ALLEN & OVERY

Act on the Implementation of the Directive on Cross-border Reorganisations (UmRUG)

January 2023

On 20 January 2023, the German parliament (*Bundestag*) approved the Act on the Implementation of the Directive on Cross-border Reorganisations and on the Amendment of further Acts (*Gesetz zur Umsetzung der Umwandlungsrichtlinie und zur Änderung weiterer Gesetze*, **UmRUG**). Hence, for the first time, cross-border spin-offs (*Spaltung*) and changes of legal form (*Formwechsel*) can be carried out within the EU and EEA member states. These new rules complement the well-established provisions on cross-border mergers and allow for a simplified transfer of assets as well as a legally secure transfer of the registered office within member states.

The UmRUG also provides for fundamental changes within the national reorganisation law and thus eliminates problematic issues that had been criticised for decades.

The UmRUG will not, as previously planned, enter into force together with the Act on Employee Codetermination in the Event of Cross-border Changes of Legal Form and Cross-border Spin-offs (*MgFSG*) on 31 January 2023, but on the day after promulgation, thus, probably at the end of February 2023.

Overview of the substantial changes

Through the implementation of the Directive on Cross-border Reorganisations dated 27 November 2019[1], an amending directive to the directive relating to certain aspects of company law,[2] cross-border spin-offs and cross-border changes of legal form are made possible for the first time. The German legislator also uses the opportunity to remedy long-standing points of criticism of domestic German reorganisation law.

With regard to the government draft dated 5 October 2022 (*Regierungsentwurf*), only minor changes have been made, which are listed as an overview in the appendix.

In essence, the UmRUG provides for the following changes:

- introduction of a new 6th book of the German Reorganisation Act (*Umwandlungsgesetz*, **UmwG**) titled 'Cross-border Reorganisations: It includes the previous provisions on cross-border mergers (sections 122a et seq. UmwG) as well as the cross-border spin-off and the cross-border change of legal form;
- extended deadline for the disclosure of the merger report in the case of cross-border mergers;
- abuse control by the commercial register;
- introduction of cross-border spin-offs by way of formation of a new entity as well as cross-border spin-offs by way of absorption for corporations;
- introduction of cross-border changes of legal form for corporations;
- limitation of joint and several liability (*Nachhaftung*) for domestic and cross-border spin-offs;
- complete exclusion of the claims against the valuation of the shares brought by the shareholders of the acquiring legal entities and by the shareholders of the transferring legal entities from the legal challenge against shareholders' resolutions (*Beschlussmängelklage*) and, instead, such claims to be raised under the appraisal proceedings;
- possibility of granting shares instead of supplementary cash payment;
- widening of the dispensability of reorganisation reports to further group constellations;
- concentration of proceedings with regard to appraisal proceedings.

Amendments to the rules on cross-border mergers

The provisions on cross-border mergers provided in sections 122a to 122m UmwG are transferred to sections 305 et seq. of the new draft UmwG (**UmwG-E**). However, the procedure remains unchanged; the provisions are subject to only minor changes.

Scope

The scope of cross-border mergers is extended. In addition to corporations, commercial partnerships (*Personenhandelsgesellschaften*) with fewer than 500 employees may be involved as an acquiring or newly established entity in the future (section 306 para. 1 no. 2 UmwG-E).

Extended information in the merger plan

New information to be provided in the merger plan includes information on safeguards offered to creditors (section 307 para. 2 no. 14 UmwG-E) and information on the effect of the merger on

[1] Directive (EU) 2019/2121 of the European Parliament and of the Council of 27.11.2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and spin-offs.
[2] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14.6.2017 relating to certain aspects of company law.

occupational pensions and occupational pension rights (section 307 para. 2 no. 16 UmwG-E). Furthermore, details of an offer of a cash compensation pursuant to section 313 UmwG-E must be included. In particular, the postal address and email address to which shareholders can address their acceptance of the cash compensation offer should be mentioned. If shares of a German limited liability company (*Gesellschaft mit beschränkter Haftung,* **GmbH**) are offered as consideration for the cash compensation, the shareholders' declaration of acceptance requires notarial certification (*notarielle Beurkundung*) pursuant to section 15 para 4 of the German Act on Limited Liability Companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, **GmbHG**).

Special advantages granted to the auditor of the merger do no longer need to be mentioned in the merger plan.

