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Rolf Sethe

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§5.01 INTRODUCTION

[A] Survey of Corporate Forms

[1] Corporations, Partnerships and Mixed Forms

The aim of this chapter is not to describe the law of associations in general, but to concentrate on business associations. They occur in two different types: corporations and partnerships. German business law provides for three forms of corporations: the stock company (*Aktiengesellschaft* – AG), the public limited partnership by shares (*Kommanditgesellschaft auf Aktien* – KGaA), and the limited liability company (*Gesellschaft mit beschränkter Haftung* – GmbH). In practice, the limited liability company is predominant. In 2016, there were 1,186,598 limited liability companies, 15,453 stock companies and 293 public limited partnerships by shares in Germany. Since 2008 the law provides for the entrepreneurial company (*Unternehmergesellschaft (haftungsbeschränkt) – UG (haftungsbeschränkt)*) which is a subtype of a limited liability company with a share capital that falls short of the regular minimum share capital. The German legislator wanted to establish a domestic alternative to the rising number of incoming British limited liability companies founded with £1. In 2016, there were 115,644 UG and 8,891 UG & Co. KG in Germany.

Civil law and commercial law provide for five forms of partnerships: the partnership under the Civil Code (*BGB-Gesellschaft*), the non-trading partnership under the Partnership Act 1994 (*Partnerschaftsgesellschaft*), the general partnership (*offene Handelsgesellschaft* – OHG), the limited partnership (*Kommanditgesellschaft* – KG) and the “dormant” partnership (*stille Gesellschaft*). In 2016, there were about 24,215 general partnerships and 257,681 limited partnerships (including GmbH & Co KG).

Other types of associations such as the incorporated association (*eingetragener Verein*), the “unincorporated” association (*nicht eingetragener Verein*), the foundation under the Civil Code (*Stiftung*), the shipping company (*Reederei*) and the registered cooperative (*Genossenschaft*), are not covered here because they are of little or no practical importance to business. As the scope of this article is limited to German law, supranational business associations (e.g., Societas Europaea, European Economic Interest Grouping) are excluded as well.

Finally, it should be noted that under German company law, there are no general restrictions on mixing corporate forms. On the one hand, shareholders may give the company an individual structure which differs more or less from the respective form’s standard legal model. On the other hand, mixed corporate forms may emerge from mixing basic types by means of one company’s participation in another. The most common example is that of the limited liability company & Co. (GmbH & Co. KG): it is a limited partnership (KG) in which a limited liability company (GmbH) participates as the sole personally liable partner. However, a vast amount of court decisions have turned the GmbH & Co. KG almost into a business association in its own right. The same considerations apply *mutatis mutandis* respectively to the UG and the UG & Co. KG.

[2] The Characteristics of Corporations and Partnerships

Both corporations and partnerships may acquire rights and obligations and can sue or can be sued. But in contrast to corporations, partnerships only have partial legal personality. A consequence of the legal personality of corporations is that the corporation itself is the owner of its assets, whereas a partnership is not able to own assets: all assets belong to the partners in joint ownership (*Gesamthandsgemeinschaft*, § 719 BGB). The principle of joint ownership means that two or more persons hold property not in distinct shares but jointly, each having an identical interest in the undivided whole. An asset may be transferred only with the consent of all partners, which can be given either in the partnership contract (e.g., by authorizing the management to make such transactions) or in a general meeting of the partners.

A corporation's credit is the fixed share capital, whereas partnerships do not have fixed amounts of capital (with the exception of the limited partnership, *see infra* §5.03[C][2]). Instead, the partners are personally, jointly and severally liable to the partnership's creditors for any debts of the partnership to the full extent of their private assets. All business associations have a contractual basis to complement the statutory law and to adapt it to the needs of the partners and the members of the corporation respectively. Even the one-person limited liability company (*Ein-Personen-GmbH*) or the one-person stock company (*Ein-Personen-AG*) is deemed to be based on a contract.

The agreement of incorporation for corporations is called "memorandum of association" (*Satzung*). It is the fundamental document, which contains not only the constitution and powers of the company but also the necessary internal regulations, such as the amount of capital or the number of directors. Thus, German law does not differentiate between "memorandum of association" and "articles of association." It provides for one document only. However, separate contractual agreements among groups of shareholders or all shareholders (e.g., agreements binding the parties in the exercise of their membership rights) are often used.

The partnership agreement and the memorandum of association of a limited liability company are by and large governed by the principle of freedom of contract. In contrast, the law of stock corporations leaves little room for the individual structuring of a corporation (*cf.* § 23 V AktG).

[B] The Law of Capital Markets

In industrialized countries' legal systems, corporate law is generally closely linked with the law of capital markets (securities regulation). In Germany, only stock corporations and limited partnerships by shares may list shares (equity) to the country's regulated capital markets whereas all business associations may list bonds (*Anleihen*) or profit participation certificates (*Genussscheine*).

Until the 1990s, capital market law in Germany had not only been practically restricted to stock exchange law but, at the same time, had lacked any consistent regulatory model. In part, this may be attributed to the fact that capital markets themselves were underdeveloped for many decades. Beginning in the 1950s and in

Germany's post-war economy, private savings, if any, were put into low-risk investments. Accordingly, corporate finance was obtained either by self-financing or by borrowing capital.

In the mid-1960s it became obvious that industrial growth without the development of a capital market system of corporate finance was not feasible. At the same time, holders of large amounts of capital were looking for investments offering better returns than those from savings accounts. However, such a market was not generated by the stock corporation. Instead, investors were attracted by new types of investments offered by companies neither organized as stock corporations nor subject to any existing capital market regulation. This led to the birth of the "grey" capital market, which was not subject to statutory regulation. The "grey" market was governed by some judge-made law providing only a minimum of investor protection. This was partly achieved by adapting company law applicable to the investment company to capital market needs, and partly by creating pre-contractual obligations of those participating in the distribution of investments (especially by introducing special disclosure requirements and a quasi-contractual liability regime).

Both competing national and international financial markets as well as the implementation of EU company, banking and capital market harmonization directives in German law have led to a modernization of the country's regulated capital market. Simultaneously, the efforts to live up to international standards of securities regulation have introduced into Germany's capital market laws a variety of legal norms, thereby not only affecting the stock companies' behavior in capital markets but also the companies' organization. This is most obvious with respect to the Securities Trading Act (*Wertpapierhandelsgesetz 1993*) that, *inter alia*, provided for increased disclosure obligations for listed stock companies, such as intermediate (accounting) and immediate disclosure requirements (ad hoc publicity), obligations to report and disclose directors' dealings and major investments or disinvestments in the capital stock of a listed company. The modernization of capital market law is also visible in the imposition of an obligation to publish a prospectus for securities, which are offered to the German public for the first time (*Wertpapier-Verkaufsprospektgesetz 1990*). In order to regulate the "grey" market in 2004 a similar obligation was imposed on the public distribution of any securities other than shares that grant a participation in the profits of a business association or of fiduciary assets. In addition, since 2012 investment advisors and investment brokers of "grey" market's products have to be registered and to abide by investor protection obligations when selling such products. In 2002, the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) came into force. It provides for special procedural rules and disclosure obligations during takeover bids as well as for a mandatory bid if the bidder has gained control of the target company (i.e., 30% of the voting rights). During the last decade a growing part of the national capital market legislation has been substituted by EU regulations that are self-executing (*cf.* Article 288 II TFEU) such as the Market Abuse Regulation EU No. 596/2014 and the Prospectus Regulation (EU) No. 2017/1129.

§5.02 CORPORATIONS

[A] The Stock Company

[1] The Two Types of Stock Companies and the Applicable Law

The Stock Company Act of 1965 (*Aktiengesetz* – AktG), as amended on May 10, 2016, is the legal basis for the stock company and the public limited partnership by shares (*see infra* §5.02[B]). The AktG has been amended several times since 1965, mainly to implement the EU company law harmonization directives. However, the principal objectives of the amendments between 1994 and 2016 were deregulation and modernization: Several sections that had proved to be inadequate or too onerous for small companies were simplified, the notional no-par-value share was introduced and a Corporate Governance Codex was adopted. The administration of a listed stock company is required to declare to what extent the company observes the Codex and, where necessary, to explain why the company does not comply with certain provisions of the Codex (§ 161 AktG). Listed stock companies that fall within the scope of Co-determination Acts (*see infra* §5.02[D]) must meet a gender ratio of at least 30% of each sex in the supervisory board (§ 96 II, III AktG). Stock companies that are either listed or co-determined are under the obligation to take all necessary measures to reach such a ratio within the board of directors, among the top executives who support the board of directors and within the supervisory board (§§ 76 IV, 111 V AktG) by defining a target quota to be reached within the following five years.

In matters not specifically addressed by the AktG, the laws generally applicable to associations also apply to stock companies. For example, §§ 238 et seq. of the Commercial Code of 1897 (*Handelsgesetzbuch* – HGB) provide for most of the regulations relating to commercial records and accounting requirements. Also, pursuant to § 31 BGB, stock companies are vicariously liable for any wrongful acts of their directors and other senior members of management. In addition, a company can be held liable for its employees' misconduct under the general rules of the Civil Code (§§ 278, 831 BGB).

[2] The Legal Nature of the Stock Company

The stock company (*Aktiengesellschaft*) is a corporation with a fixed capital stock (§§ 6, 7 AktG) divided into transferable shares (§ 1 II AktG). Shareholders are not personally liable for the company's obligations (§§ 1 I 2, 54 I AktG). The stock company, a legal person pursuant to § 1 I 1 of the AktG, has an incorporated organization. Regardless of the actual purpose of the enterprise, the stock company is always deemed to be a commercial company (§ 3 I AktG). Consequently, all provisions of the HGB dealing with merchants apply (§ 6 HGB), even if the company serves a non-profit purpose.

[3] The Incorporation of the Stock Company

The stock company becomes a legal entity upon registration in the commercial register (§ 41 I 1 AktG). To qualify for registration, five requirements have to be fulfilled:

(i) The memorandum of association is drawn up by one (or more) founder(s) in notarized form (§§ 2, 23 I AktG). Section 23 II-IV AktG sets out minimum content requirements for the document. Further stipulations are possible, but may only differ from the AktG if the law explicitly allows for deviations (§ 23 V AktG). Because such exceptions are rare, German stock company law is rather strict in comparison with other legal systems.

