The German Limited Liability Company

Rosengarten / Burmeister / Klein

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C.H.BECK

principal property rights adhering to a share are the right to dividends and the right to the proceeds of liquidation. The principal control and management right adhering to the share is the right to vote. An example of a personal shareholder right which is a property right is the right to receive an extra dividend; while an example of a personal shareholder right which is a control and management right is the right to appoint one, several or, for that matter, all of the managing directors.

cc) Preferential Rights or Shares, Special Privileges

General

Shareholder rights granted by the GmbH-Act – such as the right to dividends and the proceeds of liquidation and the right to vote on shareholder resolutions – are in principle granted as rights adhering to all shares equally in proportion to the amounts of the different shares. The articles, however, may deviate from this allocation of rights and provide certain shareholders with rights disproportionately greater than the amounts of their shares. The articles may also create rights of a type not provided for in the GmbH-Act, such as the right to sell certain products to the GmbH. The articles may also allocate extra or disproportionately greater rights either to a specific share as rights attaching to that share or to a specific shareholder as personal shareholder rights. **110**

When the articles allocate extra or disproportionately greater rights to shares as rights attaching to those shares, such shares are usually referred to as "preferential shares" (*Vorzugsgeschäftsanteile*), and the respective rights as "preferential rights" (*Vorzugsrechte*). When the articles grant extra or disproportionately greater rights to a shareholder as personal shareholder rights, such rights are usually referred to as "special privileges" (*Sondervorteile*). **111**

Types of Preferential Rights or Shares and Special Privileges

The law leaves great freedom to the articles to create preferential shares or rights and special privileges as the shareholders see fit. Few mandatory provisions in the GmbH-Act restrict this freedom. The most important of these mandatory provisions is that which prohibits repayment of share capital to the shareholder.[21] **112**

The following are just a few examples that illustrate the great flexibility available. **113**

With respect to *property rights,* the articles may, for example, provide for: **114**

- increased rights to the profits of a GmbH, such as a percentage of the profits in excess of that which is proportionate to the share;
- the right to share in the profits before they are allocated to other shares;
- the right to a minimum profit expressed by a certain percentage of the stated amount of the share;
- increased rights to liquidation proceeds;
- pre-emptive rights with respect to shares of other shareholders or a straight-forward right ("call option") to buy such shares on specified terms in specified circumstances.

With respect to *control and management rights*, the articles may, for example, provide for: **115**

- veto rights, such as a veto right with respect to specified types of shareholder resolutions;
- increased voting rights;
- rights to appoint one, or several, or all managing directors, or to be appointed a managing director;
- rights to give instructions to the managing directors on specific or on all matters; or

[21] No rights may be granted to a shareholder which would result in an illegal repayment of share capital to him. *Cf.* paras 177 *et seq. infra*.

– rights to appoint one, or several, or all members of the supervisory board (if a supervisory board has been created), or to be appointed as a member of the supervisory board.

116 The articles can attach to a single share, or grant to one shareholder, more than one preferential right or special privilege. The articles can also combine preferential rights or special privileges with a reduction of other rights available to the share or shareholder. For instance, if the articles give a specific share or shareholder extended control and management rights, they may at the same time provide that this share or shareholder shall only participate in the company's profits after an advance dividend has been paid to the other shareholders. This right to an advance dividend can either be a preferential right adhering to the other shares or a special privilege granted to the other shareholders.

Creation of Preferential Rights or Shares and Special Privileges

117 Both preferential rights and special privileges may be created by the articles when the company is formed. If preferential rights or special privileges are not set forth in the original articles, their subsequent creation requires an amendment of the articles. For such an amendment a majority of three quarters of the votes cast, which is generally the percentage required for any amendment of the articles, is not sufficient. Rather, the consent of all shareholders adversely affected is required, because the grant of the right or privilege is a deviation from the principle of equal treatment of shareholders.[22] However, the original articles can provide that preferential rights or special privileges may subsequently be created by an amendment of the articles without the consent of the shareholders who would be adversely affected.