Amended publication period of the merger plan

Contrary to the government draft and the existing provision in section 122d UmwG, the one-month period before the shareholders may resolve on the resolution concerning the cross-border merger is no longer triggered by the submission of the merger plan to the commercial register, but only on the date of its publication (section 308 para. 1 sentence 4 UmwG-E). Hence, in the future, sufficient processing time by the commercial register must be taken into account when submitting the merger plan.

Threefold spin-off of the merger report

A new requirement is the prescribed threefold spin-off of the merger report into a general section, a shareholder-specific section and an employee-specific section (section 309 para. 2 to para. 5 UmwG-E). Alternatively, two separate reports may be prepared consisting of a general section and a shareholder-specific section on the one hand and a general section and employee-specific section on the other (section 309 para. 3 UmwG-E).

While the general section is intended to explain and justify the effects of the cross-border merger on the economic activity of the company, the shareholder-specific section particularly serves the purpose to explain the exchange ratio, any cash compensation amounts, underlying valuation methods and remedies. The employee-specific section must provide employees with a sufficient information basis for submitting an opinion by disclosing information on effects on the employment relationship.

6-week period for making the merger report available

In the future, the merger report must be made electronically accessible to the shareholders of the reporting companies and to their works council (or their employees, if no works council exists) no later than six weeks before the date of the shareholders' resolution (section 310 para. 1 sentence 1 UmwG-E). This extended period leads to the peculiar situation that the merger report must be made available before the merger plan must be made available. In practice, it is to be expected that the merger plan (draft) will be completed earlier and made available at the same time as the merger report (cf. section 310 para. 1 sentence 3 UmwG-E).

Possibility to submit comments and statements

A new feature is the possibility for shareholders, creditors and works councils (or employees, if no works council exists) to submit comments on the merger plan to the company no later than five working days before the date of the shareholders' meeting. Reference must be made hereto when the merger plan is published (section 308 para. 1 no. 4 UmwG-E).

Works councils (or, alternatively, employees) may also submit statements on the merger report to the company no later than one week before the shareholders' resolution (section 310 para. 3 UmwG-E). Shareholders must to be informed thereof and provided with a copy of the statement.

Comments and statements submitted in due time must be attached to the application of the merger when it is submitted to the commercial register (section 315 para. 2 no. 1, no. 2 UmwG-E).

Widened dispensability of the merger report

As before, the merger report will still be dispensable in accordance with the general exceptions of section 8 para. 3 UmwG-E, which have been extended to further group constellations through the

UmRUG. These constellations now also include the merger of sister companies (so-called side-stream mergers) that are held directly by the same parent company. In addition, regarding the transferring legal entities of a cross-border reorganisation, the shareholder-specific section of the merger report is dispensable in the case of mergers of sister companies in which the shares are held only indirectly by the same parent company, provided that no shares are granted to the shareholder of the transferring legal entity (section 307 para. 3 no. 2 lit. b). lit. c) in conjunction with section 309 para. 6 sentence 2 UmwG-E).

The employee-specific part is dispensable if the participating company and its subsidiaries do not employ any employees (section 309 para. 6 sentence 3 UmwG-E).

Increased protection of creditors of the transferring legal entity

The time limit for creditors of the German transferring legal entity to demand the granting of safeguards for their claims was extended from two to three months (section 314 para. 3 UmwG-E). For this, the claim for the granting of safeguards must now be asserted by judicial process.

The government draft had originally intended a significantly increased protection of the creditors of the transferring legal entity by requiring the management board to make a declaration – subject to criminal prosecution in case of wrongful declaration – when applying for registration of the merger with the commercial register that no granting of a safeguard had been asserted by judicial process within the period set forth in section 314 para. 3 UmwG-E. This is no longer included in the final version of the UmRUG. This means that the 3-month period must only be expired before the court's comment stating that the prerequisites for the cross-border merger are met is entered in the commercial register (cf. section 316 para. 2 sentence 1 UmwG-E). However, the comment may not be entered into the commercial register if a claim requiring a safeguard has been asserted by judicial process, unless the company has proven to the court that the safeguard has been granted.

Abuse control in the context of the commercial register's assessment

Pursuant to section 316 para. 1 sentence 1 UmwG-E, the commercial register must now examine within three months whether the conditions for the cross-border merger are met for the transferring legal entity. This period may be extended by a further three months.

