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Germany makes private deals more secure

**- No third party *bona fide* acquisition of shares
between signing and closing -**

Introduction

In German private M&A transactions, the target is normally organized as a *GmbH* (limited liability company). This is so because the *GmbH* is, with over one million registered entities, by far the most widely used legal form in Germany. The buyer may decide to either acquire the assets of the target company (asset deal) or its shares (share deal). This newsletter exclusively deals with the latter. In a share deal transaction, more often than not one or several conditions precedent for the closing, i.e. for the transfer of the shares becoming effective, are agreed upon. Such conditions precedent may, for instance, be the merger control clearance, the entering into of certain agreements, or the complete payment of the purchase price. In such cases there will be a time lag between signing and closing, in the event of difficult merger control clearance procedures or cumbersome third party negotiations sometimes even a considerable time lag. In that period, the seller still holds title to the sold shares. What happens if the seller decides to transfer the shares to a third party after signing, but before closing? Will the third party acquire valid title to the shares? If so, are there protective measures available to the buyer to safeguard his legal position?

Legal situation until recently

There is a statute in the German Civil Code (*BGB*), sec. 161 para. 1, the application of which leads to the result that, as a basic rule, the third party will eventually not acquire valid title if and when all conditions precedent under the first agreement are fulfilled and the transfer of the shares to the (first) buyer therefore becomes effective. However, sec. 161 para. 3 of the German Civil Code stipulates an exception to this rule in the event the third party should benefit from one of the *bona fide* provisions German law provides for. As a result of a recent amendment, German law does now indeed also provide, in sec. 16 para. 3 of the German Limited Liability Company Act (*GmbHG*), for a somewhat restricted possibility of a *bona fide* acquisition of shares in a *GmbH*. Because of the restrictive language (which says that there may be a *bona fide* acquisition if the seller is listed as holder of the share in the shareholders' list as kept by the commercial register) and since this statute has only come into effect some three years ago, it has been a point of heavy debate in the recent past whether the *bona fide* acquisition possibility would also exist in the case at hand, i.e. whether a third party could acquire valid and permanent title on the grounds of the cited provision in the period between signing and closing.

The new decision of the German Federal Court of Civil Justice

The German Federal Court of Justice (*BGH*) has now brought greater clarity into the discussion. In its ruling of September 20, 2011 (docket no. II ZB 17/2010) the Court has ruled that there is no *bona fide* acquisition of a share in a *GmbH* that has already been sold and transferred to a buyer, albeit under conditions precedent not yet fulfilled. The reasoning of the *BGH* is that in the case at hand the (second) buyer cannot benefit from the *bona fide* acquisition provisions as cited above. The seller, so points out the *BGH*, has not ceased to be the true and lawful owner of the share. A *bona fide* acquisition would however only be possible if the seller were not the owner of the share, but the buyer (in our case: the third party) would believe him to be the owner on the basis of the information gathered by inspection of the shareholders' list as kept by the commercial register. The *BGH* also rejected the idea of an analogous application of the *bona fide* acquisition rules.

Conclusio

The *BGH* has clarified the situation. Through its judgement private M&A deals involving shares in a *GmbH* have become more secure. In the time before the decision was handed down, German lawyers and notaries had feared that there might be the possibility of a *bona fide* acquisition by a third party during signing and closing and had searched for legal means to secure the position of the (first) buyer of the sold shares. This has all now become moot. There is no need for protective measures since there is no danger of the (first) buyer losing or even diminishing his legal position. Legal practitioners will therefore be happy with the judgement.

However, from a more scholarly point of view, the decision is not entirely convincing. It results in the somewhat weird situation that the legal position of the third party (the “second” buyer) is stronger if the third party acquires the share from someone who is definitely not the owner of the share (the third party may then acquire the share on the grounds of a *bona fide* acquisition) than if the third party acquires the share from the true owner. And, from the point of view of the (first) buyer, it is also astonishing that the mere prospective right of the first buyer to be the future owner of the share is stronger than his final legal position of holding full title after all conditions precedent have been met. He cannot lose the prospective right on the grounds of a *bona fide* acquisition by a third party, but he may lose his full title on the grounds of a *bona fide* acquisition by a third party if no updated shareholders’ list has been filed with the commercial register. So, it seems that the last word has not yet been spoken here. For the time being, however, again, the situation has become clearer and more reliable for the parties of an SPA involving the shares in a German *GmbH*.

If you have questions on the foregoing, please contact Klaus J. Müller (mueller@schiedermair.com) or one of the other notaries of our firm. Please note that the information contained in this newsletter is not meant to replace legal counsel. You should seek specific advice before taking any action with regard to the matters discussed above. All of our newsletters are available at www.schiedermair.com.