Cancellation of Preferential Rights or Shares and Special Privileges

118 The cancellation of preferential rights requires both an amendment of the articles by a majority of three quarters of the votes cast[23] and the consent of the owner of the preferential share. In contrast, for the cancellation of a special privilege, an amendment of the articles is not involved. Instead, as the special privilege creates a right of the shareholder against the company in addition to, and separate from, his share, its cancellation requires a waiver agreement between the beneficiary and the company. However, the articles can be drafted to facilitate a subsequent cancellation of a preferential right or special privilege created in the articles. For instance, they can create preferential rights or special privileges subject to the condition that they may be cancelled by a majority decision of the shareholders or can be bought out by the company or by other shareholders.

c) Shareholder Obligations

119 **aa) Obligations Adhering to Shares, Personal Shareholder Obligations.** As with shareholder rights, shareholder obligations may either be obligations adhering to shares or obligations imposed upon a specific person as shareholder.

120 The obligations imposed on the shareholder by the GmbH-Act, particularly the obligation to make the share capital contribution subscribed to, attach to the share. They pass automatically with the share if the share is transferred, subject, in the case of share capital contributions,[24] to the continued liability of the preceding holder which is imposed to ensure the full contribution of the share capital to the GmbH.

121 Obligations imposed on shareholders by the articles, such as the obligation to serve as managing director or to provide other services to the company, may either adhere to the share or be imposed upon a specific person who is a shareholder, depending upon what

[22] Regarding the equal treatment principle, *cf.* paras 343 *et seq. infra*.
[23] *Cf.* para 347 *infra*.
[24] *Cf.* para 165 *et seq. infra*.

the articles provide. If the obligations adhere to the shares they pass automatically with the share if the share is transferred. The previous owner of the share does not continue to be liable primarily or secondarily for the obligations that adhere to the share unless the articles provide otherwise.[25] If an obligation is imposed on a shareholder as a personal obligation, and that shareholder transfers his share, the obligation may, depending on what the articles provide, expire; remain with the transferor of the share; or be assumed by the transferee pursuant to a separate agreement.

bb) Ancillary Obligations

General

122 In addition to the statutory obligations to pay the share capital contribution subscribed to and to pay supplementary contributions authorized in the articles when they are required to be paid, the articles may impose upon shareholders a variety of additional obligations,[26] which are usually referred to as "ancillary obligations" (*Nebenleistungspflichten*). Ancillary obligations may either be created in the articles as obligations which adhere to the shares or as personal shareholder obligations, whatever the articles may provide.

123 Ancillary obligations may be imposed upon all shares or shareholders equally; upon all shares or shareholders differently; or upon one or more shares or shareholders particularly. The imposition of ancillary obligations can thus be used to distinguish between various shareholders. In combination with the creation of preferential rights or shares or special privileges,[27] the imposition of ancillary obligations is an ideal means of allocating roles which may be very different for different shares or shareholders. In particular, the imposition of ancillary obligations can be used to balance preferential rights or special privileges allocated to a share or shareholder by simultaneously imposing compensatory ancillary obligations on such share or shareholder.

Types of Ancillary Obligations

124 In principle, the GmbH-Act contains no limitation on the types of ancillary obligations which may be created by the articles. The wide range of ancillary obligations which may be imposed allows the shareholders a particularly high degree of flexibility in shaping the company and their roles in it according to their interests.

125 The following are merely a few examples of ancillary obligations which can be imposed:

- The obligation to provide the company with financial means in addition to the share capital contributions and supplementary contributions, if any. Such additional financial means may be in the form of payment of a surplus upon the share capital contribution;[28] of a loan; or of other types of arrangements.
- The obligation to make specified assets available to the GmbH, such as real estate, production facilities, patent rights, know-how or other tangible or intangible and movable or immovable assets, either with or without consideration.
- The obligation to serve as a managing director of the GmbH;[29] to be available as its consultant; or to provide other services to the GmbH with or without consideration.
- The obligation, within the limits set by antitrust law, not to compete with the company.

