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Lisbon Treaty to Impact Foreign Companies Operating in EU

Changes made through the Lisbon Treaty were intended to make EU institutions more efficient. However, the Lisbon Treaty also goes beyond that and makes changes that will impact companies doing business in or with Europe. *Page 4*

Corporate Due Diligence Review in Germany: Important Facts to be Established

There are times when a corporate due diligence review might show that a seller does not actually own the shares up for sale. *EuroWatch* discusses these problems and sets out procedures for creating legal certainty in such cases. *Page 11*

New Russian Law to Enforce Penalties for Breaches of Competition Law

While criminal sanctions technically existed in Russia under the previous law, they were not enforced in practice. Now the new law sets up criminal penalties for violations under Article 11 (cartels) and Article 10 (abuse of dominant position), including the possibility of seven years imprisonment. *Page 14*

Bribery Bill to Boost Anti-Corruption Enforcement in UK

After several years of criticism over lax enforcement of existing anti-corruption laws, expected passage of the pending Bribery Bill would give the UK a strong platform upon which to build new anti-corruption enforcement efforts. *Page 15*

REMINDER TO OUR READERS: We will be publishing only one issue of **EuroWatch** in December. Our twice-monthly schedule will resume with the January 15, 2010 issue.

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Amendment to the Domestic Parent-Subsidiary Regime

French companies are generally exempt from corporate tax on at least 95% of dividends received from subsidiaries, subject to various conditions including a threshold of 5% ownership and a minimum holding period of two years. This regime, which applies to holdings in French and non-French entities, is not subject to a minimum level of corporate tax imposed on the subsidiary.

Effective January 1, 2011, dividends received from a legal entity situated in an uncooperative State or territory would be excluded from the parent-subsidiary regime. In certain cases, this exclusion would indirectly result in the French interest holder being denied the possibility to benefit from an exemption of 95% of the capital gains on the sale of holdings in a foreign entity.

Non-Deductibility of Certain Expenses

Effective January 1, 2011, certain expenses (interest, royalties, payments for services) paid to entities or individuals in an uncooperative State or territory would not be deductible for tax purposes, unless the taxpayer demonstrates that such payments are being made in connection with a transaction whose main purpose and effect is not to allow the localization of these payments in a uncooperative jurisdiction.

Reinforcement of Existing CFC Legislations

Article 209B of the French Tax Code, which applies to French corporations holding 50% or more of a foreign entity which benefits from a privileged tax regime, would be modified in order to tighten safe harbor rules when the entity is in an uncooperative State or territory.

Modifications to Article 123 bis of the French Tax Code, which concerns French individuals holding 10% or more of a foreign tax-privileged entity, would include a presumption that the 10% threshold would be passed when the foreign entity is in an uncooperative State or territory and the creation of a safe harbor rule to exclude EU entities from the scope of this article, except in cases where an artificial arrangement is set up to circumvent French tax law. ❑

GERMANY

Who Owns the Company?

By Martin Schulz (Jones Day)

One of the most important facts to be established by any corporate due diligence review is whether the seller actually owns all of the shares that are up for sale. Often, the result of such a review is that this is unclear. At worst, the review might even show that, due to an undetected invalid share transfer in the past, the seller definitely does not own the shares up for sale. This article discusses these problems and sets out procedures for creating legal certainty in such cases.

Review of the Ownership of Shares

German corporations do not have share registers providing conclusive evidence regarding the identity of their shareholders. Although the owners of the registered shares of a stock corporation have to be listed in a share register and the shareholders of a limited liability company have to be registered on a shareholders' list, these registrations are merely of a declaratory nature and have effects only between the shareholder and the company. Thus, a bona fide buyer cannot rely on the correctness of these registrations and therefore cannot validly acquire the shares from an incorrectly registered "non-shareholder." However, an exception to this general rule went into effect on November 1, 2008. If a "non-shareholder" of a limited liability company has been incorrectly registered on the shareholders' list for more than three years, a bona fide buyer can acquire shares from the "non-shareholder" unless the incorrectness of the shareholders' list cannot be imputed to the real shareholder, or the buyer knew or should have known that the shareholders' list is incorrect.

German corporations do not have share registers providing conclusive evidence regarding the identity of their shareholders.

Therefore, in order to clarify whether the seller is the owner of all shares that are up for sale, the buyer has to

Who Owns the Company?, continued on page 14

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Who Owns the Company? *(from page 11)*

review all the share issuances and share transfers that took place since the formation of the company. Yet it is often the case, particularly with respect to companies that have existed for a long time, that the seller is not in possession of all the documents evidencing such an uninterrupted chain of share issuances and title transfers.

An even worse situation—though much less common—arises when a buyer detects during its due diligence review that one of the past share transfers or share issuances is void.