As part of the abuse control, the commercial register also examines whether the cross-border merger serves abusive or fraudulent purposes that lead to evading national or EU law or pursuing criminal objectives. It is particularly welcome that, contrary to the government draft, the final version of the UmRUG now mentions specific examples of abusive or fraudulent purposes (section 316 para. 3 sentence 4 UmwG-E).

The cross-border spin-off

The standardisation of cross-border spin-offs in sections 320 to 332 UmwG-E follows the modular system of the UmwG and refers comprehensively to the provisions on cross-border mergers and provisions on domestic spin-offs. The procedure, time limits and exceptions therefore apply mutatis mutandis. In this respect, only spin-off-specific peculiarities will be discussed below.

Scope

As the transferring legal entity or the newly established legal entity, only corporations (the German stock corporation (*Aktiengesellschaft,* **AG**), the European stock corporation (*societas europaea,* **SE**), the German partnership limited by shares (*Kommanditgesellschaft auf Aktien,* **KGaA**) and the German limited liability company (*Gesellschaft mit beschränkter Haftung,* **GmbH**)) can participate in the cross-border spin-off.

Under German law, both the cross-border spin-off by way of establishing a new entity and the cross-border spin-off by way of absorption are possible. In this way, the UmRUG is implementing the directive on cross-border reorganisations excessively.

Limited scope of the cross-border spin-off by way of absorption

In contrast to the cross-border spin-off by way of establishing a new entity, the applicability of the cross-border spin-off by way of absorption is limited to (i) a transferring domestic legal entity with fewer than 400 employees or (ii) an acquiring domestic legal entity employing less than four-fifths of the number of employees which triggers co-determination in the state of the transferring foreign company (section 332 sentence 1 UmwG-E). The calculations are based on the 6-month average prior to disclosure of the spin-off plan. This prevents the question of the employee participation procedure in the event of a spin-off by absorption, which is not regulated by EU law.

Extended disclosures in the spin-off plan

According to section 322 para. 2 UmwG-E, information required in the spin-off plan specifically for a spin-off includes, inter alia, any amendments to the articles of association of the transferring legal entity and an indicative timetable for the process of the spin-off. In addition, the assets and liabilities of the transferring entity must be clearly described and their allocation explained. A novelty is also the information on the valuation of the assets and liabilities remaining with the transferring legal entity.

Limitation of joint and several liability (for domestic and cross-border spin-off)

In the case of a cross-border spin-off, joint and several liability (*Nachhaftung*) is also valid, i.e. the transferring legal entity and the acquiring legal entity are jointly and severally liable for the liabilities of the transferring legal entity which were established before the spin-off came into effect (section 133 para. 1 in conjunction with section 320 para. 2 UmwG-E). With the UmRUG, the legislator now sets a limitation of liability for the joint and several liability for both domestic and cross-border spin-offs: According to section 133 para. 3 sentence 2 UmwG-E, subsequent liability is limited to the value of the net assets allocated on the day the spin-off takes effect, i.e. to the surplus of assets that the company involved receives by way of the spin-off.

Cross-border change of legal form

The cross-border change of legal form pursuant to sections 333 to 345 UmwG-E also follows the modular system of the UmwG. The procedure, time limits and exceptions are broadly the same as for cross-border mergers and, in the case of a change of legal form into a member state's legal form (*Hinausformwechsel*), broadly the same as for the domestic change of legal form. In this respect, only special features specific to changes of legal form will be discussed below.

Scope

The cross-border change of legal form standardises the change of a company incorporated under the law of an EU or EEA member state into a legal form of another member state by transferring the registered office to this state (section 333 para. 1 UmwG-E). Entities changing the legal form and new entities can only comprise corporations, i.e. under German law only AG, KGaA, GmbH and the already established SE.

Extended information in the plan for the change of legal form (Formwechselplan) and formal requirement

Specific requirements regarding the information in the plan for the change of legal form are an indicative timetable and the description of the incentives or subsidies that the company has received in the last five years (section 335 para. 2 no. 5, no. 10 UmwG-E).

Contrary to the domestic change of legal form, the plan for the change of legal form in a cross-border context must be notarised (section 335 para. 3 UmwG-E). However, the written form is still sufficient for the submission to the commercial register for disclosure.

