

net amount of liabilities transferred to it as a result of the merger⁸⁶². Should that not be the case, the merger would result in a violation of section 30 LLCA and would therefore not be permissible. As a remedy, one might contemplate a capital decrease of the successor entity then.

cc) Sidestream merger. For a merger where all of the shares both in the predecessor and in the successor entity are held by one and the same shareholder (what one might term a “sidestream merger”), the legislature has introduced a new provision into the Transformation Act a couple of years ago that allows to effect sidestream mergers without capital increase⁸⁶³. Pursuant to this provision it is possible to skip the capital increase if all shareholders of the predecessor entity waive their right to receive (additional) shares in the successor entity. The respective waiver declarations must be notarially recorded⁸⁶⁴. This is a sensible solution, also for sidestream merger scenarios. The shareholder of the predecessor entity is the only shareholder of the successor entity anyway so that its position would be the same regardless of a capital increase. A capital increase is therefore not necessary with respect to maintaining the participation ratio of the shareholders of the predecessor entity⁸⁶⁵.

However, it is true that the position of the creditors is affected by a sidestream merger without capital increase. Some judicial precedents⁸⁶⁶ and legal scholars⁸⁶⁷ had therefore taken the position (under the old statutory rules which had left it open whether an increase was required or not) that a capital increase was required nonetheless. They had argued that the stated share capital of the successor entity after the merger should not fall short of the combined stated share capitals of the successor and the predecessor entity before the merger so as to provide the same degree of protection to the entities’ creditors⁸⁶⁸. Therefore, the safe route to follow here was, until the change in the statutes discussed in the preceding paragraph, to have the successor entity increase its capital even if owned by the same shareholder as the predecessor entity. As for the amount of the capital increase there was some debate on whether the nominal amount of the share capital of the predecessor entity should be added to that of the successor entity or whether the parties were at liberty as regards the amount of the capital increase⁸⁶⁹.

Be that as it may, it now follows from the statutory material that a capital increase is not required. The creditors may, instead, avail themselves of their rights under section 22 Transformation Act⁸⁷⁰.

⁸⁶² Kai Mertens, *Aktuelle Fragen zur Verschmelzung von Mutter- auf Tochtergesellschaften* – down stream merger (Topics of downstream mergers as currently discussed), AG 2005, 785, 786.

⁸⁶³ Section 54 para. 1 sentence 3 Transformation Act.

⁸⁶⁴ Section 54 para. 1 sentence 3 Transformation Act.

⁸⁶⁵ Kallmeyer, in Kallmeyer, *Umwandlungsgesetz*, section 54 margin notes 10.

⁸⁶⁶ See, e.g., *OLG Hamm*, decision of August 3, 2004, – 15 W 236/04 –, NZG 2004, 1005 = ZIP 2005, 662.

⁸⁶⁷ Cf., e.g., Petersen, *Der Gläubigerschutz im Umwandlungsrecht* (Protection of creditors in transformation law), 208, 210 *et seq.*

⁸⁶⁸ This was also the view of the legislature when creating, back in 1994, the Transformation Act (see quotation by Stratz, in Schmitt/Hörtnagl/Stratz, section 2 *UmwG* margin note 21). This reasoning, however, is attacked by Kallmeyer, in Kallmeyer, *Umwandlungsgesetz*, section 54 margin note 11 (capital increase follows the ratio of the respective true value of the entities involved in the merger and does not mean that the respective nominal amounts of the registered share capital must be combined).

⁸⁶⁹ See Stratz, in Schmitt/Hörtnagl/Stratz, section 2 *UmwG* margin note 23 for further information.

⁸⁷⁰ See below 10.

8. Application for registration in the commercial register

a) Form requirements of application letter

The managing bodies of the entities involved in the merger must apply for registration of the merger in the commercial registers competent for both the predecessor and the successor entities. The application letters must be executed by such number of members of the managing bodies as are required to legally represent the respective entity (i.e., it is, in most cases, not required that all members of the managing body sign the application letter). However, the application for registration of a capital increase by a successor *GmbH* must be signed by all of the managing directors of the *GmbH*⁸⁷¹.

The signatures under the application letter must be notarially certified⁸⁷².

b) Contents of application letter

The application letter must contain, besides the notification of the merger, a declaration that no legal proceeding was brought contesting the validity of the merger resolution or that, if brought, such proceeding was conclusively rejected by the court or withdrawn by the plaintiff⁸⁷³. An application letter lacking this declaration will not result in registration of the merger, unless – and this is widely made use of in intra-group mergers – all shareholders have waived their right to appeal the validity of the merger resolution.