(ii) The founders have to subscribe for all shares (§§ 2, 28, 29 AktG) and pay in the amount of capital that is determined in the memorandum of association. Section 36a I AktG requires the company to call up at least 25% of the issue price of a share and the entire premium, where shares are issued for an amount higher than the nominal value. A shareholder may not set off a contribution and the company may not waive the obligation to pay the shares (§ 66 I AktG) or to repay a contribution (§ 66 II AktG). Contributions in kind must be verified by independent auditors to determine whether they are equal to the amount stated in the memorandum (§§ 27, 33 III-V, 34, 35 AktG). Section 33a AktG provides for an exception with regard to certain financial instruments or assets with a market value. Such contributions must be fully performed (§ 36a II AktG).

(iii) The founders elect the first auditors and the supervisory board (*Aufsichtsrat*, § 30 I-III AktG) which in turn appoints the board of directors (*Vorstand*, § 30 IV AktG). The founders, the supervisory board, the board of directors, and the first auditors are subject to special civil and criminal liability rules in all respects relating to the correct incorporation of the company (§§ 46 et seq. AktG).

(iv) The founders deliver a written incorporation report that the supervisory board and the board of directors check as to whether all conditions for proper incorporation have been met (§§ 32 et seq. AktG). In special cases, e.g., if one of the founders is a member of the supervisory board, the court must appoint independent auditors to verify the report.

(v) The founders, the supervisory board and the board of directors apply to the local commercial register for registration and submit all data and documents specified in § 37 IV AktG. The registrar verifies whether the above-mentioned conditions have been met. If this is not the case, the application for registration is rejected (§ 38 AktG). Otherwise the court registers the company in the commercial register, Section B. Registration contains the name and purpose of the company, its registered office (which has to be in Germany, *cf.* § 5 AktG), the date of the memorandum of association (including the date of subsequent changes), the nominal stock capital and the signatures of the directors (§ 39 AktG). The content of the commercial register is deemed to be correct with regard to third parties acting in good

> faith (§ 15 I, III HGB). The registration is effective immediately. Once registered, a court may declare the incorporation void only on grounds of severe errors (§§ 262 I no. 5, 275 AktG).

A company may operate to a limited extent even before its registration. However, in that case, persons acting on behalf of the company are jointly and severally liable for the obligations and debts incurred prior to the incorporation (§ 41 I AktG).

[4] Shares

The shareholder's right of membership is incorporated in the share. The shareholder acquires membership in the company either as a founder, by subscribing for shares, or by a transfer or transmission of shares subsequent to the incorporation.

In addition to conferring membership, shares carry a second function. They represent a part of the total share capital of the company. According to § 7 AktG, the minimum share capital (*Grundkapital*) is €50,000. It is divided either into shares with a nominal value or in no-par-value shares (proportional shares). The minimum value of a share with a nominal value or of a proportion of a no-par-value share is €1 (§ 8 II, III AktG).

The third function of a share is its use as a security. Membership in the company is represented by a written document (share certificate) that can be transferred within or outside the stock market. Bearer shares, issued only after full payment of the contribution (§ 10 II AktG), are transferred by agreement and delivery of the certificates (§ 929 BGB), whereas registered shares are transferred by agreement, endorsement of the certificates and delivery (§ 68 AktG; §§ 12, 13 Wechselgesetz). The memorandum may require the company's consent to a transfer of a registered share (§ 68 II AktG: *vinkulierte Namensaktie*), to be granted by the board of directors.

In order to prevent money laundering a company may only issue bearer shares if a transfer of ownership leaves a paper trail. Therefore bearer shares are only permitted for listed stock companies or for companies that register their shares in a central securities depository (§ 10 II AktG).

The memorandum may provide for different classes of shares. The most common use of this option is to create preferred shares (*Vorzugsaktien*) without voting rights (§§ 12 I 2, 139 et seq. AktG).

[5] Capital Increase and Other Forms of Financing the Company

As previously stated (*see supra* §5.02[A][3]), the amount of share capital has to be determined in the memorandum of association. The share capital may be increased according to business fluctuations. Capital increases may take four different forms: capital increase against contributions (*Kapitalerhöhung gegen Einlagen*), conditional capital increase (*Bedingte Kapitalerhöhung*), authorized capital (*Genehmigtes Kapital*) and capital increase from the company's funds (*Kapitalerhöhung aus Gesellschaftsmitteln*).

[a] The Capital Increase Against Contributions

A capital increase against contributions requires a special resolution of the general meeting of shareholders (*Hauptversammlung*) by a qualified majority of at least three-fourth of the share capital represented at the meeting. The memorandum of association may require a larger or a smaller majority (§ 182 I 1, 2 AktG). If different classes of shares were issued, a majority of each class of shareholders has to consent (§ 182 II AktG). If contributions in kind are made, the principles described for the incorporation apply (§ 183 AktG). A capital increase against contributions may only be performed by the issue of new shares, not by an increase of the nominal value of already existing shares or the proportion of no-par-value shares (§ 182 I 4 AktG). The board of directors and the chairman of the supervisory board apply for entry of the resolution in the commercial register; if contributions in kind are made, an auditor's report on the contributions must be attached (§ 184 I AktG), unless the exception with regard to certain financial instruments or assets with a market value applies (§§ 183a, 33a AktG). Subsequently, the subscription for new shares takes place. The pay-in conditions correspond to those prescribed for incorporation (*see supra* §5.02[A][3]). The board of directors and the chairman of the supervisory board certify the fulfillment of these conditions to the commercial register (§ 188 AktG).

A share capital increase is valid and takes legal effect as soon as it has been registered (§ 189 AktG). The new shares may then be issued (§ 191 AktG). To protect the proportionate interests of shareholders, the AktG provides for pre-emptive rights (*Bezugsrecht*), i.e., new shares must first be offered to existing shareholders in proportion to their shareholdings (§ 186 AktG). The offer must be published and must then remain open for at least fourteen days (§ 186 I AktG). Pre-emptive rights may be wholly or partly excluded by a special resolution of the general meeting (§ 186 III AktG). The exclusion has to be expressly announced in the agenda of the general meeting deciding on the issue. Moreover, the board of directors has to deliver a written report setting forth the grounds for the exclusion. A shareholder doubting that the resolution is based on reasonable grounds can contest the resolution in court and may obtain a judgment declaring it void.

In practice, indirect forms of subscription and pre-emptive rights are common. To effect the increase of capital, all shares are subscribed for and paid in by a bank or a consortium of banks with an obligation to offer the shares to the existing shareholders before selling them on the open market (§ 186 V AktG).

[b] The Conditional Capital Increase

A second form of capital increase is the conditional capital increase (§§ 192 et seq. AktG). It is permitted only to grant a conversion to the owners of convertible bonds (*Wandelschuldverschreibungen*), to prepare the merger or acquisition of several enterprises, and to grant pre-emptive rights to employees or options to board members of the company or affiliated companies (§ 192 II AktG). All other pre-conditions resemble those just explained with respect to a capital increase against contributions. The share capital increase takes effect as soon as the new shares are issued (§ 200 AktG). The board of directors annually reports to the commercial register the amount of shares issued throughout the financial year (§ 201 AktG).

[c] The Authorized Capital

The third form of capital increase is the authorized capital (§§ 202 et seq. AktG). The board of directors may be authorized for a maximum period of five years (starting from the day of the registration of the resolution in the commercial register) to issue a certain amount of new shares against contributions. The authorization may be granted either in the memorandum of association or by a subsequent amendment to it, requiring a special resolution of the general meeting of shareholders by a qualified majority of at least three-fourth of the share capital represented at the meeting. The memorandum may prescribe a higher majority (§ 202 II AktG). Each different class of shares needs the consent of the required majority (§§ 202 II, 182 II AktG). The board of directors may decide to use the authorization wholly or in part. It may issue the new shares only with the consent of the supervisory board (§ 202 III AktG). The issue of new shares is performed in the same manner as in the case of a capital increase against contributions (*see supra* §5.02[A][5][a]).

[d] The Capital Increase from the Company's Funds

The fourth form of capital increase is called capital increase from the company's funds (§§ 207 et seq. AktG). The general meeting of shareholders may convert all or part of the "share premium account" (i.e., capital-surplus) or the "revaluation reserve" (i.e., retained-earnings) into share capital. A special resolution is required according to the modes described above. The conversion must not exceed 10% of the previously existing capital stock; a higher percentage is only permissible if the memorandum of association so provides (§ 208 I AktG). Such a capital increase must be based on a properly audited and certified balance sheet of recent date (§§ 208, 209 AktG). The share capital increase is effective as soon as it has been registered (§ 211 AktG). The new shares may then be issued (§ 191 AktG). Each shareholder has a mandatory pre-emptive right on the new shares of his or her class of shares (§ 212 AktG).

[e] Convertible Bonds, Debentures and Participating Bonds

With the approval by a special resolution of the general assembly, the company may issue convertible bonds, debentures and participating bonds (§ 221 AktG). In contrast, ordinary credit financing without the issuing of securities requires only a decision of the board of directors. It does not require the consent of the general meeting.

[6] The Capital Reduction

[a] Legal Basis

The amount of share capital fixed in the memorandum may be reduced. However, it may not be dropped below the minimum stock capital of €50,000 unless it is combined with a parallel capital increase against contributions in cash (§ 228 I AktG).

A capital reduction may serve several different purposes: High losses leading to a balance deficit may require the company to reduce its share capital; by adjusting the capital figures to the actual level of assets, financial soundness is restored. Further objectives may be the distribution of committed assets of the company among the shareholders or the establishment of a free reserve.

Capital reductions may take one of three different forms: ordinary capital reduction, simplified capital reduction, and capital reduction by redemption of shares. The ordinary capital reduction and the capital reduction by redemption of shares may serve all three purposes described above, whereas the simplified capital reduction is available only for the restoration of financial soundness or the establishment of a free reserve (§ 229 I AktG). All forms of capital reduction require a special resolution of the general meeting of shareholders by a qualified majority of at least three-fourth of the share capital represented. The memorandum may prescribe a higher majority and/or further requirements (§§ 222 I, 229 III, 237 II AktG). The purpose of the reduction must be stated in the resolution.

[b] The Ordinary Capital Reduction

The ordinary capital reduction is effected by a reduction of the total share capital and – in the case of a company having shares with a nominal value – by a reduction of the nominal value of the shares. This is not possible where the nominal value of shares is already set at the legal minimum of €1. A capital reduction would then take the form of a consolidation of shares (§ 222 IV AktG). The ordinary capital reduction is effective as soon as it has been registered (§ 224 AktG). The company must secure payment to all creditors who cannot demand immediate consideration of their claims, on the condition that they apply for the security within six months after registration of the reduction. Payments to shareholders may only be made after the expiry of this six months period (§ 225 AktG).

