

## FUNDAMENTAL REFORM OF GERMAN COMPANY LAW APPROVED BY GERMAN BUNDESTAG

July 3, 2008

To Our Clients and Friends:

After extensive debate and discussions during the past years, on June 26, 2008, the German *Bundestag* finally approved the Law for the Modernization of the Law on German Limited Liability Companies and the Prevention of Mispractice (generally known under the acronym “*MoMiG*”). *MoMiG* is expected to become effective in October or November 2008 once the German *Bundesrat* has also approved the *MoMiG*. The general purpose of *MoMiG* is to modernize and deregulate the *GmbH* law, to facilitate business start-ups and to accelerate the registration of *GmbHs*. The legal form of the *GmbH* shall also become more competitive internationally.

Below we would like to describe some of the fundamental elements of *MoMiG*.

Entrepreneur's GmbH with no minimum capital. Currently, a *GmbH* is required to have a minimum share capital of €25,000. *MoMiG* changes this by introducing a special start-up type of a *GmbH*, the “*Unternehmersgesellschaft (haftungsbeschränkt)*” (“Entrepreneur's *GmbH*”). The Entrepreneur's *GmbH* is not a new corporate form, but a *GmbH* that may be incorporated without any share capital, even with zero Euros. However, a Entrepreneur's *GmbH* may only distribute a maximum of 75% of its annual profits to its shareholders until a share capital of €25,000 is saved over time. Until then, 25% of its annual profits must be retained and booked as a statutory reserve in the balance sheet of the Entrepreneur's *GmbH*.

Standardized templates for incorporation. For standard incorporations with the share capital being paid up in cash and a maximum of three shareholders, *MoMiG* introduces standardized templates of the articles of association and the commercial register application. These simplified templates will combine the articles, the appointment of directors and the shareholders' list into one document.

Acceleration of registration process. Registration time was decreased in 2007 by the introduction of electronic commercial registers and online filing. The registration process will be further accelerated since it will no longer be required that necessary business permits must be obtained before the *GmbH* can be registered.

Administrative seat of the company outside of Germany. Unlike other companies incorporated under the laws of the European Union, a *GmbH* was prohibited from having its administrative seat outside of Germany. *MoMiG* eliminates this prohibition, and thus a *GmbH* can have separate administrative and registered seats. This will increase the ability of German companies to do business outside of Germany and could present an attractive opportunity for

German enterprises to organize their foreign subsidiaries in the familiar form of a German *GmbH*.

Increased importance of shareholder list. In the future, only those persons who are listed on the shareholder list filed with the commercial register will be considered shareholders of the *GmbH* and be entitled to voting and dividend rights.

Bona fide acquisition of shares. Under *MoMiG*, the shareholder list filed with the register will also become the basis for a *bona fide* acquisition of shares. Specifically, it will now be possible to acquire a *GmbH* share from a person who is not the owner of this share if (i) such person has been listed as the shareholder for the past three years and (ii) no objection has been filed with the register. A *bona fide* buyer may also acquire title even if a seller without title has been listed as the shareholder for less than three years and such inaccuracy is attributable to an act or omission of the actual owner of the relevant shares.

Facilitation of cash-pooling. In the recent past, the admissibility of inter-company upstream loans in the context of cash-pooling systems has become uncertain due to an extensive interpretation of the relevant capital maintenance rule by German courts. *MoMiG* now clarifies that a *GmbH* may extend upstream inter-company loans if the loan transaction is a mere accounting exchange on the asset side of the balance sheet, *i.e.*, if the claim for repayment of the loan covers the loan payment to the shareholder and is valued at par. *MoMiG* further clarifies that the relevant capital maintenance rule will not apply to payments between parties to a so-called “domination agreement” or “profit and loss transfer agreement” (*Beherrschungs- oder Gewinnabführungsvertrag*).

Deregulation of the law on shareholder loans. The complex provisions regarding the repayment of so-called shareholder loans *in lieu of equity* (*eigenkapitalersetzende Darlehen*) has been simplified and deregulated under *MoMiG*. In the past, the question was whether a shareholder loan granted to the *GmbH* by its shareholder had to be treated as debt or equity based on whether the loan was granted during a “financial crisis” of the *GmbH* or not. Shareholder loans *in lieu of equity* could not be repaid by the *GmbH* during a financial crisis and were subordinated as equity when the *GmbH* became insolvent. Under *MoMiG*, whether shareholder loans will be treated as debt or as equity is no longer relevant. In a fundamental change, *MoMiG* now allows a *GmbH* to repay any shareholder loans during a financial crisis but prior to insolvency. However, in a subsequent insolvency, any repayments made during the preceding year have to be returned to the insolvent estate of the *GmbH*. On the other hand, all shareholder loans (whether granted during a financial crisis or not) will now be subordinated in the insolvency of the *GmbH*. Please note that certain exceptions to the subordination of shareholder loans (such as in the case of restructurings) will remain in effect.

Outlook. *MoMiG* is the most fundamental reform ever of the law on *GmbHs*. It will affect legal and corporate practice in many ways. The extent to which small business start-ups will actually make use of the Entrepreneur's *GmbH*, and whether the legal form of the *GmbH* will indeed have a more competitive edge over other popular company concepts in Europe, such as the English Limited, remains to be seen.

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This memorandum is only a brief summary and is not intended to be legal advice. Readers should seek legal advice before taking any action regarding the matters described above. For further questions please contact:

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