
Germany

Financial Assistance

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Contact

Dr Emanuel P Strehle

Hengeler Mueller, Munich

Emanuel.Strehle@hengeler.com

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INTRODUCTION

This guide sets out an overview of how the concept of financial assistance is dealt with in Germany in connection with limited liability companies (*Gesellschaften mit beschränkter Haftung – GmbHs*) and stock corporations (*Aktiengesellschaften – AGs*). The main focus of this guide is on the functioning of the statutory system governing financial assistance in Germany. It should be noted that German law provides for explicit rules regarding financial assistance for AGs only, whereas no explicit rules exist for GmbHs.

GENERAL OVERVIEW

■ What are the origins of financial assistance under German law?

The rules on financial assistance for AGs under German law originate from Article 23 para. 1 of the Second Company Law Directive of 13 December 1976 (77/91/EEC), and were integrated in the German Stock Corporation Act (*Aktiengesetz – AktG*) in 1978 as section 71a para. 1 sentence 1 AktG by the act for the implementation of the Second Company Law Directive of 13 December 1978. The Second Company Law Directive has been replaced by Directive 2012/30/EU on Capital Maintenance of 25 October 2012 which governs financial assistance in Article 25. Article 25 of such directive allowed the EU member states to relax the strict rules on financial assistance. However, Germany has not implemented such less rigid standard. Directive 2012/30/EU has recently been replaced by the Company Law Directive of 14 June 2017 (2017/1132/EU) which provides for an identical rule on financial assistance in its Article 64. Prior to 1978, only one judgment of the Supreme Court of the German Reich (*Reichsgericht*) in 1930 had addressed the issue of financial assistance, stating that the provision of a loan or security by an AG for the acquisition of shares in that AG constituted a prohibited redemption of capital.

For GmbHs, there are no explicit rules on financial assistance. However, restrictions apply in connection with the rules on capital contributions and maintenance.

■ What should be understood as financial assistance under German law?

Section 71a para. 1 sentence 1 AktG explicitly defines the grant of an advance or a loan and the provision of security by an AG to another person for the purpose of acquiring shares in that AG as cases of financial assistance. However, this list is not exhaustive and, in fact, merely states certain categories of legal acts which fall under the term of financial assistance; it is rather broadly interpreted by the German courts and literature. For example, contributions without consideration or without an adequate repayment claim such as donations, waivers of debts, or lost grants are widely accepted to constitute financial assistance. Break-up fees, however, are generally accepted to not constitute financial assistance as such fees are only payable if the relevant transaction fails and, thus, no acquisition of shares takes place. Furthermore, it is not relevant if the act of financial assistance leads to an outflow of liquidity of the AG, or if it seriously endangers the AG's assets. All kinds of financial support which leave an AG exposed to a risk, as insignificant as it may be, which did not exist before and therewith enables or supports another person to acquire shares in that AG, are covered by the prohibition under section 71a para. 1 sentence 1 AktG.

- **Is financial assistance accepted under German law?**

- As a general rule, German law does not allow AGs to provide financial assistance to third parties for the acquisition of its own shares.
- No such prohibition exists for GmbHs. Financial assistance is therefore generally permitted for such companies unless the act of financial assistance violates capital contributions and maintenance provisions, which also impose extensive limitations.

- **Are there any exceptions under German law as regards the general prohibition of providing financial assistance to third parties?**

The AktG recognises three (3) exceptions from the general prohibition of financial assistance in section 71a para. 1 sentences 2 and 3 AktG. Namely, these are transactions concerning: (i) credit institutions, financial services institutions, or securities institutions; (ii) employees; and (iii) group companies in the event that a domination and/or profit and loss transfer agreement is in place under the respective provisions of the AktG.

- **What are the consequences of providing financial assistance?**

If a transaction violates the provisions of financial assistance under the AktG, such transaction is null and void and the AG may claim restitution for the benefits provided to the respective shareholder under such transaction.

LIMITED LIABILITY COMPANIES

No rules equivalent to section 71a AktG exist with respect to GmbHs, and section 71a AktG is also not applicable to GmbHs by way of an analogy. Thus, in transactions where the target company is a GmbH, financial assistance is generally permitted, unless such transactions violate other provisions applicable to GmbHs.

In particular, the rules regarding capital contributions and capital maintenance must be observed. Pursuant to such rules, the assets of the company required for the preservation of the share capital must not be paid out to shareholders (cf. section 30 para. 1 sentence 1 GmbHG). However, it should be noted that this does not apply with respect to payments made under a domination and/or profit and loss transfer agreement, or payments that are fully covered by a repayment or counterclaim against the shareholder (cf. section 30 para. 1 sentence 2 GmbHG). Furthermore, the repayment of a shareholder loan and the satisfaction of other claims resulting from legal arrangements that are similar to a shareholder loan from an economic perspective are permitted under German law (cf. section 30 para. 1 sentence 3 GmbHG). However, it should be borne in mind that in the case of insolvency of the GmbH an act of granting security or granting satisfaction for such loans could be subject to avoidance if the security was granted ten (10) years prior to insolvency or the loan was repaid one (1) year prior to insolvency. In any event, a loan may not be granted to the managing directors, other legal representatives, authorized signatories (*Prokurist*), or holders of a general authorization to act (*Handlungsvollmacht*) in respect of the assets of the company required for the preservation of the share capital, and any such loan has to be repaid immediately, irrespective of agreements to the contrary (cf. section 43a GmbHG).