[c] The Simplified Capital Reduction

The simplified capital reduction may only be executed to compensate for a deterioration of the value of assets, to cover losses or to transfer value into the capital reserve. Thus, it is only permissible if certain other (reserve) funds have been used to cover the losses (§ 229 II AktG). The procedure for a simplified capital reduction resembles, for the most part, that of an ordinary capital reduction with one exception: as previously stated, assets remain untouched and payments to shareholders are forbidden (§ 230

AktG). Creditors are therefore less endangered. Their interests are properly secured by a limitation of the distribution of dividends to shareholders (§ 233 AktG).

[d] The Capital Reduction by Redemption of Shares

In contrast to other forms of reduction, which concern all shareholders, the capital reduction by redemption of shares is a cancellation of the rights of individual shareholders. A capital reduction by redemption of shares can be executed in two ways: either by redemption subsequent to the company's purchase of shares or by compulsory redemption. The latter is only permissible if it is provided for in the original memorandum of association or a subsequent amendment thereof. The rules governing ordinary capital reductions are applicable in general, but the requirements for, and the method of, execution of the redemption must be set down either in the memorandum or in a special resolution (§ 237 II AktG).

[7] Membership and Minority Protection

The legal position of the shareholders may be looked at from two different perspectives: on the one hand, a shareholder has property rights, on the other hand, he or she has administrative rights.

[a] Property Rights

Shareholders have a right to dividends (§ 58 IV AktG), pre-emptive rights (*see supra* §5.02[A][5][a]) and a right to participate in the distribution of assets after liquidation of the company (§ 271 AktG).

[b] Administrative Rights

Shareholders have individual administrative rights. The most important of these is the right to vote (§§ 12 I, 134 AktG), which is exercised in the general meeting of shareholders. A shareholder may be represented by the use of a written proxy (§ 134 III AktG). It is a special feature of German stock company and capital market law not to encourage proxy contests. As a corollary, a large percentage of voting rights in publicly-held companies are exercised on the basis of a proxy voting power for deposited shares held by banks (*Depotstimmrecht*) (§ 135 AktG), whereas proxy voting using shareholder associations is less common. Since most shareholder-depositors refrain from instructing the depositary on how to exercise the voting rights, banks often have a significant influence on the company.

The right to vote implies the right to attend the general meeting (§ 118 I AktG) or, if the memorandum provides for, not to attend the meeting but to exercise the shareholder rights by electronic means. It also requires adequate information as a solid basis for decisions. Complementing a variety of ordinary and extraordinary disclosure and reporting obligations, the board of directors has a special duty to inform shareholders, upon request, about all matters concerning the company, its interests and its policy (§ 131 I, II AktG). Only in certain specific cases (§ 131 III AktG) may the board of directors refuse to inform the shareholder, e.g., in order to avoid damage to the company. Lastly, the shareholder has the right to contest the validity of a resolution of the general meeting (§ 245 AktG), e.g., on grounds of violation of the law or of the memorandum of association (§ 243 AktG).

In addition to these individual rights, shareholders have collective administrative rights in the form of minority rights. A minority representing 5% of the share capital (or a lesser percentage if the memorandum provides for) may request a general meeting (§ 122 I AktG). Similarly, a minority representing 5% of the share capital or €500,000 par value may request that additional items be put on the agenda of the general meeting (§ 122 II AktG). The same minority may also, under certain circumstances, contest the validity of a resolution not to declare a dividend in order to retain profits (§ 254 II AktG) or request the court to order a special examination of an impermissible undervaluation (§ 258 AktG). Some other minority rights are worth mentioning: a company may waive or restrict its damage claims against founders (§ 50 AktG), members of the board of directors (§ 93 IV AktG), or the supervisory board (§ 116 AktG) for breach of duties, unless a minority of shareholders representing 10% of the share capital opposes the resolution. Such a minority may also request that the company enforces its damage claims (§ 147 AktG). A separate discharge of each member of the board of directors or of the supervisory board can be requested by a minority representing €1 million par value or 10% of the share capital (§ 120 I AktG). The same minority may seek the removal of a member of the supervisory board who was not elected but appointed according to a special provision in the memorandum of association (§ 103 III AktG). A minority of 5% or €500,000 par value may, under certain circumstances, petition the court to replace the annual auditor (§ 318 III HGB). A minority of 1% or €100,000 par value can ask for the judicial appointment of special auditors (§ 142 II AktG).

[c] The Shareholders' Duties and Liabilities

Original shareholders are obligated to pay in their contributions (*see supra* §5.02[A][3]). Shareholders are not personally liable to creditors of the company (§ 54 I AktG). However, shareholders who received unlawful payments by the company are required to reimburse such amount; creditors may claim this amount directly from the shareholder if the company is not able or willing to meet its obligations (§ 62 AktG).

Like any other member of the company, a shareholder is liable for any damages if, by taking advantage of his influence upon the company, he intentionally induces a member of the board of directors or of the supervisory board to act to the detriment of the company or its shareholders (§ 117 AktG). In exceptional cases an individual shareholder may be liable for the debts of the company. The courts have pierced the corporate veil (*Durchgriffshaftung*) if an obvious undercapitalization works to the disadvantage of creditors, and if the company's and the shareholders' private assets have been commingled.

[8] The Administration

The stock company has three required organs: the general meeting (*Hauptversammlung*), the supervisory board (*Aufsichtsrat*), and the board of directors (*Vorstand*).

[a] The General Meeting of the Shareholders

The general meeting is the assembly of all shareholders. It has to be called at least once a year (§ 175 I AktG). In addition, it must be convened in cases provided for either by the memorandum of association or by law, e.g., if a minority so demands (*see supra* §5.02[A][7][b]) or when it becomes necessary for the welfare of the company (§ 121 I AktG).

The general meeting's competence is not comprehensive but limited to questions assigned to it by law or by the memorandum of association, such as the election of the members of the supervisory board and the auditors (§ 119 I no. 1, no. 7 AktG), the appropriation of accumulated earnings (§§ 119 I no. 2, 174 AktG), the discharge of the members of the board of directors and of the supervisory board members (§§ 119 I no. 3, 120 AktG), the appointment of annual auditors (§ 119 I no. 4 AktG), the amendment to the memorandum of association (§§ 119 I no. 5, 179 et seq. AktG), changes in the capital basis (§ 119 I no. 6, *see supra* §5.02[A][5]), certain decisions relating to the law of "affiliated companies" (§§ 291 et seq. AktG), conversions and fusions (i.e., amalgamations and mergers as regulated by the Law Regulating the Conversion of Companies – *Umwandlungsgesetz* – of 1994), the total transfer of assets (§ 179a I AktG), and the dissolution of the company (§§ 119 I no. 8, 262 I no. 2 AktG).

At the time of writing this chapter, the general meeting of a stock company does not have the competence to decide on the remuneration of the board of directors or the supervisory board (so-called say on pay); nor is any decision of the shareholders, should the topic be on the agenda, binding (*cf.* § 120 IV AktG). § 120 IV AktG will be modified when the "EU-Directive 2017/828 of 17 May 2017 as regards the encouragement of long-term shareholder engagement" will be implemented into German law (expected for summer 2019).

[b] The Supervisory Board

The supervisory board is an independent organ elected by the general meeting for a maximum period of four years (§ 102 AktG). If provided in the memorandum of association, some members of the supervisory board may be appointed by certain shareholders (§ 101 II AktG). The board consists of at least three members. The memorandum may set a higher number. The maximum number is determined in relation to the amount of share capital (§ 95 AktG). A company with a share capital of more than €10 million may have a supervisory board of twenty-one members (there are special requirements for companies falling within the scope of the Co-determination Acts, *see infra* §5.02[D]). Only natural persons with full legal capacity may become board members. The memorandum may prescribe additional personal requirements such as age, nationality or special professional qualifications (§ 100 IV AktG). The accumulation of memberships in supervisory boards of different companies is limited to ten (§ 100 II no. 1 AktG). Certain overlaps in capacity are prohibited. Thus, for example, a person serving on the board of directors of a subsidiary company may not be a member of the supervisory board of the parent company (§ 100 II no. 2 AktG).

The supervisory board appoints and supervises the board of directors. Supervision extends to all activities of the board of directors and pertains to both the legality and the commercial soundness of these activities. In order to ensure proper supervision, the board of directors must report regularly on its activities (at least four times a year, § 90 AktG). If necessary, the board of directors must inform the chairman of the supervisory board of any important developments in the company or its subsidiaries. The supervisory board may call a general meeting if the welfare of the company requires it (§ 111 III AktG). In addition, the board must give its consent before certain decisions can be taken (§ 111 IV 2 AktG).

[c] The Board of Directors

The company's management and representative organ is the board of directors. Its members are elected by the supervisory board. The board of directors may consist of one or more persons (§ 76 II AktG). A company with a share capital of more than €3 million must have at least two directors, unless the memorandum of association provides otherwise. Only natural persons with full legal capacity may be board members (§ 76 III AktG). Persons convicted of certain offenses (e.g., in relation to bankruptcy) may not be appointed (§ 76 III AktG). The appointment is for a maximum period of five years (§ 84 I AktG) and is renewable. The same applies to the employment contract between the appointed persons and the company. It is one of the subject matters of such a contract to fix the remuneration and other terms of employment of board members. The law provides for special stipulations concerning the financial compensation of directors, such as salaries, profit-sharing, expense allowances, retirement, and pension plans (*cf.* § 87 AktG). The supervisory board may dismiss a member of the board of directors for cause (§ 84 III AktG), e.g., following a vote of no confidence of shareholders at a general meeting.

The management of the company is the sole responsibility of the board (§ 76 I AktG). As a corollary, the board is not subject to any instructions from the general meeting (§ 119 II AktG). It represents the company in and out of court (§ 78 I AktG). The powers of the board to represent the company with regard to third parties are unlimited and may not be limited through special provisions of the memorandum. The *ultra-vires* doctrine does not apply in Germany.

In contrast, the internal powers of the board may be limited by the declared purpose of the company, the memorandum of association, the supervisory board and by certain resolutions of the general meeting. The most important limitation is that the memorandum or the supervisory board may require certain decisions or transactions to be undertaken only with the consent of the supervisory board (§ 111 IV AktG). In addition, members of the board of directors have fiduciary duties toward the company that may limit the board's internal competence.