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[25] However, if and insofar as obligations were already due at the time of the transfer, both the transferor and the transferee are jointly and severally liable for such obligations: § 16 para 2 GmbH-Act.

[26] § 3 para 2 GmbH-Act.

[27] *Cf.* paras 117 *et seq. supra*.

[28] *Cf.* para 62 *supra*.

[29] This obligation will often be combined with a right (preferential right or special privilege) to serve as managing director.

– The obligation in certain circumstances to sell a share to the company, to other shareholders, or to a third party named by the company or by the other shareholders; or to respect pre-emptive rights (*Vorkaufsrechte*) of such parties.[30]

126 As these examples show, the ancillary obligation may be to provide the company with funds, assets or services for consideration. In such a case the arrangement is subject to the implied condition that the consideration must not reduce the net assets of the company below the amount of its stated share capital, since this would result in an illegal repayment of the company's share capital.[31]

Creation or Increase of Ancillary Obligations

127 An ancillary obligation must be created by the articles.[32] If an ancillary obligation was not created by the articles when the company was formed, its subsequent creation requires an amendment of the articles. In addition to the three-quarter majority of the votes cast generally required for passage of amendments to the articles, the consent of those who are to be obligated is required.[33] The same rule applies to any subsequent increase of the scope of an ancillary obligation.

Reduction or Cancellation of Ancillary Obligations

128 A reduction or cancellation of ancillary obligations set forth in the articles requires an amendment of the articles and thus a three-quarter majority of the votes cast. In contrast to a subsequent introduction or increase of ancillary obligations, the reduction or cancellation does not require the consent of any particular shareholder, including those who are negatively affected by the reduction or cancellation.

5. Transfer and Inheritance of Shares

129 While shares are not negotiable instruments[34] and the law does not therefore encourage the transfer of, or the trading in shares of GmbHs which is consistent with the nature and function of the GmbH,[35] shares are transferable and inheritable[36] subject to certain restrictions which may be imposed by the articles.[37]

a) Transfer of Shares

130 Unlike some other legal systems, German law distinguishes strictly between the transfer of title on the one hand (which is called a "contract of disposition", *Verfügungsgeschäft*) and the contractual commitment underlying such transfer on the other hand (which is called a "contract of obligation", *Verpflichtungsgeschäft*). This strict distinction is also applicable to the transfer of shares.

131 **aa) Contractual Commitment to Transfer or Acquire Shares.** In order to be valid any contractual commitment to transfer[38] or acquire a share must be recorded (*beurkundet*) by a notary.[39]

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[30] Regarding purchase options and pre-emptive rights with respect to shares, *cf.* para 133 *infra*.
[31] *Cf.* paras 177 *et seq. infra*.
[32] § 3 para *2* GmbH-Act.
[33] § 53 para 3 GmbH-Act.
[34] *Cf.* para 101 *supra*.
[35] *Cf.* para 5 *supra*.
[36] § 15 para 1 GmbH-Act.
[37] § 15 para 4 GmbH-Act.
[38] § 15 para 4 cl. 1 GmbH-Act.
[39] Regarding the concept of recording (*Beurkundung)* by a notary, *cf.* para 25 *supra*. All agreements, including side agreements, related to the commitment must be recorded: Federal Court of Justice, decision

A commitment not so recorded is invalid and unenforceable. Nevertheless such a commitment will subsequently become fully valid if the *transfer* for which it provided is eventually recorded (*beurkundet*) by a notary[40], i. e. the duly recorded *transfer* agreement "cures" the invalid (not so recorded) agreement containing the *commitment* to transfer. **132**

