

# The German UMAG of 22 September 2005

by Frank Wooldridge

The above law, the Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) contains a number of important amendments to the German Aktiengesetz (AktG). The lengthy title may be translated as the “Law Furthering Corporate Integrity and the Modernisation of the Regime Covering Shareholder Actions.” The most significant feature may well be the new paragraph 148 incorporated in the AktG governing shareholders’ actions against directors of public companies. The former more restrictive provisions of paragraphs 147(3) and (4) AktG have been repealed. Furthermore, UMAG provides for a new electronic section of the Federal Bulletin, the use of which may facilitate such actions and other kinds of corporate litigation. In addition, UMAG also contains provisions governing the identification and authorisation of shareholders for the purpose of meetings, which may be of most significance in the law of bearer shares, which are very commonly used by German public companies.

Certain of its provisions are designed to restrict the effect of the very extensive information rights available to shareholders in German public companies, which have sometimes been employed abusively. The UMAG also endeavours to restrict the facility enjoyed by shareholders to bring actions to declare decisions taken by the general meeting void on the ground that they are in breach of statutory provisions or the company’s articles. The UMAG contains a number of other provisions as well, for example in relation to special investigations (Sonderprüfungen), but of its rather disparate provisions the aforementioned ones appear the most important and are thus considered below.

## ACTIONS BY SHAREHOLDERS AGAINST DIRECTORS

The right to sue the members of management or supervisory board of a public company for breaches of their duties is governed by paragraphs 147 and 148 AktG. If the action is against members of the management board, the company is represented by the supervisory board. If it is against members of the supervisory board, it is represented by the management board. The former rules contained in paragraph 147(1) concerning actions by members for damages on behalf of the company against managers were found to be unsatisfactory. They could be brought by the holders of 10 per cent of the share capital

or persons holding share capital at least equivalent to €1 million. The holders of such shares were sometimes represented on the supervisory board, and were often satisfied with a settlement between the managers and the supervisory board. The employer representatives on that board sometimes also favoured such a settlement. The new procedure under paragraph 148 may prove to be more satisfactory.

This new procedure has a preliminary stage. A minority consisting of the holders of 1 per cent of all the shares or a nominal capital of at least €100,000 may invoke it, which may result in direct shareholder litigation against the company. It remains that the company may bring an action against members of either board if the general meeting so resolves by a simple majority.

Paragraph 148 AktG contains detailed rules governing the permission of the court. Such permission will be granted if certain requirements are satisfied. Shareholders desirous of suing, or their predecessor in title, must have acquired the shares before they became aware of the alleged breach of duty or alleged damage. Furthermore, they must have endeavoured to induce the company to sue the defaulting officers before they make an application to the court. In addition, the relevant facts must give rise to the suspicion that there has been dishonest conduct or a serious breach of the articles which has caused damages to the company. Furthermore, there must be no overriding grounds based on the welfare of the company for not bringing an action against the company’s relevant officers. If the former requirements are satisfied the court will allow a direct action by the shareholders against officers of the company. The competent court is the Landgericht in the territory in which the company has its seat.

The former rules governing costs contained in paragraph 147(4) AktG, which has been repealed, discouraged potential plaintiffs from bringing actions. The new provisions of paragraph 148(6) AktG concerning costs are quite complex. According to paragraph 148(6), the costs of the preliminary procedure have to be borne by the plaintiff, to the extent that a request to bring proceedings is rejected. However, if such rejection is based on considerations of the welfare of the company, which ought to have, but have not, been mentioned by it before the proceedings began, the company must pay the plaintiff’s

costs. The allocation of costs is decided upon in the final judgment of the court. If the company brings the action itself or takes over an identical action brought by the shareholders, it bears the costs of bringing the action, or those incurred by the shareholder. If the action is dismissed wholly or partially the company has to reimburse the plaintiffs for their costs provided that they were not granted permission to bring the action by deliberately or grossly negligently making incorrect statements.

The new provisions governing derivative actions appear generally balanced and cautious. The use of the procedures provided for in paragraph 148 AktG may be furthered by those of paragraph 127a AktG, which was also incorporated in the Aktiengesetz by UMAG. The latter provision stipulates that shareholders or groups of shareholders may place a notice in the electronic version of the Federal Bulletin with the intention of inducing other shareholders either collectively or with the help of an authorized representative, to make a submission or a claim under the AktG, or to use their voting rights at a general meeting in a particular way. The invitation to the shareholders must contain certain required particulars, and may mention the internet site of the claimants and their electronic addresses. The company may place a rejoinder to the invitation which has been made in the electronic version of the Federal Legal Gazette (Bundesanzeiger). The relevant information might involve giving notice of the intention of the shareholders to pursue a preliminary procedure under Article 148, to initiate a special investigation (Sonderprüfung) of certain managerial conduct, or to propose a vote on a particular topic at a shareholders' meeting (see V Noack and Z Zetzsche, "Corporate governance reform in Germany", 16 EBL Rev (2005), p1033 at p1052 in this sense).

### **INFORMATION CONCERNING THE IDENTIFICATION AND AUTHORISATION OF SHAREHOLDERS FOR MEETINGS**

The recent statute abolishes the old system of *Hinterlegung*, which had long been a feature of German law, and which was referred to in the relevant provisions of the Aktiengesetz of 1965. This system originally involved the deposit of the share certificate, but in recent years it has come to mean the certification of ownership of the relevant shares by the depository banks which hold them. The principal changes to the formerly existing rules set out in new paragraphs 123(1) AktG, which have been incorporated therein by UMAG. Paragraph 123(1) provides that the general meeting must be summoned at least 30 days before the date of the meeting, and only makes minor changes to the previously existing rules.