In all of these situations it is either unclear whether the seller is the owner of all shares that are up for sale or it is even clear that the seller is not the owner. This poses the question for the buyer whether there are possibilities to move forward with the deal despite such problem.

Guarantee

Typically, the seller guarantees in the share purchase agreement that it is the owner of the sold shares. However, if there are serious doubts as to whether the seller actually is the owner, a guarantee alone will not solve the problem; i.e., the buyer cannot acquire the shares if the seller does not own them, regardless of a guarantee. If the guarantee is incorrect, the seller is merely liable for damages. However, the parties frequently agree that the seller shall not be liable if the buyer knew or should have known that the guarantee is incorrect, particularly if the incorrectness can be observed from the due diligence materials. Finally, guarantees are subject to statutes of limitations.

Repetition

If the due diligence review reveals that a certain share transfer is problematic or that documents evidencing a certain share transfer are missing, one possible option is to repeat such share transfer. However, the parties to that share transfer must still be available and must be willing to repeat it. This is often impossible, particularly with respect to share transfers that occurred a long time ago.

Asset Deal

A further possibility for the buyer is to acquire the business by means of an asset deal instead of a share deal. However, a major problem in the case of an asset deal is that pursuant to German law, contracts and liabilities can be transferred only with the consent of the respective contractual partner or creditor. Obtaining these consents can be time-consuming if there are a great number of contracts and liabilities to be transferred. If a consent cannot be obtained, the parties can contractually agree to treat each other internally as if such consent had been obtained. However, if there are certain very important contracts, e.g., with key customers, the buyer will not want to acquire the business without the consent of the respective contractual partners. If the partners refuse to give their consent, an asset deal is not a solution.

Transformations Pursuant to the German Transformation Act

Finally, in order to clarify the ownership of the shares of a company that is up for sale, it is possible to perform a merger or spin-off pursuant to the German Transformation Act. In the first alternative, the seller has to establish a new company and then merge the company that is up for sale into the new company. Upon registration of the merger in the commercial register, the merged company ceases to exist and the new company becomes its legal successor. Furthermore, upon registration of the merger, there are virtually no circumstances under which it can be reversed. Since the seller has established the new company into which the company that is up for sale was merged, there is legal certainty as to the ownership of the shares in the new company. Alternatively, the company that is up for sale can spin off its entire business into a newly established company pursuant to the German Transformation Act. However, procedures pursuant to the German Transformation Act are often time-consuming and costly.

In order to clarify whether the seller is the owner of all shares that are up for sale, the buyer has to review all the share issuances and share transfers that took place since the formation of the company.

Shareholders' Resolutions

In addition to creating legal certainty, a buyer has to review the possible consequences of an (undetected) void share transfer with respect to shareholders' resolutions adopted after such void transfer. There is the risk that such resolutions are void or challengeable because a "non-shareholder" has participated in the resolution and because the real shareholder was not invited to the respective shareholders' meeting.

However, with respect to limited liability companies, this risk is rather low, because in relation to the company, only persons whose shareholder status has been notified to the company (the legal situation until November 2008) or persons registered on the shareholders' list (the legal situation since November 2008), respectively, are deemed to be the shareholders. If only persons legitimatized that way have adopted a shareholders' resolution, such share-

holders' resolution is valid in principle, provided that all other requirements for the effectiveness of the shareholders' resolution are satisfied. This applies even if the person notified or registered as a shareholder is not in fact a shareholder, e.g., due to an undetected void share transfer. Yet there is an exception to this general rule if the management of the company knew about the void share transfer, but such a case is hardly conceivable in real life.

With respect to stock corporations, the regime is identical if the shares are issued as registered shares. In relation to the stock corporation, only the persons listed in the share register are deemed to be the shareholders. Furthermore, resolutions passed in a general shareholder assembly where real shareholders have not been admitted or "non-shareholders" have voted are not void but challengeable. However, any civil actions challenging a shareholders' resolution of the general assembly must be filed within one month of the general assembly. Therefore, shareholders' resolutions of a stock corporation that are older than one month cannot be challenged on the basis of an undetected void share transfer and therefore are not problematic.

Conclusion

The risk that a shareholders' resolution of a corporation is void due to an undetected void share transfer is rather low. Nevertheless, an unclear situation regarding the ownership of the shares that are up for sale poses a significant problem for the buyer, not only because the buyer might in fact not acquire the company that it has sought to buy, but because the financing of the purchase price by means of bank credits might fail if the financing banks have doubts whether the purchaser will actually acquire the shares upon completion of the transaction and thus whether the purchaser will be able to pledge the shares to the banks. Furthermore, if the ownership of the shares is unclear, the buyer might not be able to sell the company in the future. If the required persons are available, the problematic share transfer should be repeated. In all other cases, the buyer should consider acquiring the business by means of an asset deal or having the seller clarify the situation regarding the ownership of the shares by means of a merger or spin-off pursuant to the German Transformation Act. ❏

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