The application letter to the commercial register of the successor entity must also contain the application for registration of a capital increase unless a capital increase is not permissible (upstream merger) or not required (downstream merger and sidestream merger)⁸⁷⁴.

c) Attachments to application letter

The application letter must be accompanied by the following statutorily prescribed set of attachments⁸⁷⁵. If the application letter is submitted to the commercial register with any of the following documents missing, the commercial register will not register the merger:

- Merger agreement.
- Merger resolutions of the shareholders' meetings of both the predecessor and the successor entities. In the event a capital increase by the successor entity is necessary to allow the shareholders of the predecessor entity to become shareholders of the successor entity, the respective resolution of the shareholders' meeting of the successor entity and the amended wording of the articles of association must be provided.
- Merger report, if required.
- Audit report of the merger auditors, if required.
- Written evidence that the merger agreement or its draft was timely submitted to the works council(s); in the event that no works council exists, corresponding declaration of the signatory of the application letter. A lower court once ruled that a simple declaration would not be sufficient, but that a formal affidavit

⁸⁷¹ Section 78 LLCA.

⁸⁷² See Chapter 1 VIII 2 as regards notarial certification.

⁸⁷³ Section 16 para. 2 Transformation Act.

⁸⁷⁴ See above 7c) for details regarding capital increases in connection with the merger.

⁸⁷⁵ Cf. section 17 Transformation Act.

would be required⁸⁷⁶. This ruling, though, and fortunately so, has not found its way into standard practice applied by German commercial registers.

- To the commercial register of the predecessor entity only: closing balance sheet of the predecessor entity as of a date no earlier than eight months prior to the application of the merger to the commercial register (if the annual balance sheet shall be used in this regard, the merger therefore must be applied for registration by August 31 of the following year at the latest).

It should be noted in the context of the last bullet point (balance sheet and eight-months period) that if the application letter with all of the required attachments has not reached the court within this eight-month period, the commercial register can be expected to reject the application for registration, and the merger proceedings must be started all over again. It is not necessary, though, to wait until the next annual balance sheet is available; rather, an interim balance sheet may be drawn up and used as closing balance sheet, thereby pushing forward the eight-month deadline.

9. Registration/publication/effects

The merger is registered first in the commercial register of the predecessor entity. The commercial register competent for the predecessor entity then informs the commercial register of the successor entity of the registration of the merger. Thereafter, the commercial register competent for the successor entity registers the merger. The merger becomes effective as of the date of registration in the commercial register of the successor entity⁸⁷⁷.

In the event that the shareholders of the successor entity have also had to approve a capital increase (in order to issue shares to interest holders of the predecessor entity), the merger will only be registered after the registration of the capital increase⁸⁷⁸.

The commercial registers of each of the entities involved in the merger will publish the respective entries electronically⁸⁷⁹.

The registration of the merger in the commercial register of the successor entity effectuates the merger with the following results:

- All of the assets and liabilities of the predecessor entity are transferred in their entirety (i. e., by way of universal succession) to the successor entity⁸⁸⁰.
- The predecessor entity ceases to exist⁸⁸¹.
- Shareholders of the predecessor entity become shareholders of the successor entity. This is only then not true if, and to the extent, the successor entity was a shareholder in the predecessor entity before the merger⁸⁸².
- Any deficiencies regarding the procedure of notarial recording of the merger agreement and/or declarations of consent or waiver of individual shareholders are cured⁸⁸³.

10. Rights of creditors

The position of the creditors of either the predecessor or the successor entity may possibly be weakened by the merger. If this is so, they may notify the successor

⁸⁷⁶ *AG Duisburg*, decision of January 4, 1996, – 23 HRB 4942, 5935 –, GmbHR 1996, 372.

⁸⁷⁷ Sections 19 para. 1 and 20 para. 1 Transformation Act.

⁸⁷⁸ Sections 53 and 66 Transformation Act.

⁸⁷⁹ Section 19 para. 3 Transformation Act in conjunction with Section 10 Commercial Code.

⁸⁸⁰ Section 20 para. 1 no. 1 Transformation Act.

⁸⁸¹ Section 20 para. 1 no. 2 Transformation Act.

⁸⁸² Section 20 para. 1 no. 3 Transformation Act.

