Global Private M&A Guide - Limited External Content - Germany

Common deal structures

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# What are the key private M&A deal structures?

The acquisition of a German company or business is typically structured as a purchase of shares or a purchase of assets. In addition, the German Transformation Act and general corporate law provide for alternative structuring possibilities for acquisitions (e.g., mergers) and in carve-out scenarios (e.g., demergers). The most common acquisition method in Germany is the purchase of shares. A purchase of assets is, in most cases, more complex and time-consuming and, therefore, less frequent. Another reason for sellers preferring a share deal is the fact that it is generally more tax-favorable for the seller.

Auction processes are very common in Germany. Such processes are typically administered by investment banks or other financial/M&A advisers that put together the teaser, information memorandum and virtual data room and organize procedural matters by way of process letters. In the course of the auction process, the bidders are initially requested to submit nonbinding indicative bid letters and, at a later stage, so-called binding bid letters and a markup of the seller's draft SPA. Although referred to as binding bids, from a German law perspective, such bids may still be nonbinding if the target is a GmbH. The obligation to purchase shares in a GmbH requires a notarial recording of the agreement. Since the bid letters typically are not notarially recorded, the obligation to purchase the shares at the offered price cannot be enforced. It is, therefore, common that final negotiations take place with more than one bidder after the bidders have submitted the final bids.

The German Transformation Act governs mergers and divisions of legal entities. A merger is the combination of at least two legal entities into one legal entity by way of transferring all assets and liabilities of the transferring (disappearing) entity, the transferor, to the receiving (surviving) company, the transferee. The act distinguishes between two basic types of merger: merger by acquisition and merger by the formation of a new company. In the first (more frequently seen) case, the transferee already exists, while in the second case (very rarely seen in practice), the transferee will be established by the merging transferors. The interest holders of each transferor receive shares or memberships in the transferee in return for shares or memberships in the transferor being dissolved by the merger. This is not always required; for example if the transferor is a 100% shareholder of the transferee.

A demerger is the split of a legal entity by transferring certain parts of its business (i.e., assets and liabilities, contracts, employees, etc.) to a receiving company. The act distinguishes between three basic types of demerger:

Split (Aufspaltung)

Spin-off (Abspaltung)

Hive-down (Ausgliederung)

Each of these types of division can be affected by acquisition or the formation of a new company and is a commonly used tool in carve-out transactions.

# Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most popular forms of incorporated entities (Kapitalgesellschaften) are the GmbH and the stock corporation (Aktiengesellschaft (AG)). Both are legal entities that provide limited liability for their shareholders. In general, when conducting business through one of these two corporate bodies, only the company's (and not the shareholder’s) assets are accessible by the creditors of the company to satisfy their claims. In return, the establishment of both entities requires a certain minimum capitalization and the share capital is subject to certain capital maintenance restrictions.

The GmbH is the most common vehicle to conduct business, and it suits almost all kinds and sizes of operation. Its governing regime, the German Limited Liability Company Act (GmbHG), does provide the shareholders with broad possibilities regarding the arrangement of the entity's organization and corporate governance. Due to its flexibility, it is widely accepted among small and medium-sized corporations.

# What are the different types of limited liability companies?

The vast majority of German companies exist in the form of a GmbH. However, German law also offers a number of other legal forms, including AGs and partnerships (Personengesellschaften). A GmbH may be formed by one or more shareholders. The minimum share capital of a GmbH is EUR 25,000. Beyond the duty to pay in the share capital subscribed for, the shareholders are, in principle, neither liable for obligations of the GmbH nor required to pay in any additional share capital.

The corporate governance of the GmbH is structured as a two-tier system, consisting of one or more managing directors on the one hand and the shareholders' meeting on the other hand. Such a two-tier structure, however, is not mandatory. The articles of association may provide for the existence of a third tier, such as a supervisory board or an advisory board. Sometimes, the existence of a supervisory board is mandatory. Such mandatory supervisory boards have to have a ratio of employee representatives on the board.

The managing directors are responsible for the management of the GmbH and its representation vis-à-vis third parties. Their signatory power is unlimited vis-à-vis third parties and can only be restricted by granting a joint signature power to be exercised together with another managing director or a registered representative (Prokurist). In addition, it is possible to implement internal restrictions, such as approval requirements regarding certain transactions. However, such restrictions generally do not apply vis-à-vis third parties, who may rely on the managing director's unrestricted signatory power unless the third parties are aware of any internal restrictions.

In spite of the rather far-reaching powers of managing directors, the ultimate authority in a GmbH without a mandatory supervisory board remains with the shareholders, who are entitled not only to collectively decide on the appointment and removal of the managing directors but also to give the managing directors binding instructions on issues relating to the management of the company. Further, the shareholders' meeting has the competence to make decisions for the company with regard to certain fundamental issues provided for by law or the articles of association, such as the amendment of the articles of association, an increase or decrease of the registered share capital, the use of profits, liquidation or transformation of the company, etc. Nevertheless, the shareholders do not have authority to represent the GmbH vis-à-vis third parties.

# Is there a restriction on shareholder numbers?

Both a GmbH and an AG, can have one or several shareholders. With respect to partnerships, the number of partners needs to be at least two.

# What are the key features of a share sale and purchase?

By acquiring all of the shares or partnership interests in a legal entity, a buyer acquires all rights associated with the ownership of the shares or partnership interests. In particular, this includes the right to control the legal entity and to receive profits generated by it. At the same time, the buyer indirectly (as the new owner of the legal entity) acquires all liabilities and risks associated with the legal entity.

Since the change in ownership of the shares or partnership interests occurs only on the shareholder level, the legal entity and its business will not change as a result of the acquisition.

The sale of shares in a GmbH requires the SPA, including all exhibits and annexes, to be notarized by a German notary. SPAs relating to shares in other types of companies (e.g., stock corporations or partnerships) generally do not require notarization and may be entered into by simply signing the SPA.

# What are the key features of an asset sale and purchase?

German law does not provide for specific regulations regarding the sale and transfer of a business as a going concern. Instead, each asset must be sold and transferred individually. In particular, with respect to the transfer of ownership, it is important to observe the statutory requirements regarding the different types of assets that make up the business being sold.

An asset sale does not typically require any notarization unless the sold assets include owned real estate, shares in a GmbH or the seller is selling all or almost all of its assets as a whole. An APA is typically more extensive and detailed because it has to specify all individual assets, liabilities, contracts, employees, etc., that make up the sold business. This typically results in extensive exhibits to the APA. In particular, with regard to tangible assets, German law requires an exact specification of the assets in the APA, or an exhibit.

Although the liabilities and risks of an acquired business generally do not transfer to the buyer unless specifically provided for in the APA, there are circumstances under which a buyer may become liable for the obligations of the previous owner of the business. This will be the case, for example, where an acquired business is carried on under the previous company or trading name of the seller (Section 25, Handelsgesetzbuch  (HGB)). Such assumption of liabilities by operation of law can be avoided by an agreement between the seller and buyer, which becomes effective vis-à-vis third parties when published in the Federal Gazette and registered in the commercial register.

Buyers without a German entity that can acquire the assets making up the sold business, usually set up a special purpose vehicle that acts as a buyer and conducts the German business operations going forward.

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