The requirement of notarial recording does not apply solely to contracts creating mutual obligations to transfer and receive a share, as would be the case in a sales agreement. It also applies to contracts containing a commitment of one of two parties only, as in the cases of contracts which grant an option to sell (put option) or an option to purchase (call option); or grant a pre-emptive right (*Vorkaufsrecht*) or a right of first refusal to the other party. The requirement of notarial recording also applies to a mere pre-contract (*Vorvertrag*), which is a contractual commitment to enter into a final contract at a later stage. It even applies to a purely one-sided offer to enter into a contract, such as an offer to sell or purchase a share, which is a technique often used to create the effect of a put or call option without entering into a contract. In order to be valid and binding, such offer must also be recorded by a notary. The same is true for the acceptance of such an offer. To the extent that parties want a so-called *letter of intent* to have a binding effect, it also needs to be notarized if it also provides for an intended sale of shares in a GmbH. **133**

bb) Transfer Agreement. The transfer of a share does not take place by unilateral act of the owner but requires an agreement between the transferor and the transferee that the ownership of the share shall be transferred. In addition to the contractual *commitment* to transfer or acquire a share, the transfer agreement itself must also be recorded (*beurkundet*) by a notary in order to be valid.[41] **134**

In many cases the contractual commitment to transfer and the transfer as such take place at the same time and are thus contained in the same notarized document. When both such agreements can be made at the same time, it may nevertheless be advantageous if the underlying contract, which is often a voluminous document, is not recorded but merely signed, possibly abroad, by the parties, so that only the transfer agreement, which is usually a very brief document, need be recorded by the notary. Such a recording of the transfer agreement causes the underlying contract to become fully valid as well. This technique, which can help the parties avoid the time-consuming[42] process of notarial recording of the larger document, is not practical if the contractual commitment and the transfer itself cannot be made at more or less the same time; for example, when pre-contracts, options, or pre-emptive rights are involved. In these cases, when the transfer of the share itself will follow the underlying commitment after some delay, the parties will usually not wish to accept that the underlying commitment is invalid and unenforceable until the envisioned transfer itself is duly recorded by a notary. **135**

Upon completion of the transfer, title to the share and the rights and obligations adhering to it[43] pass to the transferee (unless the transfer was made conditional, e. g. upon payment of the purchase price). This will not, however, be acknowledged by the company **136**

of June 30, 1969, BB 1969, 1242. It has long been controversial whether the commitment to transfer and the transfer itself can be validly notarized by a non-German notary. According to a recent decision of the Federal Court of Justice of December 17, 2013, the submission of the list of shareholders regarding the transfer of shares by a foreign notary is permissible, if the recording abroad is equivalent to a recording by a German notary, BGH NJW 2014, 2026.

[40] § 15 para 4 cl. 2 GmbH-Act.

[41] § 15 para 3 GmbH-Act.

[42] Particularly time-consuming due to the need to read the full text of the agreement aloud, *cf.* para 24 *supra*.

[43] *Cf.* paras 107 *et seq.* and paras 120 *et seq. supra*.

until the transferee has been duly registered in the list of shareholders as accepted by the commercial register.[44]

137 **cc) Transfer Restrictions and Formalities Imposed by the Articles.** The statutory requirement of a notarial recording of a commitment to transfer and of the transfer itself is mandatory, and the articles cannot modify or dispose of this requirement.

138 However, the articles can and often do require additional formalities for the transfer of shares, or impose restrictions on such transfers.[45] Such provisions in the articles may either relate only to the form of the transfer or may restrict the transferability of shares, or both.

139 The following are a few examples of possible provisions of this type:

- The articles may require that the transfer of a share cannot be made without the prior consent of the company, of a majority of the shareholders by shareholder resolution, of all shareholders, of one or several specific shareholders, or of the supervisory board if one has been created.
- The articles may provide that a share be transferred only to a party who meets certain qualifications, such as being a member of a certain profession, belonging to a certain family, not being engaged in a certain type of business or being an affiliate of the majority shareholder.
- The articles may provide that a share can only be validly transferred if the transfer is in compliance with specified purchase options or pre-emptive rights granted to a shareholder or a third party.[46]