⁸⁸³ Section 20 para. 1 no. 4 Transformation Act.

entity and have the right to claim security, provided that their claims are not yet due for payment⁸⁸⁴. The creditors must satisfactorily show why and how the merger impairs their position. If, e.g., an over-indebted company is merged into another company the creditors of the latter may argue (depending on the impact of the merger on the financial situation of the successor entity) that the discharge of their claims is at risk⁸⁸⁵. The creditors must notify the successor entity within six months following the date on which the merger was published pursuant to section 19 para. 3 of the Transformation Act⁸⁸⁶. Particular problems of how to calculate the amount of the claim of the creditor may arise if his claims are based on a long-term contractual relationship with the company⁸⁸⁷.

11. Managing and supervisory bodies of the predecessor entity

The managing directors or members of the board of management, as the case may be, of the successor entity continue to represent the successor entity, and its supervisory board, if any, remains in place. The members of the managing body of the predecessor entity, however, will not automatically become members of the board of management or managing directors of the successor entity. Rather, their appointment will end upon registration of the merger by operation of law⁸⁸⁸. The rights and obligations under their service agreement, however, will pass on to the successor entity. The appointment of members of a supervisory board of the predecessor entity ends upon the merger becoming effective⁸⁸⁹, and the same is true with respect to their claim for remuneration⁸⁹⁰.

Directly below the level of the managing body, German law provides for a special type of officer whose authority to represent the company is based on a power of attorney, but whose scope of authority is statutorily defined in a rather broad manner and who is registered in the commercial register: the so-called *Prokurist*⁸⁹¹. Here, again, while the employment contract passes on to the successor entity, the appointment of the *Prokurist*, according to the prevailing view in legal literature, ends upon the predecessor entity ceasing to exist⁸⁹².

12. Domination and profit and loss absorption agreements

In intra-group mergers, one often comes across domination and profit and loss absorption agreements (*Beherrschungs- und Gewinnabführungsverträge*)⁸⁹³ that have

⁸⁸⁴ Section 22 Transformation Act.

⁸⁸⁵ Petersen, *Der Gläubigerschutz im Umwandlungsrecht* (Protection of creditors in transformation law), 238.

⁸⁸⁶ Cf. above 9.

⁸⁸⁷ In this regard see Schröer, *Sicherheitsleistung für Ansprüche aus Dauerschuldverhältnissen bei Unternehmensumwandlungen* (Granting security for claims arising from long-term contracts in transformation processes), DB 1999, 317 *et seq.*

⁸⁸⁸ Grunewald, in Lutter, *UmwG*, section 20 margin note 28.

⁸⁸⁹ Wulff/Buchner, *Sicherung der Amtskontinuität des Aufsichtsrats bei Verschmelzung und Formwechsel* (How to ensure that the supervisory board is kept in place in mergers and conversions), ZIP 2007, 314.

⁸⁹⁰ Marsch-Barner, in Kallmeyer, *Umwandlungsgesetz*, section 20 margin note 16; Grunewald, in Lutter, *UmwG*, section 20 margin note 28.

⁸⁹¹ For details in connection with the *Prokura* see Klaus J. Müller, *Prokura und Handlungsvollmacht* (The *Prokura* and other specific powers of representation with a statutorily defined scope), JuS 1998, 1000 *et seq.*

⁸⁹² Marsch-Barner, in Kallmeyer, *Umwandlungsgesetz*, section 20 margin note 24.

⁸⁹³ As for more information on such agreements, see Chapter 8 IV.

been entered into between the predecessor and the successor entity, or between either of these entities and a third entity not involved in the merger⁸⁹⁴.

A domination and profit and loss absorption agreement survives the merger

- if the dominating entity is merged into a third entity not being a party to the domination and profit and loss absorption agreement before the merger (with the third entity then becoming the dominating entity as a result of the merger); or
- if a third entity is merged into the dominating entity; or
- if a third entity is merged into the dominated entity, unless, for the first time, outside shareholders participate in the capital of the dominated entity as a result of the merger.

As for a possible termination of a domination and profit and loss absorption agreement as a result of the merger, see Chapter IV 4.

III. Conversion

1. Purpose of a conversion

When the concept of conversion was first introduced by the Transformation Act in 1994 (there was no such concept in German law before the Transformation Act), the effect of conversion was compared with a person just changing their clothes, and rightly so. In fact, a successful conversion will result in a legal entity being organized in a legal form different from the legal form it had prior to the conversion, without its identity as a party to contracts, proceedings of any nature or any relationship being affected by the conversion process. The converting entity does not cease to exist and is not deemed to be newly created in its new legal form. It continues to exist as it existed before the conversion with the only change being that of its legal form⁸⁹⁵. In short, a conversion does not effectuate a transfer of assets or liabilities of any sort.