No widened dispensability of the change of legal form report

Unlike in the case of cross-border mergers and spin-offs, there are no widened exemptions for further group constellations since only one entity is involved in a cross-border change of legal form. The

shareholder-specific section of the change of legal form report (*Formwechselbericht*) is therefore only dispensable if only one shareholder is involved or if all shareholders waive the report. The employee-specific section of the change of legal form report is not required if the entity and any subsidiaries employ no employees.

Change of legal form audit

Contrary to the domestic change of legal form, but in accordance with the cross-border merger and the cross-border spin-off, a cross-border change of legal form requires an audit pursuant to sections 9 to 11 and 12 para. 1 UmwG. The subject of the audit is the (draft) plan for the change of legal form, in particular the appropriateness of the cash compensation and the underlying valuation method. The audit report must be made available to shareholders no later than one month before the date of the resolution on the plan of the change of legal form (section 338 para. 1 sentence 3 UmwG-E).

Application and registration

The application and registration of the change of legal form into a member state's legal form (*Hinausformwechsel*) as well as the change of legal form from a member state's legal form into a domestic legal form (*Hereinformwechsel*), (section 345 UmwG-E) is conducted according to the two-steps procedure as it is the case for the cross-border mergers and spin-offs.

Amendments to co-determination rules in cross-border reorganisations

Furthermore, in the case of cross-border mergers, there will also be a change in the Act on Co-determination of Employees in Cross-border Mergers (*Gesetz über die Mitbestimmung der Arbeitnehmer bei einer grenzüberschreitenden Verschmelzung*, **MgVG**). The new version of section 5 no. 1 MgVG lowers the threshold for the applicability of MgVG provisions on co-determination of employees by agreement or by law in the sense of a "four-fifths rule". Deviating from the previous threshold of 500 employees, in the future the decisive threshold will be that at least one of the participating companies employs an average number of employees that corresponds to at least four fifths of the threshold triggering employee participation as specified in the law of the member state of such company in the six months before disclosure of the merger plan. This is intended to prevent national thresholds from being circumvented by means of a cross-border mergers at an earlier time.

A parallel provision can be found for the cross-border change of legal form and the cross-border split in section 5 No. 1 MgFSG.

Amendments to the domestic reorganisation law

Synchronisation of claims regarding the valuation by shareholders of acquiring legal entities and transferring legal entities

The exclusion of claims against the valuation by shareholders of a transferring legal entity from the legal challenge against shareholders' resolutions (*Beschlussmängelklage*) and, instead, such claims to be raised under the appraisal proceedings provided for in section 14 para. 2 UmwG, is extended to shareholders of acquiring legal entities. Thus, after many years of criticism, the unjustified different treatment of the claims concerning the valuation of shareholders of transferring legal and shareholders of acquiring legal entities has been resolved. The claims concerning the valuation are uniformly shifted to the appraisal proceedings. As a consequence, the method of a reorganisation by way of establishing a new entity, where no shareholders exist in the acquiring legal entity prior to registration and which is often chosen in practice to avoid a blockage of the registration with the commercial register, is no longer necessary for reasons of minimising the risk of litigation.

Possibility of granting shares instead of supplementary cash payment

Instead of the supplementary cash payment pursuant to section 15 UmwG, an acquiring AG, KGaA or already existing SE with its registered seat in

Germany, may in the future compensate an inappropriate exchange ratio by granting shares (sections 72a, 72b UmwG-E). Previously, since the compensation determined by way of the appraisal proceedings was necessarily made by cash payment, this could lead to a considerable and in advance hardly calculable burden on the liquidity of the entity concerned.

The option to grant shares in lieu of cash payment must be exercised upon conclusion of the merger agreement and is binding (section 72a para. 1 UmwG-E). Apparently, a mixed form of compensation is not possible, i.e. the inappropriate exchange ratio cannot be compensated partly by shares and partly in cash; exceptions exist, inter alia, in the case of compensation of fractional amounts (section 72a para. 3 no. 1 UmwG-E).

Section 72b UmwG-E provides for a special provision for the purpose of granting shares pursuant to section 72a UmwG-E by allowing the issuance of new shares by way of a capital increase against contributions in kind. In this context, the claims of the shareholders to receive additional shares as determined by way of appraisal proceedings or by court settlement serve as contribution in kind (section 72b para. 1 sentence 2 UmwG-E). Provisions on subscription rights do not apply in this case (section 72b para. 2 sentence 2 UmwG-E). Measures taken in the meantime (e.g. capital increases) or distributed profits are to be compensated (section 72a para. 5 UmwG-E).

