

German News Flash



GERMAN NEWS FLASH

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Corporate

MOMIG IN DETAIL – MAINTENANCE OF SHARE CAPITAL

MoMiG, the act aimed at reforming the over one hundred years old German law on limited liability companies (*GmbHG*), will among others remodel the rules for maintenance of capital within a limited liability company (*GmbH*). The new law – expected to come into force on 1 November 2008 – will remove legal uncertainties related to corporate financing through cash pooling and more distinctively separate insolvency law and corporate law rules.

The present GmbHG prohibits any “payments” (e.g. in form of loans or even grants of securities) from a GmbH to a shareholder that affect the company’s share capital. Regardless of possible counterclaims for repayment, such payments are invalid, if as a result the remaining assets of the company would not cover the share capital. This has led to considerable difficulties and uncertainties particularly in regard to cash pooling, as cash pooling usually implies that a subsidiary transfers its capital funds to the cash pool leader by means of upstream loans. Furthermore, the present legal situation can obstruct the repayment of loans granted by shareholders to the company.

While not challenging the traditional rule in principle, the new law allows for two major exceptions. Firstly, the rule will no longer apply to performances based on a control agreement or profit and loss transfer agreement (*Beherrschungs- oder Ergebnisabführungsvertrag*) as well as other payments backed by a recoverable counterclaim. >>



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Secondly, the general rule will not be applicable to loans granted by shareholders or economically equivalent acts of shareholders. MoMiG thus introduces a strictly balance sheet-oriented approach: If a claim is recoverable and can therefore be booked by its nominal value, or if a claim arises within the framework of a cash pool agreement, the corresponding payment by the subsidiary will be valid irrespective of any consequences for the share capital. Furthermore, MoMiG redefines the rules on shareholders' loans. According to the new approach, the relevant body of law will be insolvency rather than corporate law. The reasoning is that the shareholders' right to claim redemption of the loan will only become a serious issue, if a company becomes insolvent. In summary, MoMiG will introduce some promising reforms to capital maintenance law in order to meet current challenges and to correct some undesired tendencies resulting from recent court rulings. Therefore, the changes of capital maintenance law will contribute to the general objective of turning the GmbH into an internationally competitive form of company.

MOMIG IN DETAIL – MODIFICATION OF THE LAW ON “CONCEALED CONTRIBUTIONS IN KIND”

MoMiG will also clarify the rules governing concealed contributions in kind (*verdeckte Sacheinlagen*) by a shareholder of a GmbH and thereby eliminate the considerable legal uncertainty in this field of law. A contribution in kind may be on hand if the shareholder and the GmbH formally agree on a contribution in cash, but the company – from an economic perspective – actually receives a tangible asset from the shareholder. The courts have developed complicated and severe rules regarding contributions in kind, which in the end – commonly when the company has become insolvent – often result in the shareholder having to make his contribution twice. According to the new law, concealed contributions in kind may constitute valid performance of a shareholder's obligation towards the company. The value of his contribution in kind is automatically deducted from the company's claim for capital contribution. The uncertainty as to the precise definition of a concealed contribution in kind will thus be mitigated by means of an automatic set-off. However, the shareholder bears the burden of proof regarding the fact that the value of the transferred asset equals the amount owed as cash contribution. If he is not able to prove this, he must pay the difference in cash.





Corporate

EUROPEAN COMMISSION PRESENTS DRAFT STATUTE FOR A EUROPEAN PRIVATE COMPANY

The European Commission has presented a draft statute for a European Private Company (*SPE – Societas Privata Europaea*). The SPE is a limited liability company designed to address the obligations involved in crossborder operations and the setting up of different company forms in various member states, which are particularly onerous on small and medium-sized enterprises. By ensuring that companies can be set up in the same form and with the same management structure in any member state, entrepreneurs are to be put in a position where they save time and money on legal advice, management and administration.

According to the draft, an SPE is allowed to have its registered office and its headquarters in different member states. It will also be possible for the SPE to transfer its registered office to another member state without affecting the company's legal personality. The statute shall cover those matters which are essential to the corporate life of the SPE, whereas other matters – particularly matters of labour law, tax law, accounting and insolvency law – shall be governed by the national law of the member state in which the SPE has its registered office.

In order to facilitate business start-ups, the minimum registered capital of an SPE is only 1 Euro. This concept is similar to the English limited company, but new for countries like Germany and Sweden where a higher minimum legal capital has traditionally been required for the purpose of creditor protection. However, the draft statute also provides for certain rules protecting the company's creditors, particularly by stipulating that any kind of distribution of the company's assets to the shareholders (e.g. payment of dividend, purchase of the company's own shares) can only be made if

the remaining assets fully cover its liabilities. Furthermore, the proposal contains rules protecting minority shareholders and rules on employees' participation in the SPE.

The draft statute will now be submitted to the European Parliament and Council of Ministers. According to the wording of the draft, the statute is planned to come into effect in all member states on 1 July 2010.

