of shares. It will be interesting to await the position that crystallizes in court judgments in the long term.

A. ACQUISITION IN GOOD FAITH OF SHARES THAT HAVE ALREADY BEEN SOLD SUBJECT TO A CONDITION PRECEDENT

When advising corporate clients and drafting agreements, it often happens that sales of shares in limited companies are structured so that the assignment of the shares is made subject to the condition precedent of payment of the purchase price. This makes it possible to preclude the possibility that one of the two parties – the seller by assigning the rights to the respective shares and the purchaser by paying the purchase price – discharges its obligations and at the same time runs the risk of not receiving the corresponding consideration.

Before the MoMiG went into force, the assignment of shares in a private limited company subject to the condition precedent of payment of the purchase price meant that the seller still had the right to assign the respective shares to a third party up to the performance of the condition precedent, but the seller's powers of disposition were, however, still restricted by the provision contained in section 161(1) sentence 1 of the German Civil Code (Bürgerliches Gesetzbuch – BGB) since all rights in the respective shares extinguished in the event of the occurrence of the condition precedent, i.e., payment of the purchase price, to the extent that they would negate or impair the effect of fulfillment of the condition.

The amendment of the MoMiG has changed this legal situation. Section 161(3) of the German Civil Code stipulates that the provisions pertaining to acquisition in good faith apply. The MoMiG makes it possible for the first time to acquire shares in a private limited company in good faith pursuant to section 16(3) of the Private Limited Companies Act. Whether or not section 16(3) of the Private Limited Companies Act even applies in cases in which shares in a private limited company are assigned to a buyer subject to the condition precedent of payment of the purchase price, thereby permitting acquisition by a third party in good faith, is currently the subject of vigorous debate in the scholarly literature. However, until the highest court explicitly rules that this is not the case, the wording of section 16(3) of the Private Limited Companies Act makes it necessary to assume that this provision also applies in the case of an assignment of shares in a company subject to the condition precedent of payment of the purchase price and that the acquisition in good faith of shares subject to such a condition by a third party is also possible in such cases.

Given this situation, a buyer who is charged with fulfillment of a condition precedent is faced with the question as to how to protect itself against the acquisition of those shares in good faith by a third party. Various solutions to this quandary are being discussed in the scholarly literature.

For example, it is argued that it would be possible to protect the buyer subject to the condition precedent by using what is referred to as a double-list model, which would involve filing a list of shareholders with the commercial register that is provided with a column for recording any assignment of shares in a company subject to a condition precedent, thereby documenting the rights of the buyer upon fulfillment of the condition precedent. However, the Munich Higher Regional Court (Oberlandesgericht) clearly rejected the use of such a double-list model with a separate column reserved for changes in its order dated 8 September 2009, justifying its decision, among other things, by stating that the legally-stipulated content of the list of shareholders of a private limited company may not be arbitrarily expanded to include items that are considered desirable by the parties to a sale of shares in a private limited company subject to fulfillment of a condition precedent. Apart from the question as to whether another line of argumentation could

be advanced in this regard, the order of the Munich Higher Regional Court dated 8 September 2009 makes it impossible for the buyer of shares in a private limited company subject to a condition precedent to rely on a double-list model to provide the necessary protection against acquisition of those shares by a third party while fulfillment of the condition precedent is still pending; instead, the buyer must effect such protection in another manner.

In that regard, assigning an objection to the list of shareholders, which is an option that was also introduced by the MoMiG, is a possibility. This involves including a clause in the agreement concerning the assignment of the shares in a private limited company subject to a condition precedent to the effect that the parties file an objection and consent to its deletion and at the same time irrevocably engage and authorize a notary to submit the application for and consent to an objection to the commercial register. After the parties inform the notary of the occurrence of the final condition, then - and only then - may he submit the new list of shareholders and at the same time delete the objection. The parties to an agreement concerning the sale of shares in a company subject to a condition precedent may also instruct their notary to have the objection deleted at the request of the seller if performance of the precedent condition does not take place by a certain date or one of the parties validly repudiates the agreement.