When managing the corporation, board members must apply the care of a diligent and prudent manager (§ 93 I AktG). Members of the board of directors who fail to fulfill their duties are jointly and severally liable for any damages caused to the company (§ 93 II, III AktG). The supervisory board enforces such a claim, but under certain conditions creditors have this right as well (§ 93 V AktG).

[9] The Law of Affiliated Companies

[a] Structure of the German Law of Affiliated Companies

Sections 291 et seq. AktG regulate affiliated companies by establishing a system of responsibilities and liabilities for the controlling company. This system is built on the definitions of "dependency" (*Abhängigkeit*, §§ 15, 17 AktG) of one company on another and of the group of companies (§§ 15, 18 AktG), the dependent company being under the unitary management of the controlling company. The law of affiliated companies provides primarily for the protection of creditors and of minority shareholders of the dependent company. The law covers two forms of control: control on the basis of an agreement between two companies (§§ 291 et seq. AktG – *Vertragskonzern* or "contractual group"), and control based on the *de facto* exercise of management power without such an agreement (§§ 311 et seq. AktG – *faktischer Konzern* or "*de facto* group").

[b] Contractual Groups

In cases of control on the basis of an agreement, the controlling company is entitled to give instructions to the board of directors of the dependent company (§ 308 I AktG). In turn, the board of directors of the dependent company is authorized to follow those instructions, even if they work to the disadvantage of their own company (§ 308 II AktG). While the agreement gives the dominating firm the right to place the dependent firm under its management, the directors of the controlling enterprise are liable for any damages caused to the affiliated company as a result of their instructions (§§ 308, 309 II AktG). The controlling company is liable for any annual deficit of the affiliated company (§ 302 AktG).

In addition to the obligations and liabilities of the members of the board of directors, the interests of minority shareholders are taken into account through heightened requirements as to the conclusion, amendment or termination of a contract of domination or a contract to transfer profits (§§ 293–299 AktG). If such agreements are concluded, outside shareholders have the option, guaranteed by an appropriate recurring compensation payment, to remain in the company (§ 304 AktG) or to leave it with an adequate indemnity for the takeover (§ 305 AktG). Because of the disadvantages for minority shareholders of the controlling company arising from these obligations, § 293 II AktG requires the consent of the shareholders' meeting of the dominating company for the conclusion of such an agreement.

[c] De facto Groups

When drafting the Stock Company Act of 1965, it was the legislature's intention to prohibit all other forms of active control of another company. The draft therefore required that the exercise of group management power is permissible only after the conclusion of a contract of domination. Yet, it turned out to be impossible to reach this goal and to ban the non-contractual exercise of management power in a group. Instead, the law provided for strict liability of the *de facto* dominating company. However, this regulation demonstrates all the problems arising from compromises diluting the original legislative concept.

The law provides that the dependent company must not be subject to instructions or measures that would have a disadvantageous effect on the dependent company (§ 311 I AktG), unless it is compensated immediately or at the end of the fiscal year (§ 311 II AktG). If the disadvantage is not compensated by the controlling company, the dependent company and its shareholders are entitled to claim damages from the controlling company and its management (§ 317 AktG). In order not to make this system of compensation ineffective right from the outset, the law provides for increased disclosure and verification of dependency relationships: the dependent company's board of directors must deliver a report on the relationships with affiliated companies (§§ 312 et seq. AktG – *Abhängigkeitsbericht*). If the disadvantageous measures are not indicated in the report, the dependent company's board of directors is liable to the company as well as to its shareholders for any damages caused (§ 318 AktG).

It is doubtful whether the legislature did succeed in putting the dependent company in the same position as if it were independent. Thus, the legal arrangements for *de facto* groups in stock corporation law are widely regarded as being in need of reform.

[10] Dissolution and Liquidation

Section 262 AktG lists the causes of a dissolution of the company: the expiration of the period determined in the memorandum of association, a special resolution of the general meeting of shareholders by a qualified majority of at least three-fourth of the share capital represented at the meeting, the opening of bankruptcy proceedings and a final court decision declaring the memorandum of association unlawful (§ 399 FamFG). On request of a competent agency of the federal state in which the corporation has its seat, a court may dissolve a company if it endangers public welfare (§ 396 AktG). In case of a total lack of funds, certain public authorities (e.g., the tax office) may request that the court dissolve the company (§ 394 FamFG). The dissolution has to be entered into the commercial register (§ 263 AktG).

Following the dissolution, liquidation takes place unless bankruptcy proceedings have already been initiated. Usually, the directors are appointed liquidators. They complete current transactions, collect outstanding claims, liquidate the assets and settle the company's liabilities. The liquidators give public notice of the dissolution and request creditors to register their claims against the company (§ 267 AktG). One year after the public announcement of the liquidation, the liquidators may distribute the remaining assets to the shareholders in proportion to no-par-value shares to the capital stock or – in the case of shares with a nominal value – in proportion to the par value of their shares (§ 272 I AktG). The company is terminated and loses its legal capacity when the liquidators have distributed all assets and have reported this fact to the commercial register (§§ 273 AktG, 6 II, 31 II HGB).

[B] The Public Limited Partnership by Shares

The public limited partnership by shares (*Kommanditgesellschaft auf Aktien* – KGaA) is a combination of a limited partnership (*Kommanditgesellschaft*, – KG) and a stock company (§ 278 AktG). Like the stock company, it is a corporation with a fixed capital stock divided into transferable shares. In contrast to the stock company, however, there are two groups of members: the general partners (*Komplementäre*) and the shareholders (*Kommanditaktionäre*). The general partners have the power to direct the company's business. At the same time they are subject to unlimited liability towards creditors of the company, whereas the shareholders are not personally liable for the company's debts (§§ 278 III, 1, 54 I AktG). This legal model can be altered. The courts have recognized the possibility that a corporation may participate as a general partner (GmbH & Co. KGaA or AG & Co. KGaA).

Section 278 II AktG provides that the law of general partnerships (§§ 105 et seq. HGB) applies to the general partners, including their rights and duties with regard to shareholders (*see infra* §5.03[C][2]). All other matters (e.g., the rights and duties of the shareholders) are regulated in the same manner as for stock companies (§ 278 III AktG). Because the public limited partnership by shares is rarely used in practice, this survey of the law of business associations omits a more detailed description of it.

[C] The Limited Liability Company

[1] Introduction

[a] The Applicable Law

The limited liability company or private limited company (*Gesellschaft mit beschränkter Haftung*) is governed by the Limited Liability Company Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* – GmbHG) of April 20, 1892, as amended on July 17, 2017. The limited liability company is a German invention without any precedent in history. The objective was to fill a gap between the existing types of associations, the stock company on the one hand and the partnership on the other hand. Other countries have adopted this model and enacted laws similar to the German provisions. The Limited Liability Company Act does not regulate all questions that arise in connection with the limited liability company. Some rules can also be found in the Stock Company Act or the Commercial Code. Since the limited liability company is a commercial association within the meaning of the Commercial Code (§§ 13 III GmbHG, 6 HGB), its rules referring to commercial associations apply to the limited liability company as well. Beyond that, other statutory provisions affect the law of the limited liability company, especially the Law Regulating the Conversion of Companies (*Umwandlungsgesetz* of 1994) and the several Co-determination Acts (*see infra* §5.02[D]).

The statutory law of *Gesellschaften mit beschränkter Haftung* has not changed much throughout the last century. Apart from several small reforms to the GmbHG which were enacted to implement EU directives into German, law the first major amendment was the Act of July 4, 1980, which came into force on January 1, 1981. The Amendment of 1980 increased the minimum share capital from DM 20,000 to DM 50,000. It allowed the incorporation of limited liability companies by a single shareholder ("One-person GmbH"; § 1 GmbHG). Last but not least, it adapted statutory law to judge-made law by introducing special rules for the preservation of share capital (§§ 32a, 32b GmbHG). The second major amendment was the Act of October 23, 2008 (MoMiG). Among other things, it allows the drawing up of a memorandum of association without a notarized form if certain requirements are fulfilled and provides for the establishment of the Unternehmergesellschaft (haftungsbeschränkt) (*see supra* §5.01[A][1]) which is a sub-type of the GmbH. The Act modified the case law regarding the circumvention of the rules on contributions in kind. It introduced the possibility of a bona fide acquisition of a share and allowed cash pooling. The above mentioned §§ 32a, 32b GmbHG and the managing director's insolvency filing obligation were transferred from the GmbHG into to the insolvency act.

The internal organization of the GmbH may, to a large extent, be structured as to suit the particular needs of its shareholders. However, the courts, being more flexible than the legislature in adapting the law to practical experience, have developed several doctrines to limit both the freedom to form the articles and the exercise of rights conferred on individual shareholders by the memorandum of association. As in general corporate law, jurisprudence and scholarship have taken the leading role in the further development of the law of the limited liability company.

[b] Some Characteristics of the GmbH

There is no statutory definition of the limited liability company. However, it can be defined as a company with legal capacity and a capital stock to which one or more shareholders contribute without being personally liable for the company's debts.

The formation of a limited liability company, including the contribution to the capital stock subscribed to by its shareholders, is less formalistic than that of a stock company. The same applies to the internal organizational structure of the GmbH. The company has only two legally required organs, i.e., the "meeting of shareholders" (*Gesellschafterversammlung*) and managing director(s) (*Geschäftsführer*). If not required by the Co-determination Acts (*see infra* §5.02[D]), the establishment of a supervisory board is not mandatory. From the outset, the GmbH may be formed as a one-person limited liability company.

Since the limited liability company is a legal entity, only the company's assets are available to satisfy its creditors (§ 13 II GmbHG). Another characteristic of the GmbH is its flexible structure: although it is neither a smaller version of the stock company nor a special case of a partnership, the memorandum of association may be shaped in a fashion that makes the limited liability company resemble either of these two models. Nevertheless, the statutory law of the limited liability company is guided by the concept of a personally structured corporation, i.e., a company based on the shareholders' close association with the common enterprise.

The procedure for joining and leaving the limited liability company resembles the law of partnerships more closely than the law of the stock company. However, contrary to the membership rights in a partnership, the shares of a GmbH are *ipso iure* transferable and inheritable (§ 15 I GmbHG), unless provided otherwise in the company's memorandum of association. Yet, in order to restrict the negotiability of limited liability shares, the transfer of such shares must be in notarized form (§ 15 III, IV GmbHG). Thus, a GmbH is not a corporate legal form suited to invite members of the public to subscribe to its shares. Accordingly, the GmbH has no access to the public capital markets (unless it issues debentures or bonds).

