



# YPOG Briefing:

## Cross-border Conversions – New Legal Framework Enters Into Force

Berlin, 8. March 2023 | Dr. Martin Schaper und Dr. Karen Frehmel-Kück

On February 28, 2023, the Law on the Implementation of the Transformation Directive and Amendment of other Laws ("**UmRUG**") was promulgated and entered into force on March 1, 2023. For the first time, the UmRUG creates a uniform legal framework for cross-border divisions and cross-border changes of legal form of German corporations (notably the joint stock corporation (*AG*), the *Societas Europaea* (*SE*), the partnership limited by shares (*KGaA*) and the limited liability company (*GmbH*)) and thus facilitates cross-border transactions and intra-group restructurings across the border.

Furthermore, the UmRUG addresses other important legal concerns of cross-border transactions: cooperation of the commercial registers of the countries involved across the border, protection of creditors and shareholders who, in the future, would be involved with a company subject to foreign law. The UmRUG not only reforms cross-border transformations, but also partially amends and standardizes the provisions of the Transformation Act (*Umwandlungsgesetz, UmwG*) applicable to national conversions.

### The Most Important Changes at a Glance

The following changes are of particular importance:

- For the first time, the UmRUG introduces statutory regulations for cross-border divisions (*Spaltungen*; henceforth Secs. 320 *et seqq.* Transformation Act) and for cross-border changes of legal form (*Formwechsel*; henceforth Sec. 333 *et seqq.* Transformation Act).
- In the case of cross-border transformations as well as in the case of domestic transformations, the rights of the shareholders will be standardized. In the future, both the shareholders of the transferring and the shareholders of absorbing entity will be able to request an appraisal proceeding to review the appropriateness of the conversion ratio.
- The joint stock corporation (*AG*), the partnership limited by shares (*KGaA*) and the *Societas Europaea* (*SE*) are able to make necessary adjustments to the value ratios in a liquidity-preserving manner by means of additional shares.
- In deviation from the subsequent creditor protection regime that applies to domestic transformations, cross-border transformations in which German companies are involved as the transferring entity will in future be subject to prior creditor protection. This impacts the implementation period of cross-border conversions and must be taken into account in when setting up the project timeline.
- Henceforth, a uniform, Europe-wide compatible process of interconnection will apply to the commercial registers involved in conversions of corporations. Furthermore, the registration



courts will play a greater role in cross-border conversions, among other things through the so-called abuse control.

### **Unification Protection of unitholders**

In the case of cross-border mergers and divisions as well as cross-border changes of legal form, the shareholders who voted against the conversion have, as of the UmRUG becoming effective, the right to exit the transferring company in return for cash compensation. In contrast to the concept of domestic conversions, the shareholders in cross-border conversions will never become shareholders of the company that will be subject to foreign law. The existing shareholders may accept any cash compensation offer within two months after the respective shareholders' resolution has been passed, whereby the shareholders must notify the company of their intention to accept the cash compensation offer within one month after the shareholders' resolution has been passed. This cash compensation offer is conditional on the cross-border conversion becoming effective.

An important innovation for both domestic and cross-border mergers, including mergers to establish a Societas Europaea, and domestic and cross-border divisions is that, as of the UmRUG becoming effective, not only in the case of the transferring entity, but also in the case of the acquiring entity, the complaint that the conversion ratio is not appropriate can no longer be used to challenge the effectiveness of the conversion. Instead, the shareholders of both the transferring and the acquiring entity can subsequently have the appropriateness of the conversion ratio reviewed in (adversarial) appraisal proceedings.

Another welcome innovation is that in case of a national or cross-border merger or division involving a joint stock corporation, a partnership limited by shares or an (existing) Societas Europaea as the acquiring company, in the case of the formation of a Societas Europaea by way of merger and in the case of a domestic change of legal form into a joint stock corporation or a partnership limited by shares, any adjustments to the conversion ratio can no longer only be made by means of an additional cash payment, but also in a liquidity-preserving manner in the form of additional shares. If this option is to be used, this must already be declared in the conversion agreement or conversion plan. The claim to receive additional shares may be satisfied (i) by granting of treasury shares and (ii) by new shares created by a capital increase against contributions in kind (contribution of the claim to receive additional shares).

### **Creditor Protection Through Prior Provision of Security**

With the UmRUG becoming effective, creditors of a German company involved in a cross-border transformation as the transferring entity, have three months as of the announcement of the merger, division or change of legal form plan to apply for the provision of security at the commercial registry responsible for issuing the preliminary certificate. The preliminary certificate may not be issued before the expiry of this three-month' period or – if an application for the provisions of security has been made – before the application has been rejected with final effect or security has been provided accordingly. This prior (rather than subsequent) assertion of claims for the provision of security by

the creditors must be taken into account in the future when planning and structuring the conversion process.

## **Uniform Commercial Register Procedure and Abuse Control**

The large-scale application of the European system of register interconnectivity, a Europe-wide compatible procedure in which the commercial registers involved communicate digitally with each other, should bring relief in the registration procedure. This harmonization of the cross-border execution of registers will hopefully facilitate and accelerate the procedure in the future.

Furthermore, the registration court will henceforth take on a greater role in cross-border conversions. In future, the register court must investigate any possibly abusive, fraudulent or criminal arrangements before issuing the conversion certificate. An abusive arrangement is deemed to exist, for example, if the number of employees in Germany already amounts to 4/5 of the target value relevant for company co-determination, no value is added in the target country and the administrative seat remains in Germany. To what extent this abuse control will impact cross-border conversions, remains to be seen in practice. If the competent register court commences to investigate a possibly fraudulent arrangement, this can prolong the conversion process by up to three months.

## **Conclusion**

In future, cross-border divisions and changes of legal form can be implemented with greater legal certainty. It is particularly welcome that the new provisions of the Transformation Act also address existing deficits of domestic conversion measures. As far as other EU and EEA Member States implement the Transformation Directive on time, the first cross-border transactions under the UmRUG can now already be implemented.