Where a transaction of a GmbH providing for financial assistance violates the rules on capital contributions and maintenance, payments made contrary to such rules must be refunded to the company. In addition, the GmbH's managing directors are liable for the damage resulting from payments out of the company's assets made in violation of the rule that the share capital must not be paid out to shareholders.

STOCK CORPORATIONS

- **General rule**

Pursuant to section 71a para. 1 sentence 1 AktG, an AG must not enter into a transaction providing for the grant of an advance or loan or the provision of security by the company to another person for the purpose of acquiring shares in that AG. For group companies, financial assistance for the acquisition of shares in a parent company must not be given by a subsidiary of that company.

- **Exceptions to the applicability of the general rule regarding stock corporations**

Pursuant to section 71a para 1 sentence 2 AktG, there are two exceptions whereby the provision of financial assistance is permitted by law, in each case provided that the AG at the point in time of the acquisition of the shares is in a position to create a reserve in the amount of the expenditures for the acquisition without reducing either its share capital or any reserve required to be created by law or the articles of incorporation which may not be used for payments to shareholders:

- (i) **Credit institutions, financial services institutions, and securities institutions** may provide financial assistance when trading in their own shares provided that this happens in the ordinary course of their business. This means that the financial assistance granted by a credit institution, financial services institution, or securities institution in relation to its own shares may not exceed the risk of a transaction involving shares of another company. The rationale for this exception is that such institutions that choose the corporate form of an AG should not be disadvantaged compared to competitors using a different corporate form.
- (ii) AGs may provide financial assistance to their **employees or employees of an affiliated enterprise** if these persons acquire shares in that AG. In particular, such exception is relevant to the provision of bonus or matching shares under incentive programs of stock corporations.

Furthermore, pursuant to section 71a para 1 sentence 3 AktG, there are exceptions for group companies in the event that a domination and/or profit and loss transfer agreement is in place under the respective provisions of the AktG. The exception is not limited to the two (2) companies directly connected by the domination and/or profit and loss transfer agreement, but extends to all financing transactions with third parties which result from the actions of the dominating entity of the group. Thus, intra-group transactions, as well as transactions with persons who have business relationships with the dominating entity of the group or other group companies, benefit from this exception. It should be noted that this only applies to groups connected by enterprise agreements pursuant to the provisions of the AktG and not to so-called *de facto* groups, where the dominating entity is merely the controlling entity as a result of its position within the group structure (e.g., because it has the majority of the voting rights) and no domination and/or profit and loss transfer agreement has been effected.

CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE

■ Nullity of transaction

Pursuant to section 71a para. 1 sentence 1 AktG, transactions in violation of the rules of financial assistance shall be null and void. It should be noted that this nullity – according to the prevailing view in literature – only relates to the promissory agreement (*Verpflichtungsgeschäft*), meaning the financing agreement or the security agreement respectively, and not to the fulfilment of the agreement (*Verfügungsgeschäft*), meaning the actual provisions of the financing service.

■ Repayment claims

Due to the nullity of the financing agreement or the security agreement, there is no claim for performance against the company. In the case that performance nevertheless occurred, the benefits received have to be returned by the shareholder to the AG. This claim of restitution has its legal basis in the AktG as well as in the general rules of unjust enrichment in the German Civil Code (*Bürgerliches Gesetzbuch – BGB*).

It should be noted that a prohibited act of financial assistance may also qualify as a repayment of the shareholders' capital contribution. In these cases, the AG has a claim of restitution against the respective shareholder to return the benefits received pursuant to section 62 AktG.

OTHER RELATED MATTERS

■ Financial assistance and takeover situations

The rules on financial assistance are highly relevant in takeover situations due to the question of financing the takeover.

- It should be noted that cases of **Leveraged Buyouts**, where the purchase price is financed externally and the cash flows or assets of the target company are used to secure and repay such debt, will be treated as prohibited financial assistance under German law. The same applies to **Management Buyouts**, which are often used as a defence in hostile takeover situations in which the management of the company acquires a controlling stake in the targeted company, also by using the company's cash flows or assets to finance the acquisition.
- In contrast, **Merger Buyouts**, where the target company in the transaction is merged into the acquiring company, which becomes indebted as a result of the transaction, or the indebted acquiring company is merged into the target company, are not assessed as prohibited financial assistance under German law. This is because the protection of capital pursuant to the German Transformation Act (*Umwandlungsgesetz – UmwG*) has priority over the rules on financial assistance pursuant to section 71a AktG.

- **Upstream loans**

Whether upstream loans are permitted under section 71a para 1 sentence 1 AktG, depends on the proposed use of the loan. Loans that serve the purpose of repayment of interim financing measures for the acquisition of shares in an AG are prohibited. This also applies if the repayment of the interim financing measures occurs after the acquisition of the shares, as long as the acquisition and the repayment of the interim financing measure are somehow related to each other. It is recommendable to analyse any such situation in detail. In general, the very appearance of such functional relationship between an upstream loan and the acquisition of shares in an AG should be avoided.