140 **dd) Transfer Notification to the Commercial Register.** While the transfer of a share is valid vis-à-vis third parties upon execution of the share transfer agreement (unless the transfer is made subject to conditions), vis-à-vis the GmbH itself the new shareholder may only exercise his shareholder rights, once he is registered in the shareholder list and such shareholder list has been filed with and properly registered by the commercial register.[47] Whenever there is a change in the persons of the shareholders or the size of their shareholding, the managing directors are obliged to submit an updated shareholder list to the commercial register.[48] Such list has to clearly identify name, address and birth date of the shareholder as well as the nominal amounts and serial numbers of each of the shares held by the shareholders.[49] The updated shareholder list has to be filed by the managing directors without delay after they have been notified of the transfer by the transferor or the transferee; notification must be accompanied by sufficient evidence of the transfer (e. g. a certified copy of the transfer agreement).[50]

141 If a notary has participated in changes of the shareholder structure of a GmbH, he (instead of the managing directors) must, immediately upon effectiveness of the transfer, prepare a shareholder list and submit it to the commercial register.[51] When doing so, the notary has to certify that the changes made to the shareholder list correspond to the

[44] *Cf.* paras 140 and 141 *infra*.
[45] § 15 para 5 GmbH-Act. As a technical matter, the articles can only impose formalities or restrictions with respect to the transfer as such, not regarding the contractual commitment to transfer. Accordingly, a contractual commitment to transfer a share in violation of a transfer restriction imposed by the articles is valid, although the shareholder is not able to fulfil it and will thus end up in breach of contract.
[46] *Cf.* para 114 *supra*.
[47] § 16 para 1 GmbH-Act.
[48] § 40 para 1 cl. 1 GmbH-Act.
[49] § 40 para 1 cl. 1 GmbH-Act.
[50] § 40 para 1 cl. 2 GmbH-Act.
[51] § 40 para 2 cl. 1 GmbH-Act.

changes that he has notarized and that the further contents of the shareholder list corresponds to the most recent list included in the commercial register files.[52]

ee) Good Faith Acquisition of Shares from a Registered Owner. While the shareholder list – together with other documents[53] – is a useful tool for the acquirer of a share, there is no completely reliable way to assure oneself of the transferor's ownership of the a share. Given that the transfer of the share is valid vis-à-vis third parties without registration of the new owner in the shareholder list,[54] a former owner may still be shown in the shareholder list which has been filed last with the commercial register, if the obligation to file a new shareholder list has not been complied with. In order to give potential purchasers more protection, the concept of good faith acquisition of shares has been introduced by the Reform Act 2008.[55] **142**

Good faith acquisition of title to shares in a GmbH or rights in such shares (e. g. pledges) from a seller who is not the legal owner, but registered as shareholder of the respective share in the shareholder list shown in the commercial register, is possible, unless: **143**

- the shareholder list has, with respect to the share to be acquired, been incorrect for less than three years and such incorrectness cannot be attributed to the true owners failure;
- the acquirer does not act in good faith because he knows that the registered owner is not the true owner or fails to recognize such lack of ownership based on gross negligence;
- an objection against the correctness of the shareholder list has been filed with the commercial register.

The new rules on good faith acquisition of shares have certainly improved the situation for an acquirer of shares in a GmbH with a long-standing history and possibly a pure documentation of past capital changes or share transfers. The purchaser acting in good faith can rely on acquiring title if the seller is registered in the shareholder list for more than three years and for all practical purposes must not analyse the details of past share transfers in the early days of the company's existence. If, however, the acquirer is made aware by the seller of potential chain of title issues (e. g. by including documents evidencing such issues into a data room in connection with an M&A transaction), full due diligence will again be necessary since, under such circumstances, the purchaser would not be able to rely on good faith anymore.