FEDERAL COURT OF JUSTICE RULES ON GERMAN COMPANIES' OBLIGATION TO UPDATE ITS REGISTERED OFFICE

According to a recent judgment by the Federal Court of Justice (*Bundesgerichtshof*) the registration of a German limited liability company (*GmbH*) is threatened to be cancelled when the company's actual domicile is no longer identical with its registered office.

A German limited liability company is legally required to determine its domicile in its articles of association. The purpose of this obligation is to ensure that creditors as well as public authorities can trace the company, e.g. when asserting claims or when serving official orders. If the factual and statutory domiciles diverge, the company's articles of association are deemed to be infringed. As confirmed by the Federal Court of Justice, this infringement can lead to the cancellation of the company's registration, regardless of whether the actual domicile was subsequently relocated or whether the company's domicile was different from its registered office from the beginning.

Banking & Finance

DRAFT LAW ON FOREIGN INVESTMENTS IN GERMANY

In August 2008 the German Cabinet adopted a draft law that – if passed by parliament – would allow the Ministry of Economics and Technology (MET) to examine and at worst forbid purchases of stakes of 25 % or more in German companies by buyers from outside the EU or the EFTA territory. Although the draft is linked to a discussion about the fear of a supposedly growing influence of sovereign wealth funds on the German economy, it would not be limited to this specific group of investors. The law is furthermore not limited to specific sectors. Nevertheless, it would apply only to a very restricted number of cases, namely situations in which the public order or safety is in significant danger. If the MET believes that this could be the case, it must take the initiative to review the acquisition within three months after conclusion of the contract or the publication of a tender. After having received from the purchaser all documents necessary to examine the matter, the authorities then have another month to decide on any measures, including a veto on the transaction. In order to avoid this period of legal uncertainty in a case that is likely to fall under the purview of the law, a purchaser can make an application to the MET requesting clearance of the deal in advance.

The minister in charge, Mr. Glos, has stressed that the law will not be relevant for the vast majority of foreign investments in Germany, as these do not touch the public order or security interests protected by the law. Nevertheless, concern has been voiced in particular by business federations that this kind of law sends wrong signals to foreign investors and may violate EU regulations on the free movement of capital and the freedom of establishment. The EU Commission is currently assessing whether the draft complies with EU principles and with the EU's international obligations. Mr. Glos nevertheless believes that the draft will be passed by parliament and the law will thus come into effect by January 2009.

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NEW LAW ON VENTURE CAPITAL INVESTMENTS

On 19 August 2008 new regulations for venture capital have come into effect in Germany. They introduce incentives that are supposed to encourage investments in young and medium-sized companies. The Venture Capital Investment Act (*Wagniskapitalbeteiligungsgesetz*), which is based on the broader Law on the Modernisation of the Legal Framework for Financial Investments (*Gesetz zur Modernisierung der Rahmenbedingungen für Kapitalbeteiligungen*), has for this purpose introduced the so-called “venture capital company” that benefits in particular from special tax breaks.

Privileges for investors are the central element of the new legislation. Especially by means of tax benefits, the legislator aims at promoting more private capital investments in young and medium-sized companies. A venture capital company is classified as non-trading (*vermögensverwaltend*) for tax law purposes and therefore exempted from trade tax, if it exclusively holds shares of target companies as defined in the Venture Capital Investment Act and is organised as a partnership (*Personengesellschaft*). The new law also reduces restrictions on loss deductions (*Verlustabzug*) that would usually apply: Irrespective of a change of control in target companies, under certain conditions current losses and loss carry forwards (*Verlustvorträge*) remain deductible. Finally, the new law increases tax allowances for business angels.

Venture capital companies must be formally recognised as such by the Federal Financial Supervisory Agency (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) in order to enjoy the described privileges. The venture capital company may be organised either as a partnership or a limited company. It has to have its seat in Germany and must be operated by at least two professionally qualified managers. The company's capital contribution respectively share capital has to amount to a minimum of EUR 1 million. The venture capital investments have to aggregate to at least 70 % of the assets managed by the company. The target companies must have their seat within the European Economic Area and may not be older than 10 years or listed at a stock exchange; in addition, their shareholders' equity may not exceed EUR 20 million.

In order to contain the risks immanent to venture capital investments, the law establishes certain restrictions: A venture capital company may only invest a maximum of 40 % of the assets it manages in a single target. The minimum tranche of an investment is fixed at EUR 25,000 in order to deter small investors from risky investments. In consideration of the purpose of the law, an investment loses its quality of a venture capital investment after the target has existed for more than 15 years or been listed for more than 3 years at a stock exchange.

The new law focuses on the early stages of private equity financing. It thus falls short of the originally contemplated, more comprehensive “Private Equity Act” that would have covered a broader scope of private equity investments, which many commentators of the law find unfortunate. Nevertheless, it is a ground-breaking first step towards an attractive and internationally competitive set of investment rules in the private equity sector.



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