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The GmbH Law Amendments of 1980

On January 1, 1981, important substantive changes in the law governing the organization and operation of the form of corporate entity known as the "GmbH" went into effect in the Federal Republic of Germany.[1] These changes represent the first major amendment of this law since its original adoption and will have a significant effect on most corporations organized as a GmbH. The changes in this law are of particular interest to those counsel advising clients maintaining GmbH subsidiaries in the Federal Republic of Germany, since the GmbH form of corporate entity has been the favorite vehicle for the establishment of a corporate enterprise in that country.

This article will thus seek to discuss and explain the principal changes that went into effect earlier this year. Before proceeding to the substance of these changes, however, a brief discussion of the history and background of the GmbH form of corporate entity would seem appropriate.

The GmbH law was first adopted by the legislature of the then German empire in the waning years of the nineteenth century. Its adoption on April 20, 1892 marked the first appearance of a statute contemplating the organization and operation of what has subsequently become known as a "limited liability company." This form of corporate entity was specifically designed for use by the smaller enterprise for which resort to the public for capital would not be required and, in general, contemplated a small group of owners working together toward a common goal somewhat in the manner of an incorporated partnership. The immediate impetus to the invention of this new form of limited liability entity arose as a result of the generally complicated procedures and steep financial requirements which had been

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[1]Gesetz betreffend die Gesellschaften mit beschraenkter Haftung [GmbHG]; [1892] Reichsgesetzblatt (RGBl) 477 (W. Ger.); [1898] RGBl 846; [1976] Bundesgesetzblatt (BGBl) I 725. (W. Ger.).

introduced in the 1880s in connection with the formation of a stock corporation. Subsequent to the adoption of the GmbH law in 1892, the pattern set by this new form of corporate entity was copied and adopted in various other European countries during the next several decades.

Since the time of its original adoption in 1892, the GmbH law has not undergone any material change. The only significant subsequent statutes which have materially affected the operation and management of a GmbH have been the so-called "co-determination laws,"[2] adopted in a series commencing in 1951 and ending with the adoption of the most recent statute in 1976, and the so-called "publicity law."[3] These statutes essentially affected only the internal management structure of the GmbH and certain matters of financial disclosure, but did not, for instance, affect the rights of creditors of a GmbH or other aspects of its organization and operation.

A GmbH formed under the GmbH law is a corporate entity in the true sense of the word. No stockholder therein bears any personal liability for the obligations of the entity solely by reason of his status as such. Moreover, the GmbH can hold, acquire and sell property in its corporate name and can sue and be sued in its corporate name. It thus has all of the attributes of a true corporate entity. Unless one of the co-determination laws applies to the entity, no more than two corporate organs, consisting of the meeting of stockholders and an executive organ (the "Geschaeftsfuehrer"), are required as a matter of law. By way of contrast, a stock corporation ("AG") must maintain three separate and distinct corporate organs consisting of the meeting of stockholders, the executive organ (the "Vorstand") and a board of overseers (the "Aufsichtsrat"). It is the latter organ which is missing in the GmbH scheme of things, unless either one of the co-determination laws imposes a requirement that such an organ be constituted or its certificate of incorporation (the "Association Agreement") provides for such organ on a voluntary basis.

Aside from its simpler form of management, a principal difference between a GmbH and a stock corporation lies in the manner in which the shares of the GmbH are constituted and transferred. Within the GmbH, in fact, shares as such in the common understanding of the term do not exist, the interests of the owners of the entity being represented by capital participations. These can be of disparate and unequal size and need not be interests of a uniform capital value. Thus, of three stockholders, one can own a capital participation equivalent to 25 percent, while the other stockholders may own capital participations equivalent to 35 percent and 40 percent. Accordingly, the capital structure of a GmbH can very much resemble that of a limited partnership in the United States, the only difference being that,

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[2]Law of Oct. 11, 1952, [1952] BGBl I 681, as amended by Law of Dec. 14, 1976, [1976] BGBl I 3341; Law of May 21, 1951, [1951] BGBl I 347, as amended by Law of Sept. 6, 1965, [1965] BGBl I 1185; Law of Aug. 7, 1956; [1956] BGBl I 707, as amended by Law of April 27, 1967, [1967], BGBl I 505; Law of May 4, 1976, [1976] BGBl I 1153.

[3]Law of August 15, 1969, [1969] BGBl I 1189, [1970] BGBl I 1113 (W. Ger).

within the GmbH, there is no fully liable general partner. Furthermore, these capital participations cannot be freely traded and are transferable only by means of a formal notarial act.