However, various opinions exist in respect of the question as to whether the assignment of an objection to a list of shareholders is permissible in the case of an assignment of shares in a private limited company subject to a condition precedent. The Cologne Regional Court affirmed that this is possible in its order dated 16 June 2009. Until a conclusive ruling is forthcoming on the issue from the highest court, it is advisable not to rely exclusively on the assignment of an objection to the list of shareholders to protect the interests of the buyer in the case of a sale subject to fulfillment of a condition precedent, but rather also to choose a second avenue of protection. For example, it is possible to work with constructs that – depending upon the circumstances and the interests of the parties involved in the individual case – are based on the assignment of the respective shares in the company with immediate effect accompanied by simultaneous reassignment in the case of any assignment to a third party. Alternatively, it could be stipulated that a further condition had to be met for the assignment to become legally effective in addition to the condition precedent of payment of the purchase price such that the assignment would take effect in the case of further disposition of the seller independently of payment of the purchase price. A pledge of the respective interest in favor of the buyer would be another possible option. Acquisition in good faith by a third party can also be prevented – if the articles of association of the private limited company involved stipulate, or are amended to stipulate, that shares in the company may be assigned only with the consent of all shareholders – by having a minor interest assigned to the prospective buyer with immediate effect so that this shareholder can actively prevent any other assignment of shares – namely the assignment of the shares intended for him to a third party – by withholding consent. Finally, the possibility of an acquisition in good faith by a third party can be precluded by assigning the respective shares in the company to a civil-law partnership consisting of the seller and the buyer, since acquisition in good faith of interests in a partnership is legally impossible and the same legal situation can be created that also prevailed for the private limited company prior to the entry into force of the MoMiG.

B. REDEMPTION OF SHARES IN A PRIVATE LIMITED COMPANY

The redemption of shares in a private limited company previously entailed the extinguishing of the respective shares. Since the entry into force of the MoMiG and the introduction of section 5(3) sentence 2 of the Private Limited Companies Act, this seems, however, to have become problematic. The new section 5(3) sentence 2 of the Private Limited Companies Act sets out that the sum total of the nominal amounts of all shares must be equal to the capital stock. According to Parliament's reasoning behind this provision, this is intended to apply not only during the incorporation phase but also permanently. As a result, the amendment of section 5(2) sentence 2 of the Private Limited Companies Act is responsible for considerable uncertainty with respect to its legal consequences.

With increasing frequency, opinions are being voiced to the effect that shareholder resolutions to redeem shares pursuant to section 34 of the Private Limited Companies Act have been invalid since the entry into force of section 5(3) sentence 2 of the Private Limited Companies Act unless the shareholders at the same time have taken measures to cancel the redeemed shares so that the capital stock

equals the nominal amount of the remaining shares. Those who voice the opinion argue that this can be achieved, for example, by carrying out the redemption in connection with a capital decrease, through an increase in the nominal value of the remaining shares or by creating new shares. However, this argument is unpersuasive, if for no other reason than because of the practical aspects of implementation of the proposed solutions. A decrease in capital stock is not a viable solution if the capital stock would fall below the minimum of EUR 25,000.00 prescribed by section 5(1) of the Private Limited Companies Act as a result of such a measure. Even if no difficulties exist with respect to the minimum capital stock, it is necessary to take into account the fact that a capital decrease must comply with the procedure pursuant to section 58 of the Private Limited Companies Act, which means, among other things, that a public notice to creditors must be issued and that the capital decrease cannot be recorded in the commercial register until a one-year waiting period has elapsed. An increase in the nominal value of the remaining outstanding shares must inevitably entail obligatory contributions to capital for the shareholders affected and will therefore regularly be contingent upon whether shareholders are prepared to make such contributions. The situation as regards the creation of new shares is similar. This procedure is also possible only if a shareholder or a third party is prepared to accept the respective interest in exchange for a corresponding contribution to equity.

Against this background, the question arises as to what procedure is practicable for redeeming shares in a private limited company now that the MoMiG has entered into force and would not entail the risk that the resolution to redeem the shares might be considered invalid because of a violation of the second sentence of section 5(3) of the Private Limited Companies Act. The definitive solution has not yet been found. It is, however, possible to have a redeemed share of a private limited company remain intact and have the company itself acquire the share in exchange for a commensurate contribution to equity. This approach is – in any event to the extent that the private limited company in question has the requisite funds – not only practicable, but also minimizes the risk of invalidity of the redemption resolution adopted by the shareholders' meeting due to possible violation of section 5(3) sentence 2 of the Private Limited Companies Act.

DR. WERNER MIELKE, LL.M. / DANIELLE MOLZ