The limited liability company must have a minimum capital stock of €25,000 (§ 5 I GmbHG). However, only €12,500 have to be paid in prior to the company's registration; if the company is founded as a one-person-company, the founder has to provide security for any cash subscription not entirely paid in (§ 7 II GmbHG). To assure the contribution and preservation of the committed capital, the GmbHG provides a broad range of safeguards such as prohibitions against release, deferment and set-off (§ 19 II GmbHG) and safeguarding rules on contributions in kind (§§ 5 IV, 7 III, 19 IV, V GmbHG).

The law provides for the Unternehmergesellschaft (haftungsbeschränkt) [UG (haftungsbeschränkt)], if the founders want to establish a corporation with a smaller amount of minimum capital (§ 5a GmbHG). It suffices if the UG holds capital ranging between €1 and €24,999. If the capital is increased to €25,000 the UG is converted *ipso iure* into a GmbH (§ 5a V GmbHG). In order to protect creditors, contributions in kind are forbidden and the UG has to transfer 25% of the net income of a year to the capital reserve. This reserve may only be used to cover losses or to carry out a capital increase from the company's funds (*Kapitalerhöhung aus Gesellschaftsmitteln*) which is the usual way to convert the UG into a GmbH. Apart from these peculiarities, all other provisions of the GmbHG apply to the UG.

The limited liability company and the UG can be established for any legitimate purpose, commercial or otherwise. However, enterprises in special branches of business, e.g., banks and insurance companies, may not be organized as limited liability companies or a UG. Whatever purpose the GmbH or UG pursue, they are always considered a commercial enterprise (*Handelsgesellschaft*) within the meaning of the Commercial Code (§§ 13 III GmbHG, 6 HGB).

[c] Appearance and Significance

Since the introduction of the limited liability company, the number of corporations organized as GmbHs has grown steadily. Today, the limited liability company is the most widely used corporate form in Germany (*see supra* §5.01[A][1]). Due to its flexible structure, the GmbH serves the purposes of small or medium-sized corporations and family-held companies as well as those of big business enterprises (e.g., Robert Bosch GmbH).

The limited liability company and the UG are frequently used in combination with a commercial partnership in the form of a so-called "GmbH & Co. KG" resp. "UG & Co. KG." This kind of company is a limited partnership in which a limited liability company rather than a natural person occupies the position of the general partner. Since the limited liability company is liable for the debts of the partnership, the "GmbH & Co. KG" and the "UG & Co. KG" are, as a matter of fact, partnerships with limited liability. The shareholders of the GmbH/of the UG and the special partners in the limited partnership are usually the same persons. A large number of limited liability companies and UG are organized as one-person companies. About one third of all limited liability companies are dominated by another corporation.

[2] The Incorporation of the Limited Liability Company

[a] Overview

The incorporation of a limited liability company is governed by statutory law. It requires a contract (memorandum of association) between the founders in notarized form (§ 2 I GmbHG). The notarized form is dispensable if there are fewer than four founders and only one managing director and if the founders use the standardized memorandum of association provided for by the law (§ 2 Ia GmbHG). The capital must be fully subscribed upon formation of the company. Once at least one quarter of each share has been paid and further capital requirements have been met (§ 7 II GmbHG), the managing directors can apply for registration in the commercial register (§ 7 I GmbHG). Upon registration, the limited liability company acquires legal personality (*cf.* § 11 I GmbHG).

[b] The Founders

The limited liability company may be formed by one or more founders. The founders and the subsequent shareholders may be natural or legal persons. Even general partnerships, limited partnerships or partnerships under the Civil Code can be founders. In contrast to many other countries, there is no limitation on the number of shareholders in Germany.

[c] *Contents of the Memorandum of Association and Its Amendments*

The memorandum of association (*Gesellschaftsvertrag*) must state at least the company's firm name and registered office, the objectives of the enterprise, the amount of the share capital and the amount of each shareholder's contribution as well as any other obligation put upon the shareholders (§ 3 GmbHG):

- The company's firm name may either indicate the company's purpose or the name of a shareholder or any imaginative term or a combination of these variants. It must have a distinctive character and must not be misleading or confusing (§§ 18, 30 HGB). Moreover, it has to be clear that the name used is the name of the company, not of a sole trader. If a limited liability company succeeds the business of a sole trader or a partnership, the previous name can be taken over. In any case, the name must include the addition "with limited liability" ("*mit beschränkter Haftung*") or the abbreviation "GmbH" as a warning to creditors of the limit upon shareholders' liability (§ 4 GmbHG). The same applies *mutatis mutandis* to the UG ("*haftungsbeschränkt*") (§ 5a I GmbHG). A German subsidiary of a foreign company may comprise the name of the foreign parent company and the words "*Deutsche*" or other reference to Germany.
- The registered office must be determined in the memorandum of association. A change of the registered office within Germany is effected by an amendment to the memorandum of association and its entry in the commercial register.
- The share capital (*Stammkapital*) amounts to at least €25,000 (§ 5 I GmbHG). There is no limit on the maximum amount. The important function of the share capital is that of a liability basis in order to protect creditors. The level of share capital can be altered only by the strict procedure of an amendment to the memorandum of association.

The company's internal organization as well as the shareholders' rights and duties may be structured by the shareholders in the memorandum. In practice, the memorandum usually sets out supplementary and detailed rules referring to shareholders' accessory rights and obligations (e.g., the right to benefits in kind, purchase rights or non-competition clauses), the obligation to make an additional contribution, representation and management of the company, shareholders' meetings and resolutions, preference rights of individual shareholders, the transfer of shares, the distribution of net profits and a supervisory or advisory board.

An amendment to the memorandum of association requires a special resolution of the shareholders' meeting by a qualified majority of at least three-fourth of the share capital represented at the meeting (§ 53 I GmbHG). Amendments to the memorandum of association must be notarized (§ 53 II GmbHG) and registered in the commercial register (§ 54 GmbHG).

[d] The Share Capital Contributions

There are strict rules to ensure that the limited liability company obtains the required share capital (§§ 7, 9, 19 GmbHG). Each founder subscribes to one or more shares on which a capital contributions has to be submitted (§ 14 GmbHG). The sum of the share capital contributions must correspond to the amount of the initial share capital (§ 5 III 2 GmbHG).

Shareholders' contributions may be paid in cash (*Bargründung*) or be made in kind (*Sachgründung*). A shareholder may not set off a contribution (§ 19 II 2 GmbHG). The company may not waive a shareholder's obligation to contribute (§ 19 II 1 GmbHG).

Transferable assets may constitute payments in kind (e.g., land, buildings, know-how, business, patents, copyrights or trademarks). If subscriptions are paid in kind, stricter provisions apply. The memorandum of association must clearly specify the items to be contributed by the shareholder and state their value. The founders have to produce a report (*Sachgründungsbericht*) in which they substantiate whether the value of contributions is equivalent to the amount stated in the memorandum. If a business is transferred as payment, the balance sheets of its last two financial years must be added to the report (§ 5 IV GmbHG). If the value of the consideration in kind is less than the value stated in the memorandum, the respective shareholder is liable to pay the difference (§ 9 GmbHG).

[e] The Application for Registration

In order to apply for registration, the entire share capital must be subscribed to by the founders. At least 25% of the nominal value of each share capital contribution in cash must be paid in; contributions in kind must be submitted in full (§ 7 III GmbHG). In the aggregate, the contributed share capital must amount to at least €12,500 (§ 7 II GmbHG). Managing directors must be elected by a resolution of the founders, unless they are already appointed by the memorandum of association (§ 6 III 2 GmbHG).

Managers have to submit the application for registration and certain documents (e.g., the memorandum of association, the signatures of the managing directors and their power of representation, a list of shareholders and their subscriptions, a domestic address of the company) to the commercial register (§ 8 GmbHG). The registrar ensures that the application for registration complies with statutory provisions (§ 9c GmbHG). He or she verifies the admissibility of the company's name by requesting that the Chamber of Industry and Commerce (*Industrie- und Handelskammer*) reviews the proposed name (§§ 6, 18 HGB, 380 FamFG). The registrar examines, in particular, the memorandum of association, the directors' appointment and the properly effected minimum capitalization. In the case of contributions in kind, the registrar reviews the valuation of these subscriptions.

[f] Defective Incorporation

Once registered, a court may declare the incorporation void only on grounds of grave error (§ 75 GmbHG), e.g., if the articles of association do not contain any provisions regarding the amount of the share capital or regarding the object of the company, or if the provisions set out in the articles of association on the object of the company are null and void.

[g] The Pre-incorporation Status of the GmbH

There are several steps on the way to incorporation of a limited liability company. Prior to the conclusion of the memorandum of association, the potential founders form either a partnership under the Civil Code or a general partnership (*Vorgründungsgesellschaft*), depending on whether or not the intended company will run a commercial business as defined by §§ 1–3 of the Commercial Code (*Handelsgesetzbuch* – HGB). The partners are personally liable for the debts incurred during this period.

For the period between the adoption of the memorandum of association and the registration in the commercial register, the limited liability company is called "pre-incorporation company" (*Vorgesellschaft*). The legal nature of this *Vorgesellschaft* is a particular form of partnership. Its objective is to obtain the registration of the limited liability company. Thus, the rules of the limited liability company apply to this partnership as long as these rules do not require legal personality. However, persons acting on behalf of the company before registration are personally, jointly and severally, liable to creditors (§ 11 II GmbHG). In addition, the founders are liable to the full extent of their subscribed shares. The rights and obligations of the pre-incorporation company pass on to the limited liability company by universal succession. Hence, the liability of persons acting for the *Vorgesellschaft* ends upon registration. Consequently, the liability of founders and the liability under § 11 II GmbHG are of importance only in cases where an incorporation is ultimately not obtained.

In addition to these rules, there are special provisions for the protection of creditors and of the public, such as the liability of founders in cases of a breach of their duties (*cf.* § 9a GmbHG).

[3] Shares

[a] Shares Versus Share Capital Contributions

When describing the legal position of the shareholders, the GmbHG uses two slightly different terms: "share" (*Geschäftsanteil*) means the sum of the rights and duties inherent in the position of a shareholder; it represents the membership in the company. For each share the member must submit a "share capital contribution" (*Stammeinlage*) (§ 14 GmbHG).