In view of the antiquity of the GmbH law, it is not surprising that there have been successive drives to substantially reform this law. Such efforts first arose in the 1930s at a time when the stock corporation law was being revised and occurred again in the 1950s. In each case, however, other legislative priorities intervened to defeat these attempts to comprehensively reform and revise the GmbH law. The principal concern behind these efforts can be found in a feeling that the GmbH law did not adequately protect the interests of creditors of that form of entity, as well as in the desire to simply bring the old GmbH law up to date in various other respects. Although a comprehensive revision did not prove possible, the West German parliament, after several years of consideration and hearings, in 1980 finally adopted a series of significant amendments to the existing GmbH law to become effective on January 1, 1981. They do fall short, however, of the long-sought comprehensive revision and, in its essential outlines, the GmbH law thus remains much as first conceived in the last decade of the nineteenth century.

The changes effected by these amendments consist primarily of four different categories. The largest category of changes involve those which were designed to strengthen the position of the creditors of the GmbH. The other three categories consist of provisions permitting a GmbH to be formed by only one person, provisions strengthening the right of stockholders to corporate information, and provisions permitting the merger of one or more GmbH entities into another GmbH.

Each of these various categories of changes will be briefly discussed below.

I. Creditor Protection Provisions

The 1980 amendments to the GmbH law seek to increase the protections afforded creditors of a GmbH in a variety of ways. Thus, they provide for an increase in the minimum capital required upon the organization of a GmbH, they introduce new rules relating to contributions in kind, both upon incorporation and thereafter, and they introduce additional provisions pertaining to the liability of the organizers of a GmbH. They also provide for a new statutory rule for the treatment of loans by stockholders to the GmbH under certain circumstances and they regulate more specifically the acquisition by a GmbH of its own shares and the grant of credit to executives of the GmbH. Each of these aforementioned changes will be briefly discussed herein.

i) Minimum Capital

Effective as of January 1, 1981, the minimum capital required to organize a GmbH has been increased from DM 20,000 to DM 50,000.[4] Thus, the organizer or organizers of a GmbH must henceforth commit at least DM 50,000 to the GmbH in one form or another. Of the required capital subscribed to, however, only the greater of 25 percent, or DM 25,000, need be actually paid in as a condition to incorporation.[5] Thus, if the GmbH is capitalized at the required minimum of DM 50,000, at least DM 25,000 must be paid in, while if the GmbH is capitalized at DM 100,000 or more, at least 25 percent of that sum (DM 25,000 or more) must be paid in as a condition to incorporation. If the GmbH is capitalized at between DM 50,000 and DM 100,000, a minimum of DM 25,000 must thus be paid in prior to incorporation.

In view of the fact that numerous GmbH entities exist within the Federal Republic with a stated capital not exceeding the previously required minimum of DM 20,000, the new provisions provide for a transitional rule for these particular entities.[6] This transitional rule essentially provides these particular GmbH entities with a period of grace until December 31, 1985 to increase their capital to the new minimum amount. In this connection, the law provides that any GmbH whose stated capital amounts to less than DM 50,000 shall be automatically dissolved effective as of December 31, 1985, unless a resolution increasing stated capital to the requisite minimum has been recorded with the Commercial Register on or before that date.[7] Moreover, the law further provides that any GmbH entity with a stated capital in excess of DM 50,000, but less than DM 100,000, shall likewise be dissolved as of December 31, 1985, unless the managing directors have on or before such date filed assurances with the Commercial Register to the effect that the minimum amount required to be paid in under the new provisions (DM 25,000) has in fact been paid into the GmbH.[8]

ii) Contributions in Kind

Prior to January 1, 1981, contributions to stated capital in kind, i.e. contributions to capital other than in cash, were not the subject of overly specific statutory regulation. Under the recent amendments, however, more stringent provisions relating to contributions in kind to the capital of a GmbH were adopted.[9]

Where a contribution in kind is to be effected upon the organization of a GmbH, the statute now requires that specific details relating to the pro-

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[4]GmbHG § 5(1).
[5]*Id.* § 7(2).
[6]Law of July 4, 1980, Art. 12; [1980] BGBl I 836 (W. Ger.).
[7]Law of July 4, 1980, Art. 12; § 1(1); [1980] BGBl I 849 (W. Ger.).
[8]Law of July 4, 1980, Art. 12, § 1(2); [1980] BGBl I 849 (W. Ger.).
[9]GmbHG § 5(4), § 7(3), § 9(1).