2. Legal forms eligible for conversion

The following legal entities may convert their legal form:

- Partnerships governed by the Commercial Code (general partnerships (*OHG*), limited partnerships (*KG* and *GmbH & Co. KG*)) and so-called partnership companies (*Partnerschaftsgesellschaften*)⁸⁹⁶.
- Companies limited by shares (*GmbHs*, stock corporations (*Aktiengesellschaften*), and partnerships limited by shares (*Kommanditgesellschaften auf Aktien*)).
- Registered cooperatives (*eingetragene Genossenschaften*).
- Registered associations (*eingetragene Vereine*).
- Mutual insurance associations (*Versicherungsvereine auf Gegenseitigkeit*).
- Certain public bodies.

Entities of one of the foregoing legal forms may convert into one of the following legal forms:

⁸⁹⁴ For further details regarding the following see Klaus J. Müller, *Auswirkungen von Umstrukturierungen nach dem Umwandlungsgesetz auf Beherrschungs- und Gewinnabführungsverträge* (The impact of changes of corporate structures pursuant to the Transformation Act on domination and profit and loss absorption agreements), BB 2002, 157 *et seq.*

⁸⁹⁵ Section 202 para. 1 no. 1 Transformation Act.

⁸⁹⁶ A relatively new legal form designed to be owned and operated by professionals in private practice, e.g., lawyers, doctors and the like.

- Civil law partnerships (Gesellschaften des bürgerlichen Rechts).
- Partnerships governed by the commercial code (general partnerships (*OHG*), limited partnerships (*KG* and *GmbH & Co. KG*)) and partnership companies (*Partnerschaftsgesellschaften*).
- Companies limited by shares (*GmbHs*, stock corporations (*Aktiengesellschaften*), partnerships limited by shares (*Kommanditgesellschaften auf Aktien*)).
- Registered cooperatives (*eingetragene Genossenschaften*).

3. General outline of conversion proceedings

A conversion involves the following steps:

- A conversion resolution must be drawn up setting forth the terms and conditions of the conversion.
- A conversion report must be prepared in which the proposed conversion is described in detail.
- The draft conversion resolution must be submitted to the works council of the converting entity.
- The conversion resolution must be adopted in a shareholders' meeting of the converting entity. In addition, the new articles of association or the new partnership agreement (if a *GmbH* is converted into, e.g., a *GmbH & Co. KG*) applicable to the entity in its new legal form must be established. In this context it should be noted that, although a partnership agreement does not normally require to be notarized, this is not so in conversions, i.e. here the new partnership agreement forms part of the conversion resolution (which must be notarized)⁸⁹⁷.
- The new legal form of the converting entity must be applied for registration in the commercial register of the converting entity.
- The conversion must be registered in the commercial register of the converting entity.

As a result of the registration of the conversion in the commercial register, the conversion becomes effective.

4. Draft conversion resolution

The draft conversion resolution must at least contain provisions covering the following topics⁸⁹⁸:

- New legal form of the converting entity after the conversion.
- Firm name of the entity in its new legal form.
- Participation of the existing holders of interest in the entity in its new legal form pursuant to the provisions applicable to the new legal form.
- Quantity, nature and nominal value of the interests to be received by the existing interest holders by way of the conversion or that are to be granted to an acceding general partner.
- Rights granted to individual interest holders and to holders of special rights, such as participations without the right to vote, preference shares, multiple voting right shares, promissory notes and special participation rights (*Genußrechte*), or the measures proposed with respect to such holders of special rights.
- A buy-out offer pursuant to section 207 Transformation Act, unless the conversion resolution requires, to be valid, that all interest holders consent to it or unless the converting entity only has one shareholder.

⁸⁹⁷ Section 234 no. 3 Transformation Act.

⁸⁹⁸ See section 194 Transformation Act.

- Consequences of the conversion for the employees and their representations (e.g., a works council) as well as future measures envisaged with respect to the employees and their representations. As a rule, the conversion does not affect the existing employment relationships and does not constitute a reason to terminate an employment contract. The conversion, however, may result in changes of the co-determination regime⁸⁹⁹ applicable to the entity in its new legal form⁹⁰⁰.

As a basic rule of conversion law, in the process of preparing the conversion documents, one must take into account that the provisions governing the formation of the new legal form are also applicable to the conversion into such legal form⁹⁰¹.