Rights and obligations are determined, first, by the memorandum of association and, second, by statutory law. Statutory law does not provide for a share certificate or a share register, but the individual shareholder may obtain a share certificate. This certificate is merely a documentary proof. It is not a security and thus not transferable as such.

As previously described (*see supra* §5.02[A][7][a]) with regard to the stock company, there are two kinds of rights inherent in a share: property rights (e.g., right to dividend, § 29 GmbHG) and administrative rights (e.g., voting rights in the shareholders' meeting as well as information and minority rights, §§ 48, 51a, 51b GmbHG). Beyond these statutory rights, the memorandum of association may allocate preferred shares as long as these shares comply with statutory law. Preferred shares carry preferential rights, e.g., the right to receive a fixed rate of dividend or a preferential dividend (§ 29 III 2 GmbHG), the right to appoint one or all managing directors or members of an optional supervisory board, the right to be appointed as managing director or a priority for the repayment of capital in the event of winding-up. The preferential rights attached to preferred shares must be distinguished from special privileges granted to shareholders individually.

[b] The Transfer of Shares

Shares (but not share certificates) are transferable and inheritable (§ 15 I GmbHG). German civil law distinguishes between the actual contract transferring the property in the share and the underlying contract creating the obligation to do so. Thus two contracts are necessary for the proper and effective transfer of shares. Both need to be notarized (§ 15 III, IV GmbHG). Upon completion of the transfer, the title to the share and the rights and duties connected to it pass to the transferee. § 16 III 1 GmbHG provides for the possibility of a bona fide acquisition of a share if the transferor is (wrongfully) registered in the list of shareholders; the true owner can only raise a limited number of objections (§ 16 III 2–4 GmbHG).

In practice, the memorandum of association often provides that the transfer must be approved by a certain shareholder or at the shareholders' meeting (§ 15 V GmbHG). It is also permitted to exclude the right to transfer the shares. The memorandum of association may provide for a right of first refusal in favor of existing shareholders or may define standards for the qualification of potential shareholders. Thus, it is possible to control the shareholders' composition and in so doing so to stabilize the influence of a family or group of founders on the company. After any transfer or amendment of a share, the managing directors must file a list of all shareholders and the amount of their shares with the commercial register (§ 40 GmbHG).

[4] Share Capital Maintenance, Capital Increase and Capital Reduction

[a] Share Capital Maintenance

The provisions to guarantee the payment of the share capital contributions (§§ 7, 9, 19 GmbHG) are complemented by provisions to ensure the maintenance of the share capital and by provisions to protect creditors (*principle of the effective maintenance of* *the share capital*). The company may neither repay a share capital contribution nor distribute the company's assets to the shareholders (§ 30 I GmbHG), if such a payment or distribution endangers the amount of share capital fixed in the memorandum of association. Shareholders receiving payments contrary to § 30 GmbHG in bad faith are required to refund the amount (§ 31 I GmbHG). In the event that a refund cannot be obtained, all shareholders are liable in proportion to their shares (§ 31 III GmbHG). Loans given to a company instead of equity capital are considered to be subordinated loans in the case of a bankruptcy of the company (§ 39 I no. 5, IV, V InsO).

Pursuant to § 33 GmbHG, the limited liability company may acquire its own shares only if the entire contributions have been paid in and if the payment to purchase the shares does not endanger the amount of the share capital or the capital reserve.

[b] The Capital Increase of Share Capital Against Contributions

The share capital can be increased only by an amendment to the memorandum of association and allotment of new shares to each existing shareholder and/or new shareholders (§ 55 II GmbHG). The statutory law on capital increase (§§ 55 et seq. GmbHG) generally refers to the rules of the incorporation (*see supra* §5.02[C][2][c] and §5.02[C][4][a]). To preserve the ownership structure of companies, new shares must first be offered to existing shareholders in proportion to the nominal value of their share capital (pre-emptive right or *Bezugsrecht*). Pre-emption rights may (similar to the provisions of the stock company, *see supra* §5.02[A][5][a]) be wholly or partly excluded by a special resolution of the shareholders' meeting. A share capital increase is valid and takes legal effect as soon as it has been registered (§ 57 GmbHG).

[c] The Capital Increase from the Company's Funds

By special resolution, the shareholders' meeting may convert (parts of) the "share premium account" (i.e., capital surplus) or the "revaluation reserve" (i.e., retained earnings) into share capital (§§ 57c et seq. GmbHG). Such capital increase must be based on a properly audited and certified recent balance sheet of recent date (§§ 57e, 57f GmbHG). The share capital increase is effective as soon as it has been registered (§ 54 III GmbHG). Each shareholder has a mandatory pre-emptive right to the new shares (§ 57j GmbHG).

[d] Reduction of Share Capital

The amount of share capital fixed in the memorandum may be reduced. However, it may not fall below the minimum stock capital of €25,000, unless it is combined with a parallel capital increase against contributions in cash (§ 58a IV GmbHG). The reduction of capital is effected by an amendment to the memorandum of association. Capital reduction may take two different forms, the ordinary capital reduction (§ 58 GmbHG) and the simplified capital reduction (§§ 58a et seq. GmbHG):

The ordinary capital reduction may serve the purposes of restoration of financial soundness, the distribution of committed assets of the company among the shareholders, or the establishment of a free reserve. The managing directors must publicly announce the capital reduction. Creditors opposing the capital reduction can demand immediate payment of their claims or apply for a security respectively. One year after the public announcement, the managing directors apply to the local commercial register for registration of the reduction and have to affirm that the rights of all creditors opposing the capital reduction have been met. The capital reduction is effective as soon as it has been registered (§ 54 III GmbHG).

In contrast to the ordinary capital reduction, the simplified capital reduction is allowed for the restoration of financial soundness only (§ 58a GmbHG) or for the establishment of a free capital reserve, so long as it does not exceed 10% of the share capital (§ 58b II GmbHG). It is only permissible if certain other (reserve) funds have been used to cover losses (§ 58a II GmbHG). The procedure for a simplified capital reduction resembles, for the most part, that of an ordinary capital reduction but with one important exception: as previously stated, assets remain untouched and payments to shareholders are forbidden (§ 58b GmbHG). Creditors are thus less endangered and may not apply for a security.

[5] The Membership

The shareholder acquires membership in the company either as a founder, by subscribing to a share, or by a transfer or acquisition of shares subsequent to the incorporation (e.g., purchase or devolution by inheritance). In the case of a transfer or acquisition of shares subsequent to the incorporation, the new shareholder may only exercise the relevant rights if he or she was previously registered in the list of shareholders transmitted to the commercial register (§§ 16 I 1, 40 GmbHG) or if this registration is made immediately after the exercise of the right (§ 16 I 2 GmbHG). Transferee and transferor are jointly and severally liable for any overdue contributions at the time of notification (§ 16 II GmbHG).

In the event of the death of a shareholder, the heir or the heirs are entitled to the share of the deceased shareholder. If several heirs inherit the share, it belongs to them in joint ownership until partition occurs according to the last will of the deceased or to statutory provisions.

The memorandum of association may provide for the redemption of shares (*Einziehung* or *Amortisation*) by shareholders' resolution (§ 34 GmbHG). Compulsory redemption requires that the provisions in the memorandum of association precisely stipulate the conditions for the redemption. Its effect is that the redeemed share accrues to the remaining shareholders. The memorandum of association usually provides that a withdrawing shareholder (or his heir or heirs) receives a lump-sum payment corresponding to the value of the share at the moment of his withdrawal.

Although the GmbHG only mentions redemption as a cause for termination of the membership, case law and scholars hold that a shareholder may terminate his or her membership for cause, e.g., a shareholder is not bound to tolerate neither a total change of the company's objectives nor a takeover of the company by another enterprise without his or her consent. In practice, memoranda of association often stipulate that a shareholder may terminate his or her membership without cause.

[6] The Administration of the Company

The statutory organs of the company are the managing director(s) and the meeting of shareholders. The extent of the organs' power depends on the memorandum of association.

[a] Management

The company must have one or more managing directors. In contrast to the general partnership or the limited partnership, managing directors do not need to be shareholders of the company (§ 6 III GmbHG). Only natural persons with full legal capacity can be appointed (§ 6 II 1 GmbHG). Persons convicted of certain offenses (e.g., in relation to bankruptcy) may not be appointed (§ 6 II 2 GmbHG). In practice, most managing directors of limited liability companies are shareholders rather than third parties. The managing directors jointly represent the company in and out of court (§ 35 I 1 GmbHG). The law provides that the directors manage the business jointly (*Gesamtvertretung)*, but the memorandum of association may grant managing directors the right to act alone (*Einzelvertretung*) (§ 35 II 1 GmbHG). Shareholders can impose internal restrictions on the ability to act on behalf of the company (§ 37 I GmbHG). However, such limitations are not effective against third parties (§ 37 II GmbHG).

Managing directors are obligated to ensure that proper accounting records are kept (§ 41 GmbHG) and they have to submit the financial statements to the shareholders' meeting (§ 42a GmbHG). They are required to call a shareholders' meeting at least once a year. Furthermore, they must provide information on the company's affairs to shareholders. In the case of bankruptcy, managing directors are required to file a petition for the commencement of bankruptcy proceedings (§ 15a InsO).

Managing directors are nominated by the memorandum of association (§ 6 III 2 GmbHG) or appointed by a resolution passed in the shareholders' meeting (§§ 6 III 2, 46 no. 5 GmbHG). The memorandum of association may set out special requirements with regard to the appointment of managing directors (e.g., additional standards regarding the qualifications of managing directors, age limits). If the company has a supervisory board pursuant to the Co-determination Acts (*see infra* §5.02[D]), it is that board that is responsible for the appointment of the management.

Unless otherwise provided in the memorandum, managing directors are subject to instructions from the shareholders' meeting (§ 37 I GmbHG). Thus, a majority of shareholders can determine the business of the company. Therefore the limited liability company is considered the most appropriate corporate legal form of a subsidiary.

As previously stated, there are two legal relationships between the company and the managing directors: first, a corporate law relationship through their appointment or dismissal and, second, a relationship governed by labor law in relation to their employment contracts. The dismissal of a managing director requires a resolution of the shareholders' meeting (§§ 38 I, 46 no. 5 GmbHG). In practice, the memorandum of association often provides that managing directors may only be dismissed for good and sufficient cause (§ 38 II GmbHG).

Managing directors are responsible to the company for the diligent performance of their duties and are liable for any damages caused (§ 43 GmbHG), unless they acted upon instruction of the shareholders' meeting. Managing directors have fiduciary duties toward the company. Thus, for example, they are forbidden to divert corporate business opportunities for their personal benefit.