posed contribution be included in the Association Agreement.[10] Accordingly, the particular item of property to be transferred to the GmbH must be identified and the amount of value attributed to it must likewise be set forth. In addition, the incorporators are required to submit a special report for filing with the Commercial Register in connection with any organization of a GmbH involving contributions in kind setting forth the facts surrounding the property and the reasonableness of the value attributed to it.[11] Where a going business constitutes the contribution in kind, the financial statements of such business for the last two fiscal years must also be included in such report.[12] If the required details are not included in the Association Agreement, the subscriber will be obligated to effect his capital contribution in cash.[13]

Furthermore, the statute now specifically provides that the subject of a contribution in kind must be transferred into the hands of the GmbH prior to incorporation. Thus, the property must be available for free disposition on the part of the managing directors before incorporation can be recorded by the Commercial Register.[14] If the Court of Register determines that the property does not attain the nominal value of the capital participations against which it is being transferred, the Court can reject the incorporation of the GmbH.[15]

In order to ensure that the value of property constituting a contribution in kind actually equals the stated value of the nominal capital which is issued in return for its transfer, the statute also requires a transferring stockholder to make up in cash any deficiency in value existing as of the date of filing of the Association Agreement for recordation.[16] The GmbH has the right to assert a claim for this amount, if any, but a statute of limitations of five years commencing upon incorporation applies to any such claim.[17]

Analogous provisions exist with respect to contributions in kind effective upon an increase in capital subsequent to the incorporation of the GmbH.[18] There again, the object of the contribution and the value attributed to it with respect to the new capital participations to be issued in exchange are to be set forth in the stockholder resolution increasing the capital of the GmbH.[19] As in the case of an original incorporation, any deficiency in value must be made up in cash by the subscribing stockholder and, before the capital can actually be increased by recordation of the requisite resolution with the Commercial Register, the object of the contribution must have

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[10] *Id.* § 5(4).
[11] *Id.* § 5(4).
[12] *Id.* § 5(4).
[13] *Id.* § 19(5).
[14] *Id.* § 7(3).
[15] *Id.* § 9c.
[16] *Id.* § 9(1).
[17] *Id.* § 9(2).
[18] *Id.* § 56(1), § 57, § 57a.
[19] *Id.* § 56(1).

been transferred into the hands of the GmbH.[20] Finally, the court has the same power as in the case of an original incorporation to reject the capital increase if it appears that the contribution in kind involved does not attain the value attributed to it.[21]

iii) LIABILITY OF INCORPORATORS

The provisions of the GmbH law relating to the potential liabilities of organizers, managing directors and original stockholders of a GmbH have been substantially strengthened. These now essentially provide that those stockholders and managing directors who have made false statements in connection with the organization of the GmbH shall be responsible for any damages arising therefrom.[22] In addition, such parties will also be responsible for the payment of any unpaid capital contributions. A managing director or stockholder will escape such liability only if he was unaware of the facts involved and, in the exercise of due care, could not have known of such facts.[23] Principals of persons who have organized a GmbH are liable in a similar manner.[24]

These provisions also apply to subsequent actions relating to capital, such as an increase in capital and contributions in kind to capital after the original organization of the GmbH.[25]

Claims based on these provisions inure to the GmbH alone and are subject to a statute of limitations of five years commencing upon incorporation or, if based on subsequent facts, five years commencing upon the happening of such facts.[26]

iv) STOCKHOLDER LOANS

The statute now contains specific provisions dealing with the treatment of loans by a stockholder to a GmbH under insolvency conditions.[27] Whether or not loans under such circumstances were to be treated as true debt or as equity was a question which heretofore had been dealt with solely by the courts and this introduction of a statutory rule represents an attempt to codify to some extent prior judicial treatment of such loans and to apply uniform standards in this area.

Under these new provisions, a loan to a GmbH by a stockholder, which was effected at a time when sound business principles would have required an injection of equity capital, cannot be asserted as a claim against the GmbH upon its bankruptcy or reorganization.[28] A similar rule applies to

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[20] *Id.* § 57.
[21] *Id.* § 57a.
[22] *Id.* § 9a(1).
[23] *Id.* § 9a(3).
[24] *Id.* § 9a(4).
[25] *Id.* § 57(4).
[26] *Id.* § 9b(2).
[27] *Id.* § 32a, § 32b.
[28] *Id.* § 32a(1).

loans to a GmbH by third parties which are secured or guaranteed by a stockholder. Thus, such a third party can, upon bankruptcy or reorganization of the GmbH, claim repayment of the loan only to the extent that the loan was not covered by the stockholder security or guarantee.[29]

