T O O U R F R I E N D S A N D C L I E N T S

M e m o r a n d u m

October 28, 2008

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German Reform Act to Modernize the Law Governing Limited Liability Companies - October 2008

The Reform Act to Modernize the Law Governing Limited Liability Companies (Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, "MoMiG") comes into force on November 1, 2008, and contains long awaited reforms.

Legislative background

The MoMiG is designed to eliminate potential disadvantages of German limited liability companies ("GmbH") compared to limited liability companies of other jurisdictions, including a number of formal requirements such as a stated share capital of €25,000.00 (half of which must be paid in at time of registration). Given these considerations, the main three objectives of the MoMiG are (1) facilitating and accelerating the business formation process, (2) eliminating competitive disadvantages vis-à-vis foreign legal structures (such as onerous formal and minimum stated share capital requirements) and (3) protecting creditors, inter alia, from fraudulent use of the GmbH structure.

New rules at a glance

- The MoMiG contains an appendix with sample notarial deeds for the formation of a GmbH. These forms may be used if the GmbH has a maximum of three shareholders and only one managing director. The sample notarial deed consists of (i) the articles of association, (ii) the appointment of the managing director and (iii) the shareholders' list, all in one single document.
- The MoMiG streamlines registration with the commercial register by reducing regulatory hurdles and burdensome formal registration requirements. Proof of payment of contribution to the stated share capital may only be requested in case of material doubts. The commercial register is no longer permitted to decline registration when there is only an insignificant overestimation of contributions in kind. Moreover, it is no longer necessary to wait for public approval for the operation of the GmbH's business; the GmbH can be registered with the commercial register without any such approval.

- The MoMiG establishes a "Mini-GmbH" (Unternehmergesellschaft). In contrast to the traditional GmbH that requires a minimum stated share capital of €25,000, a Mini-GmbH may be incorporated with a stated share capital of €1. The Mini-GmbH is then obliged to allocate one quarter of its annual profits to its capital reserve until the €25,000 level is achieved.
- Under current law, the shareholders' list is kept for informational purposes only and has no legal binding effect. In the future, a purchaser may rely on the shareholders' list as deposited with the commercial register if within the preceding three years no objection has been raised claiming the incorrectness of such shareholder lists. Going forward, this change will limit the time period for due diligence with respect to share ownership to the most recent three-year period, whereas prior to the MoMiG, the complete history of any GmbH had and will have to be investigated.
- The MoMiG permits shares to be issued in any nominal value divisible by €1 in order to facilitate the splitting of shares. In contrast to the present regime, the MoMiG allows a founding shareholder to subscribe to more than one share. Additionally, the current prohibition on transferring several parts of a share to one purchaser will be abolished, which will help to facilitate the pledging of shares for financing purposes.
- The MoMiG, for the first time, introduces the concept of authorized capital to the GmbH. The shareholders may authorize the managing directors to increase the stated share capital by up to 50% for a period of five years following the registration of the company. Making use of such authority does not require another shareholder resolution. Instead, it is only necessary to file notice regarding the increase with the commercial register.
- The MoMiG's clear regulations and guidance with regard to the formalities for raising of capital will eliminate previously existing legal uncertainties. In particular, the legislation specifically permits cash pooling throughout a group of entities.
- In contrast to current restrictions to preserve the nominal capital of a GmbH, the MoMiG permits a GmbH to grant loans to its shareholders. Additionally, the capital maintenance rules will no longer apply with respect to payments which relate to a profit and loss transfer agreement concluded by the entity.
- The provisions related to loans that had been granted by shareholders to a GmbH prior to the commencement of insolvency proceedings (Sec. 32a and 32b German Limited Liability Company Law) will be deleted. Such loans will be subject to general rules set forth in the German Insolvency Act, and courts will no longer consider previous case law when interpreting these issues. However, pursuant to the new rules, any shareholder loan will be subordinated in insolvency proceedings.
- The MoMiG enhances creditor protection by eliminating barriers to bringing claims against GmbHs. A mandatory domestic address must be registered with the commercial register. If service of process cannot be carried out at this registered address, service by public notice (öffentliche Zustellung) will be possible. If there is no current serving managing director, service of process may be effected by delivery to the shareholders.
- Currently, only the managing directors are obliged to file for insolvency proceedings if the

GmbH becomes insolvent. In the absence of a managing director, the MoMiG imposes this duty on the shareholders. Correspondingly, the MoMiG extends liability for payments executed during a crisis of a GmbH to the shareholders, whereas the current regime only provides for liability for managing directors.

- The MoMiG will refine the criteria for appointing managing directors by disallowing potential candidates with convictions for delaying the filing for insolvency proceedings, for making false statements and misrepresentations in connection with the incorporation of the GmbH, and for general criminal offenses related to entrepreneurial activity. These provisions also apply to managing directors convicted with respect to similar criminal offenses abroad. As a consequence, anyone contravening core provisions of economic criminal law will be ineligible to serve as a managing director.
- The MoMiG formally allows the GmbH to relocate to a different jurisdiction. Therefore, German entities will have more freedom to develop their business activities outside Germany.

Conclusion

The changes introduced by the MoMiG make a number of significant improvements over the former legal system. In particular, the MoMiG eliminates onerous and burdensome regulations in order to keep the GmbH competitive when compared to legal entities of other jurisdictions.

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