Managing directors are liable to third parties only in specific circumstances: first, during the pre-incorporation period; second, in cases of general tort liability for negligence and fraud; and third, in cases in which they breach certain duties associated with the negotiation and conclusion of a contract between the company and third parties (pre-contractual liability or *culpa in contrahendo*).

Recently, courts decided several cases on the issue of general liability of directors for tax fraud and similar misconduct under criminal law. These courts held that such personal liability does apply to directors in the exercise of their functions. Thus, the corporate veil does not protect managers in criminal or tax law proceedings.

Apart from the managing directors, other officers (especially agents within the meaning of the Commercial Code) may be entitled to act on the company's behalf.

[b] Shareholders' Meeting

By statutory law, the shareholders' meeting is the most important organ. It must be called by the management at least once a year. When calling it, at least one week's written notice must be given (§ 51 I GmbHG). As pointed out previously (*see supra* §5.02[C][6][a]), the shareholders' meeting appoints, supervises, and dismisses the managing directors (§ 46 no. 5 GmbHG). It decides on amendments to the memorandum of association (§ 53 GmbHG), on the approval of annual financial statements, and on the distribution of profits (§ 46 no. 1 GmbHG).

The resolutions need to be passed by a majority of votes cast unless the memorandum of association provides otherwise (§ 47 I GmbHG). Decisions on the basic legal structure or on the purpose of the company, on an amendment to the memorandum of association, on a capital increase or reduction, on an amalgamation or a merger, on a conversion into a stock company or a public limited partnership by shares (regulated by the Conversion Act 1994) and on the dissolution of the company have to be passed by a qualified majority of three quarters of the votes (§§ 53, 60 I no. 2 GmbHG).

The shareholders' resolutions do not need to be notarized, unless the resolution alters the memorandum of association (§ 53 II GmbHG). It is possible to assent to certain decisions by written agreements outside the shareholders' meeting (§ 48 II GmbHG). In the case of a one-person GmbH, resolutions are passed by drawing up and signing minutes (§ 48 III GmbHG).

Each Euro of a share entitles a shareholder to one vote (§ 47 II GmbHG), unless otherwise provided in the memorandum of association (e.g., multiple voting rights). Shareholders may not vote in the resolution on their own discharge from a liability claim or on legal transactions relating to them (§ 47 IV GmbHG). A shareholder may be represented at the meeting by use of a proxy in text form (§ 47 III GmbHG).

There are no specific statutory provisions relating to errors and defects in shareholders' resolutions. The prevailing opinion is that the provisions of §§ 241 et seq. AktG should apply *mutatis mutandis*. Thus, every opposing shareholder may contest the resolution in court, in order to obtain a judgment declaring it void or invalid.

[c] Supervision of the Management by Supervisory or Advisory Boards

There is no statutory obligation for a GmbH to set up a supervisory board (*Aufsichtsrat*), unless the Co-determination Acts apply (*see infra* §5.02[D]). In the latter case, the supervisory board of a limited liability company has the same authority as the supervisory board of a stock company.

Nonetheless, a company may establish a supervisory board by a specific provision to this effect in the memorandum of association. In case of an optional supervisory board, the law governing stock companies applies *mutatis mutandis* (§ 52 GmbHG).

Another possibility is the creation of an advisory board (*Beirat*). The shareholders are free to decide which functions are given to this board. In practice, advisory boards can be found particularly in family companies where members come from different branches of the family.

[7] Liability of the Company and the Shareholders

From the creditor's perspective, the most important question is who is liable for debts? The company as a legal entity? Its managing directors, or its shareholders? The concept of a corporate veil implies that in principle, only the assets of the company are available to satisfy claims of company's creditors. Once the limited liability company is registered in the commercial register, shareholders are not personally liable for the company's debts (§ 13 II GmbHG). However, there are some exceptions to this rule:

- If a shareholder fails to pay in his or her entire subscription and it cannot be recovered from him or her, then the remaining shareholders are liable for the difference (§ 24 GmbHG).
- The shareholders have to put up additional capital if the memorandum of association so provides (§§ 26 et seq. GmbHG).
- A shareholder-manager may be personally liable to creditors who would not have entered in a contract with the company if a petition in bankruptcy would have been filed in due time (§ 823 II BGB or § 64 GmbHG).
- According to case law, the shareholders may be personally liable if they act *contra bonos mores*, thereby depriving the company of the assets necessary to repay its debts and causing its insolvency (*existenzvernichtender Eingriff*).

- In case of severe abuse of the corporate veil, i.e., commingling of private and company assets or obvious undercapitalization, courts will “pierce” the corporate veil and hold a shareholder personally liable (*Durchgriffshaftung*). The same applies to cases in which the dominant shareholder has exercised his/her management power over a GmbH in an abusive way to the detriment of the company’s capital.
- Based on the principle of *culpa in contrahendo* (“pre-contractual liability”), a shareholder-manager is liable to a company’s creditor if he or she, while acting for the company, has personally obtained and betrayed the creditors’ trust by false representations.
- Finally, the courts have held that a shareholder-manager may be held personally liable if he or she failed to prevent damage to third parties while internally organizing the company.

[8] Accounting

The provisions of the Commercial Code (§§ 264 et seq. HGB) about annual financial reporting are applicable to the limited liability company as well. Managing directors draw up the annual balance sheet (*Bilanz*), the statement of revenues and losses (*Gewinn- und Verlustrechnung*) and the annual report (*Anhang*) of the company. They must submit properly audited and certified accounts and the annual report to the shareholders without undue delay (§ 42a GmbHG). If the limited liability company is a “small corporation” within the meaning of § 267 HGB, there is no obligation to get the annual financial statements audited by an independent certified public accountant (§ 316 I HGB); the annual financial statements have to be published according to the §§ 325 et seq. HGB). Shareholders adopt the annual financial statements (§ 46 no. 1 GmbHG) and decide about the distribution of profits.

[9] Dissolution and Liquidation

§ 60 et seq. GmbHG set forth the causes of the (compulsory) dissolution and the requirements of liquidation. Both dissolution and liquidation are regulated in a similar manner as for stock companies (*see supra* §5.02[A][10]).

[D] Co-determination

In order to secure a certain participation and influence of the employees in a company, German law provides for three different forms of co-determination (*Mitbestimmung*) in the supervisory board of a company:

[1] The Co-determination Act of 1976

The Co-determination Act (*Mitbestimmungsgesetz* – MitbestG) of 1976, as amended on April 24, 2015, applies to all corporations (stock companies, limited liability companies, public limited partnerships by shares and registered cooperatives) which are not regulated by the Coal and Steel Co-determination Act of 1951 (*see infra* §5.02[D][2]) and which employ more than 2,000 employees, including the employees of affiliated companies (§ 5 MitbestG). The law provides that employees elect 50% of the supervisory board members (§ 7 MitbestG). The board consists of twelve, sixteen, or twenty members depending on the number of employees of the company (i.e., less than 10,000, between 10,000 and 20,000 or more than 20,000). The chairperson, usually appointed by the shareholders, has two votes (§ 29 II MitbestG), whereas all other members of the board have a single vote.

Furthermore, the employees elect one member (*Arbeitsdirektor*) of the board of directors of a stock company, and one managing director of a limited liability company respectively (§ 33 MitbestG). In public limited partnerships by shares, there is no *Arbeitsdirektor* because the management of this type of corporation is personally, jointly and severally, liable for the company's debts.

[2] The Co-determination with Regard to Coal and Steel Companies

The Coal and Steel Co-determination Act of 1951 (*Montanmitbestimmungsgesetz* – MontanMitbestG), as amended on April 24, 2015, applies to stock companies or limited liability companies of the coal and steel industries which employ more than 1,000 employees (§ 1 II MontanMitbestG). The supervisory board has eleven, fifteen or twenty-one members depending on the total share capital (§§ 4, 9 MontanMitbestG). Shareholders and employees elect 50% of the members, who in turn elect the chairperson. Because of the parity the members of the supervisory board have to agree on a neutral person as a chairperson. In addition to this, employees also elect one director (*Arbeitsdirektor*; § 13 MontanMitbestG).

The Co-determination of coal and steel workers supplementary Act of 1956 (*Montanmitbestimmungsergänzungsgesetz* – MontanMitbestGErgG), as amended on April 24, 2015, covers companies that are not affected by the Coal and Steel Co-determination Act of 1951 but which control one or more companies in which the MontanMitbestG applies (e.g., groups, holding companies of mining companies). Its supervisory board consists of fifteen or twenty-one members depending on the total share capital (§ 5 MontanMitbestGErgG), with 50% shareholder representatives, 50% employee representatives and one additional member. The employees also elect one director (*Arbeitsdirektor)* (*cf.* § 13 MontanMitbestGErgG).

[3] The Employees' Representation and Co-determination Act of 1952

In companies which are not subject to the above two Acts (*see supra* §5.02[D][1] and [2]) and which employ more than 500 persons, one third of the supervisory board members must be employee representatives, *see* § 4 of the Act on the one-third participation of employees in the Supervisory Board of 2004 (*Drittelbeteiligungsgesetz* – DrittelbG), as amended on April 24, 2015.

§5.03 PARTNERSHIPS

[A] In General

German law provides for several different kinds of partnership, which may be divided into two general categories: (i) commercial partnerships (i.e., general partnerships, limited partnerships and "dormant" partnerships) which carry on commercial activities as defined by §§ 1 et seq. of the Commercial Code; (ii) non-commercial partnerships (i.e., partnerships under the Civil Code and non-trading partnerships under the Partnership Act of 1994) which serve all other purposes. Sections 705 et seq. BGB apply to non-commercial partnerships. Commercial partnerships are governed by §§ 105 et seq. HGB; the rules generally applicable to associations (mainly §§ 705 et seq. BGB) govern particular matters on which the Commercial Code does not provide specific provisions.

[B] Non-commercial Partnerships

[1] Partnership under the Civil Code

The partnership under the Civil Code (*BGB-Gesellschaft*) is the basic form of all partnerships. Thus, its law serves to supplement the more specific provisions governing the other legal forms of partnerships (*see infra* §5.03[B][2] and §5.03[C]).

