

SCHIEDERMAIR

RECHTSANWÄLTE

Newsletter Corporate/M&A

No. 3 – May 2010

No Hidden Contributions in Kind through Services

On February 1, 2010, the German Federal Court of Civil Justice (*BGH*), the highest German court in civil matters, has handed down its so-called “*Eurobike*” ruling. In this decision the *BGH* has held that if the shareholder renders services to a stock corporation (*AG*) in the context of a capital increase, the doctrine of hidden contributions in kind (*verdeckte Sacheinlagen*) does not apply.

What exactly is a “hidden contribution in kind”? This is, following a recent change of the statutes, now expressly addressed in sec. 27 para. 3 of the German Stock Corporation Act (and, for that matter, in sec. 19 para. 4 of the German Act on Limited Liability Companies). The basic concept is as follows: if a capital increase is to be effected by contributions in cash, only properly effected cash contributions will discharge the subscribing shareholder of the obligation to pay in the share capital. If it is not cash that the company receives, the shareholder is deemed not to have fulfilled the obligation to pay in the share capital and can be held liable for the respective amount. This applies in particular to situations where there is a close connection between a cash contribution by the shareholder (be it in connection with the formation or with a subsequent capital increase) and a subsequent or preceding transaction between the shareholder and the company via which the shareholder receives funds from the company, e.g. as consideration for a machine he sold to the company. The rationale behind this concept is that the shareholder should then not have chosen to subscribe to a cash contribution but should have openly gone the way of a capital increase (or formation) by way of contributions in kind. Such capital increases and formations by way of

contributions in kind follow distinct rules designed to safeguard the interests of the company's creditors.

However, while it is true that a hidden capital contribution in kind does not have any discharging effect, the legislature recently has introduced the new idea that the value of the non-cash contribution shall be taken into account. Thereby the legal consequences of a hidden capital contribution in kind have been mitigated considerably. The company's claim against the shareholder is now limited to the amount that the actual value of the non-cash contribution (e.g., the machine we just referred to) fell short of the nominal value of the respective share subscribed to. This corresponds, more or less, to what applies if "open" contributions in kind (in the event that the formal procedure of a formation in kind or a capital increase with contributions in kind has been observed from the outset) are of lesser value than reported. The shareholder, however, has the burden of proof to establish the value of the respective non-cash contribution.

In its *Eurobike* decision, the *BGH* has now ruled that the concept of hidden contributions in kind is not applicable if the shareholder did not sell goods to the company but if he had rendered (in the case at hand: consultancy) services to the company. The *BGH* has argued that services do not qualify as suitable contributions for an "open", an "ordinary" capital increase by contributions in kind. And since this is so, they neither can be considered to be hidden contributions in kind. The shareholder could not have been expected, for lack of availability of this procedure, to opt for an open contribution in kind in the first place, so he cannot be "punished" for something he had no means of doing otherwise. In the facts of the case decided by the *BGH* it was mentioned that there had not been any hints of the services in question being overpriced. The ruling might have been different, at least as regards the final outcome, had there been payments exceeding the value of the services.

The decision was rendered with respect to stock corporations. It is also of relevance, however, with regard to limited liability companies (*GmbH*) since the statutory regime is the same. In this respect, the new decision confirms the so-called "Qivive" ruling of the *BGH* of last year. The *BGH*, with these two important decisions, has created greater certainty in this field of corporate law. Before these judgements, the situation was not so clear since one could have argued that although services do not qualify for an "open" capital increase or formation with

contributions in kind, the rules on hidden contributions in kind may well apply analogously to services. This is now clear.

When forming a stock corporation or a limited liability company or when effecting a capital increase the shareholder subscribing to a cash contribution should nonetheless refrain from entering into transactions with the company, including the rendering of services, in close connection with the payment of the cash contribution. The reason therefor is that it may be difficult for the shareholder – even if there is no hidden contribution in kind – to establish that his services were of value. And this would be crucial, leaving aside the issue of a hidden contribution in kind, with respect to defending himself against the possible allegation of a so-called *Hin- und Herzahlen* (forbidden repayment of the cash contribution).

If you have questions on the foregoing, please contact Klaus J. Müller (mueller@schiedermair.com). 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.