The best evidence of ownership is an uninterrupted sequence of notarial documents showing, transfer by transfer, the passage of title to a share from the original subscriber, upon either formation of the company or a share capital increase, to the present owner. Even an uninterrupted sequence of notarial transfer documents, however, does not constitute completely conclusive evidence, since the transferor of each share may have transferred it to a third party before fraudulently "transferring" it "again" to the transferee, who will not acquire title since the transferor is no longer the owner. However, in such case the new rules on the good faith acquisition of ownership may help. **144**

b) Inheritance of Shares

Shares are inheritable[56]. When a shareholder dies, his share, which is part of his estate, passes to his heirs by operation of law. The articles cannot interfere with, or prevent, such a transfer directly. The articles may, however, be drafted to ensure that the share of **145**

[52] § 40 para 2 cl. 2 GmbH-Act.
[53] *Cf.* para 75 *supra*.
[54] *Cf.* para 140 *infra*.
[55] § 16 para 3 GmbH-Act.
[56] § 15 para 1 GmbH-Act.

the deceased does not remain with his heirs. For instance, the articles can authorize the company to redeem the share of a deceased shareholder from his heirs.[57] Furthermore, they can impose upon the heirs an obligation to transfer, or to offer to transfer, the share to the company or to other shareholders or to one or more specified third parties.[58] Such obligations can be enforced in court by obtaining a judgment granting specific performance. In addition, the articles can provide that the share can be redeemed by the company should the heirs not comply with their obligations. In any case, also a heir will be recognized by the company as a new shareholder only, if he is registered as the new owner in the shareholder list and such list has been registered with the commercial register.[59] A heir should therefore inform the company immediately of this acquisition of the share by operation of law so that the managing directors of the company can fulfil their obligation to file a corrected shareholder list.[60]

6. Division of Shares; Combination of Shares

146 Shares can be divided by way of shareholder resolution,[61] provided that the nominal amounts of the shares resulting from such split must, in the aggregate, add up to nominal amount of the share which was divided. Further, the nominal amount of each share resulting from such split must have a nominal amount expressed in full Euro.[62]

147 If a shareholder holds more than one share in a GmbH, his shares may be combined to one single share by way of a shareholder resolution.[63] The nominal amount of the combined share will be equal to the aggregate of the nominal amounts of the shares previously held by the respective shareholder.

7. Joint Holding of Shares

148 Shares can be held jointly by more than one person.[64] Joint holding of shares can occur in three situations. A share is held jointly if held[65]
- by an undivided community of heirs (*Erbengemeinschaft*);[66]
- by married persons who have agreed upon a marital regime of joint ownership of assets (*Gütergemeinschaft*) or;[67]
- by persons who have agreed to hold a share as a community of owners by fractions (*Bruchteilsgemeinschaft*).[68]

149 In each of these instances of the joint holding of a share, the GmbH-Act treats the joint holders as one shareholder. The joint holders of the share are jointly and severally liable for the payments owed to the company on the share.[69] The rights attaching to the share

[57] Regarding redemption of shares generally, *cf.* paras 152 *et seq. infra*. There is controversy among legal writers as to whether the articles could go even further by providing that the share of a deceased shareholder is automatically deemed to have been redeemed.
[58] With respect to the creation of this type of obligation, *cf.* para 125 *supra*.
[59] § 16 para 1 GmbH-Act.
[60] *Cf.* para 136 *infra*.
[61] § 46 no. 4 GmbH-Act.
[62] *Cf.* para 56 *supra*
[63] § 46 no. 4 GmbH-Act.
[64] § 18 GmbH-Act.
[65] Contrary to that, shares of a non-commercial partnership (*Gesellschaft bürgerlichen Rechts)* are, according to case law, not held by the partners jointly but by the partnership as such; *cf.* para 18.
[66] Regarding the undivided community of heirs, *cf.* §§ 2032 *et seq.* Civil Code.
[67] Regarding the marital regime of joint ownership of assets, *cf.* §§ 1415 *et seq.* Civil Code.
[68] Regarding the *Bruchteilsgemeinschaft*, *cf.* §§ 741 *et seq.* Civil Code.
[69] § 18 para 2 GmbH-Act.