[a] The Partnership Agreement and Its Contents

The partnership under the Civil Code is established by a contract between partners (§ 705 BGB) who can be natural or legal persons. A notarized contract is only necessary if real property is contributed (§§ 311b II, 925 BGB). The partners must agree on a common purpose pursued by the partnership, such as building and construction (so-called *Arbeitsgemeinschaft* – ARGE) or an underwriting syndicate (*Emissionskonsortium*). Any legal common purpose except the operation of a commercial business is permitted. If several partners operate a commercial business they automatically (§ 123 II HGB) qualify as a general partnership (OHG).

Partners are free to decide which matters shall be regulated by the partnership agreement (principle of freedom of contract). The agreement may be amended by unanimous decision, unless the partners have agreed on majority voting in advance. However, this rule is only applicable to operations in the ordinary course of business or to those decisions explicitly mentioned in the partnership contract. Unlike partnerships operating a commercial business (*see infra* §5.03[C]), a partnership under the Civil Code may be structured and operated as a purely internal partnership. In respect to his or her relationships both to the partnership and to the individual partners, each partner is bound by a general duty of loyalty.

Subject to the specifications in the partnership agreement, partners may make contributions in cash, in kind or by rendering personal services (§§ 705, 706 III BGB). In the absence of any agreement to the contrary, the law provides for equal contributions (§ 706 BGB). A subsequent increase of the original contribution is only permissible with the consent of all partners (§ 707 BGB).

[b] Legal Nature, Liability and Assets

The partnership has only a partial legal personality and, hence, no corporate organization. The partners are personally, jointly and severally, liable to the partnership's creditors. As the partners' liability is accessory to the partnership's liability, each partner may be sued directly for the full amount in dispute (by analogy with § 128 HGB). The personal liability of the partners may be excluded only by a formal agreement with the creditors.

The assets belong to the partners in joint ownership (*Gesamthandsgemeinschaft*, § 719 BGB). The principle of joint ownership means the holding of property by two or more persons not in distinct shares but jointly, each having an identical interest in the undivided whole. An asset may be transferred only with the consent of all partners which can be given either in the partnership agreement (e.g., by authorizing the management to dispose of assets) or in a general meeting of the partners.

[c] Management

The law provides that partners manage the business jointly (*Gesamtgeschäftsführung*, § 709 BGB), but the partners may agree to entrust one or more partners with the management of the partnership (*Einzelgeschäftsführung, cf.* § 710 BGB). Third persons may not be managers. The partners agree on the scope of authority of the management. If the partnership contract does not provide otherwise, the authority to manage the business is combined with the authority to represent the partners (*Vertretung*, § 714 BGB).

The partners representing the partnership act in the name of and for the account of all partners. The power to represent the partners in joint matters of the partnership may be restricted. While the personal liability of the partners may be eliminated by agreement with the creditors, it can neither be excluded by limiting a partner's power of representation nor by the partnership agreement. Partners acting beyond their power of representation are liable to the creditors (§§ 177, 179 BGB).

[d] The Distribution of Profits and Losses

Profits and losses are distributed in proportion to the number of partners (§ 722 BGB), unless otherwise agreed upon by the partners (e.g., a distribution proportionally to the amount of each partner's contribution).

[e] The Dissolution

Sections 723 et seq. BGB set forth the causes of a dissolution of the partnership: notice of termination by a partner, death of a partner, bankruptcy proceedings against a partner or a dissolution on grounds provided for in the partnership agreement. Following the dissolution, liquidation takes place (§§ 730 et seq. BGB). The partners complete current transactions, collect outstanding claims, liquidate the assets and satisfy the obligations. If there is a surplus, the contributions are repaid (§ 733 II BGB). The remaining assets are divided among the partners equally or in proportion to their contributions (§ 734 BGB). If the company's assets are insufficient to cover the debts and to reimburse the capital contributions, the shareholders are liable for the shortfall (§ 735 BGB).

[2] The Non-trading Partnership under the Partnership Act of 1994

Professionals such as doctors, architects, or interpreters are not subject to § 1 HGB. They are therefore prevented from using commercial partnerships as a form of business association. For a long time, the canons of professional ethics did not allow incorporation either. As a consequence, professionals relied on the partnership concept of the Civil Code. This form of association has several major disadvantages: unlimited liability, the lack of legal personality, and the lack of a firm name.

To improve the situation, the legislature enacted the Non-Trading Partnership Act of 1994 (*Partnerschaftsgesellschaftsgesetz* – PartGG), as amended on December 22, 2015. A partnership (*Partnerschaftsgesellschaft*) under this Act may have a common firm name (§ 2 I PartGG). The partners are still personally, jointly and severally liable to the partnership's creditors (§ 8 I PartGG). However, the partners may limit liability for wrongful acts in a way that only the partner rendering a service to the third party and acting negligently or wrongfully may be held liable (§ 8 II PartGG). The partners may limit or exclude their liability for damages caused by their professional malpractice if the partnership maintains a professional liability insurance prescribed by law for this purpose (§ 8 III, IV PartGG).

A non-trading partnership is established by a written contract between the partners. In particular matters for which neither the Partnership Act 1994 nor the partnership agreement provides specific provisions, the law generally applicable to partnerships or commercial partnerships applies (§§ 1 IV, 6 III, 7 II, III, 8 I, 9 I, 10 II PartGG).

[C] Commercial Partnerships

[1] The General Partnership

[a] The Partnership Agreement and Its Contents

The general partnership (*offene Handelsgesellschaft* – OHG) is established by a contract between the partners (§ 105 III HGB, § 705 BGB). A notarized contract is necessary only if real property is contributed (§§ 311b II, 925 BGB). The partners must agree on the operation of a commercial business under a common firm name (§ 105 I HGB). With regard to the content of partnership agreements and the contributions to be made, § 105 III HGB refers to the law of partnerships under the Civil Code (*see supra* §5.03[B][1]). The partners must apply to the local commercial register for registration (§§ 106, 107 HGB). If the partnership starts to conduct business before registration, the partnership is deemed to be effective immediately with regard to third parties (§ 123 II HGB).

Similar to a partnerships formed under the Civil Code, partners of a general partnership have a duty of loyalty both to the partnership and to their partners. The duty of loyalty is complemented by each partner's right of equal treatment.

[b] Legal Nature, Liability and Assets

A general partnership has only partial legal personality but it can have rights and obligations, acquire ownership and other rights in real property, and it can sue and can be sued in its own name (§ 124 I HGB).

Issues concerning the liability of the partners and their joint ownership are governed by the principles applicable to partnerships under the Civil Code (*see supra* §5.03[B[1][b]). As the partners' liability is accessory to the partnership's liability, each partner may be sued directly for the full amount (§ 128 HGB). While the personal liability of the partners may be excluded by agreement with the creditors, it can neither be excluded by limiting a partner's power of representation (§ 126 II HGB; *see infra* §5.03[C][1][c]) nor by the partnership agreement.

A partner who has been held liable by a creditor may demand reimbursement from the partnership (§ 110 HGB). If the partnership cannot fulfill this obligation, the partner has a right to compensation against the other partners (§ 426 I 1 BGB). Liability to third parties is also imposed upon partners newly joining the partnership. The liability extends even to the partnership's obligations incurred prior to entry of the new partner (§ 130 HGB). Partners withdrawing from the partnership may be held liable for obligations incurred prior to their withdrawal if the claim becomes due within five years after their withdrawal (§ 160 HGB).

[c] Management

The law provides that the management is carried out jointly by the partners (§ 114 I HGB), but here, too, the partners may appoint one or more from their midst to assume the management of the partnership (§§ 114 II, 115 HGB). Third persons may not be managers.

Each managing partner may represent the partnership in and out of court (§ 126 I HGB). His or her powers to represent the partnership with regard to third parties are unlimited and cannot be restricted through special provisions in the partnership contract (§ 126 II HGB).

In contrast, the powers of managing partners may be limited internally. Managing partners who do not observe such internal limitations are liable for any damages caused to the partnership. A managing partner may be dismissed for cause by final court decision (§§ 117, 127 HGB).

[d] Other Provisions

The distribution of profits and losses, dissolution, and liquidation are all carried out according to the principles as set out in regard to the partnership under the Civil Code (*see supra* §5.03[B][1][d]–[e]). However, a commercial partnership is not dissolved in the case of a notice of termination by a partner, the death of a partner or bankruptcy proceeding against a partner (§ 131 III HGB). The Commercial Code allows for dissolution of the partnership by court decision on petition by a partner alleging and proving good cause (§ 133 HGB). Membership in a partnership may be acquired by inheritance or succession if the partnership contract so provides (§ 139 HGB).

[2] The Limited Partnership

In contrast to a general partnership, the limited partnership (*Kommanditgesellschaft*) consists of two different groups of partners: the general partners (*persönlich haftende Gesellschafter* or *Komplementäre*) and the limited partners (*Kommanditisten*). The liability of a limited partner vis-à-vis the partnership's creditors is limited to the specific amount of his or her actually paid-in contribution (§§ 161 I, 171 et seq. HGB). Once the entire contribution has been submitted, the liability of the limited partner to third parties is pre-empted (§ 171 I HGB). To the extent the contribution has been repaid to the limited partner, it is deemed, with respect to creditors, never to have been made in the first place (§ 172 IV HGB). As previously stated for general partnerships, the liability of general partners is unlimited. In fact, most limited partnerships today are a GmbH & Co. KG or a UG & Co. KG, where the general partner is a limited liability company or a *Unternehmergesellschaft* (*see supra* §5.01[A][1] and §5.02[C][1][c]). As a result, only the corporate entity acting as general partner is fully liable.

All other principles governing the general partnership also apply to the limited partnership with one exception: a limited partner may not represent the partnership with regard to third parties (§ 170 HGB).

[3] The Dormant Partnership

The "dormant" partnership (*stille Gesellschaft*) is a partnership between a commercial enterprise (i.e., a corporation, a partnership or a sole trader) and the "dormant" partner who contributes a certain amount of money to the enterprise (§ 230 HGB). The dormant partnership therefore resembles the limited partnership. The main difference is that the partnership agreement has legal effect only internally, i.e., between the enterprise and the dormant partner, but not vis-à-vis third parties which may not even know of the existence of a partnership. Business activities are conducted only by the enterprise. This difference has several consequences: The partnership is not registered in the commercial register. The assets only belong to the enterprise and the principle of joint ownership does not apply. The dormant partner is not liable to the enterprise's creditors. The dormant partnership resembles a loan with participation in the profit, because the dormant partner's remuneration is paid out of the enterprise's profits. The dormant partner bears losses only if explicitly provided in the dormant partnership contract (§ 231 II HGB).

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