The provisions of new paragraph 123(2) are more complex. The first sentence of this text provides that the articles may make participation in a general meeting or the exercise of voting rights thereat dependent on the shareholder having given notice to attend. According to the

second sentence of this subparagraph, if the articles contain such a provision, the date by which the shareholders are to give prior notice of their intention to attend shall be substituted for the date of the meeting, for the purpose of determining the period of notice, unless the articles provide for a shorter time period. Finally, paragraph 123(2) provides that the notification concerning the shareholders must be received by the company at its appropriate address at the latest seven days before the meeting, unless the articles prescribe a shorter time period.

The provisions of the paragraph 123(3) are more complex than those of paragraph 123(2), and of considerable practical importance. This text provides that as far as bearer shares are concerned, the articles may provide how the entitlement of the holders to participate in meetings or to use their voting rights shall be evidenced: in such an event, paragraph 123(2) applies by way of analogy. Furthermore, article 123(3) provides that in the case of companies with a stock exchange listing, a notice in a textual form provided by the depository institution shall be sufficient evidence of relevant entitlement. In addition, in the case of such listed companies, evidence of ownership of shares at the beginning of the 21st day before the meeting must be provided by depository banks and must reach the company at the appropriate depository address at least seven days before the meeting, unless the company's articles provide for a shorter period. Finally, paragraph 123(3) provides that participation in and voting at the general meeting is only open to a shareholder who has provided the required evidence. The record date of ownership of at least 21 days before the meeting is thus of very considerable importance.

### **CERTAIN RESTRICTIONS ON SHAREHOLDERS' INFORMATION RIGHTS**

Shareholders in a German public company are given very extensive information rights by paragraph 131(2) AktG; they may however be refused information on the grounds set out in article 131(3). It has been contended that the shareholders' right to information has sometimes been abused in recent years, especially for the purpose of initiating shareholders' actions (V Noack and D Zetzsche, *op cit*, p 1044). In order to limit the number of questions asked by shareholders, which must be answered by the management board at the general meeting if they concern the company's affairs, and the required information is necessary to permit a proper evaluation of an item on the agenda, UMAG contains a provision incorporating a new paragraph 132(3), sentence 7, in the Aktiengesetz. This provision stipulates that the management board may refuse to provide information where it is available on the company's internet site at least seven days before the general meeting and is generally accessible throughout that meeting.

Furthermore, paragraph 243 (4) provides that a resolution of the general meeting can only be set aside by

reason of the provision of incomplete or inaccurate information, or for failure to provide information if a shareholder exercising objective judgment would have regarded the provision of such information as essential for the evaluation of his rights of membership and participation in the company. Paragraph 243(4) also provides that the provision of inaccurate or incomplete information or the failure to provide information in the general meeting about the determination of the amount, or appropriateness of compensation, payments by way of settlement, additional payments, or other types of payment, cannot form the basis of an attempt to avoid a resolution where there is statutory provision for a special administrative procedure (Spruchverfahren) in the case of a dispute. Such a procedure is sometimes available in disputes relating to shareholders' rights in the content of groups of companies.

### OTHER LIMITATIONS ON THE AVOIDANCE OF SHAREHOLDERS' RESOLUTIONS


As indicated above, a resolution of a shareholders' meeting may be avoided by means of an action based upon the law or the articles. It has already been shown that paragraph 243(4) AktG contains certain exceptions to this rule. The avoidance of shareholders' resolutions has sometimes given rise to prolonged disputes in the past which have not always proved beneficial to German public companies.

A further limitation on the avoidance of certain such resolutions is contained in paragraph 246a AktG, as inserted therein by UMAG. By paragraph 246a(1), if the resolution of a general meeting governing the provision of capital, its reduction, or the conclusion of an enterprise agreement is subject to an action to avoid it brought in the competent court (the district court or Landgericht), the court may make an order providing that the bringing of the action shall not preclude the registration of the resolution, and that any defects in the resolution shall not affect the operation of such registration. It is noteworthy that the avoidance of the particular types of resolution mentioned in paragraph 246(a)(1) may sometimes have a particularly detrimental effect on the company and its shareholders.

By paragraph 246a(2) AktG the court may only make such an order when the action to avoid the resolution is clearly groundless, or impermissible, or when the

immediate working of the contested resolution is according to the court's independent connection appropriate to safeguard the company and its shareholders from substantial harm. Account must be taken by the court of the seriousness of the breaches alleged in the action to amend the resolution. It is necessary to demonstrate and prove facts on the basis of which the order may be made. An appeal lies to the Regional Appeal Court (Oberlandesgericht) against the decision of the district court (Landgericht).

According to paragraph 246a(3) AktG, the order should be made within three months of being requested. If the Landgericht (court of first instance) determines that the resolution and the measures therein shall take effect, and if the resolution is found to be illegal by the Regional Appeal Court, it follows from article 246(a)(4) AktG that the claimant is entitled to damages, but the relevant measure will be treated as valid in accordance with the preliminary judgment. The preliminary procedure by which the Landgericht decides whether the management may challenge the measure must be completed within a period of three months.

The statute considered in the present short article makes a number of piecemeal changes in German law and seems to have been influenced by domestic pressure rather than any Community measures or recommendations. It should help overcome the difficulties experienced in bringing a derivative action against officers of a German public company which have received much attention in recent years. The new provisions governing the costs of such actions will probably be welcomed. The limitation placed on the powers of the general meeting will restrict the possibility of abuses of power by this organ. The rather complex rules restricting the general meeting's power to avoid certain resolutions are designed to prevent the undue protraction or frustration of certain common transactions, and appear in principle to be justified. UMAG is one of the many recent German statutes which have made important changes to German company law. These changes have been made in a rather unstructured fashion, and nothing so ambitious as the UK Company Law Act 2006 has been enacted in that country. 

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