Widening of the dispensability of reorganisation reports to further group constellations

According to section 8 para. 3 UmwG, reorganisation reports were previously dispensable if the acquiring legal entity was the sole shareholder of the transferring legal entity or if all shareholders of all legal entities involved waived the report in notarised form.

The provision on dispensability pursuant to section 8 para. 3 UmwG-E now comprises the following cases:

- the acquiring legal entity is the sole shareholder of the transferring legal entity (e.g. upstream merger);
- all shares of the transferring legal and the acquiring legal entity are held by the same legal entity (reorganisation between sister companies);
- the legal entity involved in the reorganisation has only one shareholder.

In addition, the possibility of waiving is also facilitated. In the future, the shareholders of a participating legal entity will be able to independently waive their reorganisation report by way of notarised waiver; a waiver by all shareholders of all legal entities involved is no longer necessary.

Definitions in the rules specific to changes of legal form

In addition, the purely editorial amendment of sections 190 et seq. UmwG-E, which now replaces the confusing wording of the 'reorganisation resolution' (*Umwandlungsbeschluss*) and 'reorganisation report' (*Umwandlungsbericht*) with 'change of legal form resolution' (*Formwechselbeschluss*) and 'change of legal form report' (*Formwechselbeschluss*), is highly welcome.

Amendments to the German Act on Appraisal Proceedings (Spruchverfahrensgesetz, **SpruchG***)*

Section 2 para. 2 of the new draft German Act on Appraisal Proceedings (**SpruchG-E**) provides for a concentration of proceedings. Accordingly, proceedings which are materially related but are pending before several courts or for which several courts have jurisdiction are bundled at the court first involved with the matter. This is intended to avoid conflicting rulings regarding the same reorganisation measure in the future.

Appendix: Overview of changes in the final version of the UmRUG compared to the government draft

The main changes to the final version of the UmRUG adopted by the Bundestag compared to the version of the government draft are as follows:

- *Change of the reference date of the one-month period between merger plan and shareholder resolution:*

The government draft and the previous provision in section 122d UmwG were based on the submission of the merger plan to the commercial register for the period of one month prior to the shareholders' resolution on the cross-border merger. According to the UmRUG, the calculation of the one-month period must now be based on the date of publication of the merger plan instead (section 308 para. 1 sentence 4 UmwG-E).

- *Clarification of duplication in case of dispensability of the merger report:*

In the context of the dispensability of the merger report, the government draft provided for a comprehensive reference to the constellations mentioned in section 307 para. 3 no. 2 UmwG-E. The final version of the UmRUG limits the reference in section 309 para. 6 sentence 2 UmwG-E to section 307 para. 3 no. 2 lit. b), lit. c.) UmwG-E. In this respect, however, it is not a question of restricting the content of the reference, but is of a purely editorial nature. The case referred to in section 307 para. 3 no. 2 lit. a) UmwG-E is already covered by the general dispensability under section 8 para. 3 UmwG-E (upstream merger).

- *Creditor protection arrangements for cross-border reorganisations:*

In order to protect the creditors of the transferring legal entity, the government draft had originally provided that the management board should issue a declaration – subject to criminal prosecution in case of wrongful declaration – when applying for registration of the merger with the commercial register that no granting of a safeguard had been asserted by judicial process within the period set forth in section 314 para. 3 UmwG-E. This is no longer included in the final version of the UmRUG. Accordingly, the 3-month period must only be expired before the court's comment stating that the prerequisites for the cross-border merger are met is entered in the commercial register (cf. section 316 para. 2 sentence 1 UmwG-E).

- *Specific examples of abusive or fraudulent reorganisation purposes:*

It is highly welcome that in the final version of the UmRUG, the legislator mentions specific examples of abusive and fraudulent reorganisation measures for the purpose of increased legal certainty.

Apart from the issues mentioned, the change made with regard to the government draft are mainly editorial changes.

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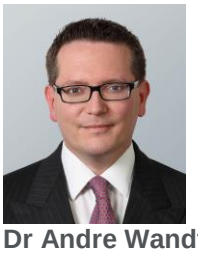

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