In the case of indebtedness secured or guaranteed by a stockholder, the statute also contains a special rule to the effect that, where a third party loan guaranteed or secured by a stockholder has been repaid within a year prior to commencement of bankruptcy proceedings, then the stockholder securing or guaranteeing such loan must pay over to the GmbH the amount of the repaid loan.[30]

v) Acquisition of Own Shares

The 1980 amendments also effected a change in the rules under which a GmbH may acquire its own capital participations. Thus, the statute provides that, as a general rule, a GmbH may not acquire capital participations which are not fully paid up.[31] For this purpose, receipt of such a participation in pledge is also deemed an acquisition. As to fully paid capital participations, such interests may be acquired by the GmbH only if the acquisition can be effected out of assets which are in excess of the stated capital of the GmbH.[32] Furthermore, such interests can be accepted by a GmbH in pledge only to the extent that the claims secured by such pledge thereof do not exceed assets of the GmbH in excess of its stated capital.[33]

vi) Credit to Managing Directors and Key Employees

The GmbH law never contained any rules relating to the grant of credit to members of the management of a GmbH.[34] The 1980 amendments now provide, however, that managing directors, other legal representatives and certain employees having the power to act for the GmbH may be granted credit by the GmbH, but only to the extent of assets in excess of its stated capital.[35] Any credit granted in violation of such provisions is void and must be immediately repaid, notwithstanding any agreements to the contrary.

II. Incorporation of GmbH by One Person

As indicated above, the 1980 amendments introduced provisions permitting one person to henceforth incorporate a GmbH.[36] Prior to these changes, at least two persons were always required to enter into the Associ-

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[29] *Id.* § 32a(2).
[30] *Id.* § 32b.
[31] *Id.* § 33(1).
[32] *Id.* § 33(2).
[33] *Id.* § 33(2).
[34] E.W. Ercklentz, Jr., Modern German Corporation Law 252 (1979).
[35] GmbHG § 43a.
[36] Id. § 1.

ation Agreement, although, after formation of the GmbH, all of the capital participations could be transferred into the hands of one individual without any adverse consequences.

Since the statute now provides that the Association Agreement can also be executed by only one person, organization of a wholly owned GmbH becomes much simpler. However, where one person organizes a GmbH or where, subsequent to the organization of the GmbH, all of the capital participations revert into the hands of one person within three years of incorporation, the amended statute now provides for a variety of new rules aimed at protecting creditors under such circumstances. Thus, the sole stockholder will henceforth have to make and keep certain administrative records and may have to render certain security to the GmbH.

Thus, for instance, where a GmbH is organized by one person and the entire stated capital is not paid in upon organization, the statute now requires the sole stockholder to provide security for the payment of that portion of stated capital which has not been paid in.[37] It will be recalled that the law permits a GmbH to be organized with only the greater of 25 percent of stated capital or DM 25,000 paid in, wherefore the remainder of the stated capital subscribed to may remain unpaid. Where two or more stockholders organize the GmbH, no security for the unpaid amount is required by law, but where only one person organizes the GmbH, the furnishing of such security is required as a condition to incorporation. This different approach in these two situations recognizes the fact that, in the case of the organization of a GmbH by only one person, the joint and several liability of all incorporators for unpaid subscriptions existing where two or more persons incorporate the GmbH is lacking, wherefore additional security to support the stated capital of the GmbH is deemed necessary.

Moreover, in the event that all of the capital participations are united in the hands of one stockholder within three years of incorporation, the same security provisions will apply and the sole stockholder will have to furnish the GmbH with security for payment of any amount unpaid upon outstanding capital participations.[38] This action must be taken within three months of the acquisition of all capital participations and is designed to prevent circumvention of the rules surrounding original organization by one person.

While there were no previous requirements with respect to the preparation of a written protocol of a stockholder meeting other than in cases involving amendment of the Association Agreement, the 1980 amendments now require a sole stockholder to record in writing, and to subscribe to a protocol as to, all resolutions adopted by him in connection with the internal affairs of the GmbH.[39]

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[37]Id. § 7(2).
[38]Id. § 19(4).
[39]Id. § 48(3).