5. Submission of the draft conversion resolution to the works council

The conversion resolution must be submitted to the works council of the converting entity in its draft form at least one month before the shareholders' resolution on the conversion is adopted⁹⁰². Since section 194 para. 2 Transformation Act is analogous to the respective merger provision in section 5 para. 3 Transformation Act, please see above II 4b) for further details concerning the duty to inform the works council.

6. Conversion report

The managing body of the converting entity must prepare a report in which the proposed conversion, including a possible buy-out offer to dissenting interest holders, is described in detail. The report must be accompanied by a summary list of the assets and liabilities (*Vermögensaufstellung*) of the converting entity.

The requirement of a conversion report may be waived by the shareholders of the converting entity. The declarations of waiver must be notarized. The waiver must be declared by all of the shareholders to negate the requirement to provide a conversion report.

7. Adoption of the conversion resolution

The conversion resolution must be adopted in a shareholders' meeting of the shareholders of the converting entity. A resolution by way of written proceedings is not sufficient⁹⁰³. However, the shareholders may be represented by attorneys-in-fact⁹⁰⁴.

The majority required for the adoption of the conversion resolution depends on the legal form of the entity in question both before and after the conversion.

All shareholders or partners must consent in the following cases:

- The converting entity is, prior to the conversion, organized as a partnership (unless the partnership agreement provides otherwise and explicitly stipulates that a majority of three quarters shall suffice to convert the partnership into another legal form).

⁸⁹⁹ As for such regimes see Chapter 4 II.

⁹⁰⁰ See Chapter 10 III 3a).

⁹⁰¹ Section 197 Transformation Act.

⁹⁰² Section 194 para. 2 Transformation Act.

⁹⁰³ Section 193 para. 1 sentence 2 Transformation Act.

⁹⁰⁴ As for the details relating to powers of attorney in this context, see above II 4c).

– The new legal form is a civil law partnership (*Gesellschaft bürgerlichen Rechts*) or a general partnership (*OHG*) or a partnership company (*Partnerschaftsgesellschaft*). This is true even if the converting entity is, prior to the conversion, organized as a *GmbH* or another form of company limited by shares where a majority of three quarters of the votes cast would normally meet the statutory majority requirements⁹⁰⁵. If the new legal form is a limited partnership (*KG* or *GmbH & Co. KG*), all of the future general partners assuming unlimited liability must vote in favor of the conversion.

A majority of three quarters of the votes cast is required where:

– A company limited by shares (e.g., a *GmbH* or *AG*) converts to another company limited by shares, unless the articles of association of the respective entity provide for a higher majority in the case of conversions.

The conversion resolution must be notarially recorded⁹⁰⁶.

8. Application for registration in the commercial register

The new legal form of the converting entity must be applied for registration in the commercial register of the converting entity⁹⁰⁷. The signatures on the application letter must be notarially certified⁹⁰⁸.

The application letter must contain, besides the notification of the conversion, a declaration that no legal proceeding was brought contesting the validity of the conversion resolution or that, if brought, such proceeding was conclusively rejected by the court or withdrawn by the plaintiff⁹⁰⁹. An application letter lacking this declaration will fail to result in registration of the conversion unless all shareholders of the converting entity have waived their right to appeal the validity of the merger resolution.

The application letter must be accompanied by the following attachments:

- Conversion resolution.
- Conversion report, if required.
- Written evidence that the draft conversion resolution was timely submitted to the works council; in the case no works council exists, corresponding declaration of the signatory of the application letter.
- Permit approving the conversion, if applicable.
- In the case of companies limited by shares (e.g., *GmbH* or *AG*) being the new legal form, the new articles of association.
- In the case of a *GmbH* being the new legal form, a list of the shareholders⁹¹⁰.

9. Registration/publication/effects

The conversion is registered in the commercial register of the converting entity. In this context, one should be aware that commercial registers in Germany are generally organized such that all companies limited by shares (e.g., *GmbHs* and *AGs*) are registered in department B whereas general and limited partnerships (*OHG*, *KG* and *GmbH & Co. KG*) are registered in department A. The competent

⁹⁰⁵ Section 233 para. 1 Transformation Act.

⁹⁰⁶ Section 193 para. 3 sentence 1 Transformation Act. As for the details of the procedure of notarial recording, see Chapter 1 VII 1.

⁹⁰⁷ Section 198 Transformation Act.

⁹⁰⁸ As for the notarial certification of the signatures, see Chapter 1 VIII 2.

⁹⁰⁹ Section 198 para. 3, section 16 para. 2 Transformation Act.

⁹¹⁰ See Chapter 6 I 6 for details regarding such list.