

Newsletter Corporate/M&A

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Notarial Form Requirements for the Sale and Transfer of Shares in a *GmbH*

– New Judgement on How to Cure Defective Share Sales –



■ Introduction

In a recent ruling, the *OLG Frankfurt am Main* (Higher Regional Court) addressed the question of how to cure an ineffective agreement on the sale of shares in a German limited liability company (*GmbH*) (judgement of February 21, 2012 – docket no. 11 U 97/11). It appears helpful, before going into greater detail as regards the judgement, to first briefly look at the basic form requirements for selling and transferring shares in a *GmbH*, the most widely used legal form for doing business in Germany. German law distinguishes between the sale (and purchase) of a share on the one hand, i.e. the promise and obligation to transfer the share against consideration (sale), and the transfer of the share on the other hand, i.e. the actual transfer of title (transfer). Both the sale and the transfer are effected by separate mutual agreements. These are each regarded as distinct contracts. This being said, German law provides, as regards the sale and transfer of shares in a *GmbH*, for certain notarial form requirements. Pursuant to sec. 15 para. 4 sentence 1 of the Law on Limited Liability Companies (*GmbHG*) the obligation to transfer a share must be notarized in order to be effective and sec. 15 para. 3 *GmbHG* requires also the actual transfer of the share to be made via a notarized agreement.

■ Facts of the Case

We have just seen that both the contract on the sale of a share in a *GmbH* and the transfer agreement need to be notarized. It is possible to enter into the sale agreement first and to later have, once the conditions precedent provided for in the agreement have been met, a separate transfer deed notarized on the closing date. However, it is also feasible – and may

be recommendable to save notarial costs – to combine both agreements in one and the same notarial deed. In that case, the deed containing the agreement to sell and purchase the share also includes the agreement on the transfer of the share, the latter being made subject to the fulfilment of the conditions precedent agreed upon. This way, the agreement on the transfer of the shares becomes automatically effective upon the occurrence of the conditions precedent. And this is what had been done in the facts of the case decided upon by the *OLG Frankfurt am Main*. However, notarization of the sale and purchase part of the deed did go awry, as will be described in the following, also giving some context information on the extent of the notarial form requirement.

■ Defective Notarization

Observing notarial form for the sale and purchase agreement means to have all declarations, stipulations, agreements, covenants etc. that relate to the sale of the shares notarized. This basically results in the need to have not only the main body of the agreement but also all attachments, schedules, exhibits and annexes notarized. This can be a cumbersome venture, in particular in M&A transactions. However, failure to abide by this comprehensive form requirement will result in a legally non-binding sale and purchase agreement. And this is exactly what had occurred in the facts of the case presented to the *OLG Frankfurt am Main*. The acting notary had, in the notarization process, skipped one of the exhibits to the sale agreement which related to the sale of the shares (not to the transfer of the shares) and had failed to properly record it (i.e. he had not read it aloud to the deponents appearing before him). Therefore, the sale and purchase portion of the deed was ineffective.

■ Curing the Ineffective Sale of Shares

Section 15 para. 4 sentence 2 *GmbHG* stipulates that a defective sale agreement lacking the required notarial form shall become effective upon the duly executed transfer of the shares, provided the latter is effected in proper notarial form.

The *OLG Frankfurt am Main* held that this, i.e. the curing of the ineffective sale agreement, is what had happened in the case at hand. The court argued that it was of no importance that the two agreements, i.e. the sale agreement and the transfer agreement, were contained in one and the same notarial deed. And – here lies the particular importance of the judgement, because no German court has ever pointed this out so clearly – the failure to have the exhibit relating to the sale part notarized did not affect the proper notarization of

the transfer part. The reason for this is that the notarial form requirement for the transfer part, as the *OLG Frankfurt am Main* has specified, is much narrower than the notarial form requirement for the sale part. For the transfer, it is only necessary to have the transfer agreement itself (including only such conditions which directly relate to the transfer) notarized, but nothing relating to the sale or relating to the provisions and agreements in connection with the sale. Therefore, the court came to the conclusion that the form defects were completely cured by the transfer of the share which had, although contained in the same notarial deed, been properly notarized.

■ Conclusion and Recommendations

The legal practitioner (and his clients, for that matter) will appreciate the higher level of certainty to be gained from the new judgement. It is not unheard of, in particular with respect to sometimes quite extensive M&A transaction deeds, that there may be flaws in the notarization process. A reason for this may be the wide and comprehensive notarial form requirement for sales of shares in a *GmbH*. This results, in bigger transactions, in notarization procedures that last for many hours, sometimes days. A practical means to overcome or at least mitigate the inconvenience of such lengthy notarial sittings would be to have the notary prepare so-called reference deeds. Such deeds, containing all exhibits and schedules, are notarized with a colleague or employee of the notary appearing as deponent before the notarization of the sale and transfer deed(s) proper, and are later referred to, approved of and ratified by the deponents appearing in the main notarization. But this only works if the notary is provided with the relevant documents well in advance prior to the notarization of the main sale and transfer deed. Be that as it may, any possible defects of the share sale agreement can be cured by a share transfer agreement meeting the – much narrower – notarial form requirement applicable to it. This also holds true if both the sale and transfer agreement are contained in one and the same notarial deed. However, no advisor worth his salt would recommend relying on this curing possibility. Instead, everything should be done to guarantee a proper share sale notarization procedure in the first place. Better care than cure!

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