III. Stockholder Rights to Information

Stockholder information rights were never very highly developed in the old GmbH statute.[40] The new amendments to the statute now specifically require the managing directors to promptly furnish each stockholder upon request information about the affairs of the GmbH and to permit them access to the books and records of the GmbH.[41] The managing directors may deny such information and such access only when they have cause to be concerned that the stockholder will use the information derived thereby for purposes conflicting with the corporate interest and thereby inflict material damage to the GmbH or one of its affiliated companies.[42] Nevertheless, a resolution of the stockholders is required to deny such information or access. The Association Agreement is specifically prohibited from making other arrangements with respect to this statutory right to information.[43] Accordingly, the provisions of the statute now override any voluntary arrangements in this respect which may be found in the Association Agreement.

In the event of a legal dispute as to the right of information and access, the applicable provisions of the stock corporation law apply analogously. Any stockholder who has been denied information or access is entitled to make application to the court for this purpose.[44]

IV. Merger Provisions

Since its original adoption, the GmbH law never contained any provisions relating to merger, consolidation or sale of assets by a GmbH.[45] Prior to January 1, 1981, a GmbH could be merged into another corporate entity in only one way, viz., by means of a merger into an AG pursuant to the stock corporation law. Neither an AG or another GmbH could be merged into a GmbH without going through a cumbersome liquidation and dissolution followed by a transfer of individual assets and liabilities.

In order to fill the gap in this area, the 1980 amendments adopted specific provisions relating to the merger or consolidation of GmbH entities. It should be noted, however, that these new merger provisions did not become part of the GmbH law itself, but were added to a separate statute relating to corporate capital increases from internal sources instead.[46]

As a result of these amendments, a GmbH can now be merged into another GmbH against the issuance of capital participations of the surviving GmbH and two or more GmbH entities can now be consolidated

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[40] E.W. ERCKLENTZ, JR., *supra*, at 318.
[41] GmbHG § 51a(1).
[42] *Id.* § 51a(2).
[43] *Id.* § 51a(3).
[44] *Id.* § 51b.
[45] E.W. ERCKLENTZ, JR., *supra*, at 520.
[46] Law of July 4, 1980, Art. 7; [1980] BGBl I 844 (W. Ger.).

through the formation of a new GmbH into which such entities are consolidated against issuance of capital participations.[47]

A merger of a GmbH requires the affirmative consent of at least 75 percent of the votes cast at a meeting of stockholders and such voting requirement may not be reduced by the Association Agreement.[48] The law also contains a special rule to the effect that, where outstanding capital participations of the surviving GmbH are not fully paid, then the consent of 100 percent of the members of the merging GmbH will have to be obtained, whether or not they appeared at the meeting.[49] After the necessary stockholder approvals have been obtained, the merger instrument is first recorded in the Commercial Register at the seat of the merging GmbH and is thereafter recorded in the Commercial Register at the seat of the surviving GmbH. The assets and liabilities of the merging GmbH are automatically transferred onto the surviving GmbH and the merging GmbH is dissolved upon the recordation of the instrument of merger by the Commercial Register at the domicile of the merging GmbH.[50]

As in the case of the stock corporation law, the law provides for the protection of creditors upon the merger of a GmbH. Thus, if a creditor applies to the GmbH within six months after the publication of the recordation of the merger, the creditor involved must be furnished security for his debt to the extent that payment cannot be demanded.[51]

Similar provisions obtain in the case of a consolidation, in which case the newly formed GmbH is considered the surviving entity, while each consolidating GmbH is considered to be the merging entity.[52]

The merger of an AG into a GmbH has also been made possible by the 1980 amendments.[53] With respect to the required vote on the part of the stockholders of the AG and various other internal matters pertaining to the merging AG, the statute provides that specified sections of the stock corporation law are to apply.[54]

By virtue of the provisions of this new statute, therefore, it is now possible (i) for one GmbH to merge into another, (ii) for two or more GmbH entities to consolidate into a new GmbH, and (iii) for an AG to merge into a GmbH. Since prior to the adoption of this statute, the only merger possibility for a GmbH was its merger into an AG by virtue of provisions of the stock corporation law, this new law thus substantially expands the variety of possible mergers. Nevertheless, the GmbH law as currently constituted still does not contain any rules providing for the sale and transfer of all or substantially all of the assets of a GmbH without liquidation.

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[47]Law of Dec. 23, 1959, [1959] BGBl I 789 (W. Ger.), as amended by Law of July 4, 1980, [1980] BGBl I 836 at 844, Art. 7, § 19(1).

[48]*Id.* § 20(2).

[49]*Id.* § 20(2).

[50]*Id.* § 25(2), § 25(3).

[51]*Id.* § 26(1).

[52]*Id.* § 32(1).

[53]*Id.* § 33(1).

[54]*Id.* § 33(3).