

Company & Commercial - Germany

Federal court to rule on non-German company directors' liability

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Introduction

In a series of judgments the German courts have subjected directors of UK limited companies with 'centres of main interest' (COMI) in Germany to German insolvency law. In its judgment of September 24 2009 the Berlin Higher Regional Court held that the director of an UK limited liability company whose COMI is situated in Berlin was personally liable for payments made after the company has become insolvent or over-indebted, as set out in Section 64, Paragraph 2 (now Paragraph 1) of the Act on Limited Liability Companies.

This issue has long been disputed by legal commentators. The case has now been referred to the Federal Court of Justice and it is unclear whether the federal court will decide on the issue itself or present it to the European Court of Justice (ECJ).

Case

In the case before the Berlin Higher Regional Court, the defendant was director of the UK limited liability company E and the director of BG Ltd, also a UK private limited company. BG Ltd operated mainly in Berlin and its business interests were concentrated there (ie, it had a German COMI according to EU insolvency law). BG Ltd was in financial crisis and was cash-flow insolvent. Nevertheless, the defendant effected cheque payments and cash withdrawals from BG Ltd's bank account totalling €131,833.82. Subsequently, insolvency proceedings were opened and the insolvency court appointed a German liquidator. The liquidator claimed the amount of €131,833.82 plus interest from the defendant, based on Section 64, Paragraph 2 (now Paragraph 1) of the Act on Limited Liability Companies. Under this provision, the director of a German limited liability company is personally liable for payments effected after the limited liability company became insolvent (cash-flow insolvency) or over-indebted (balance-sheet insolvency). Whether such payments were made for the director's own benefit is not considered relevant. Neither is it relevant whether the carrying on of the business increased the company's losses. Personal liability is excluded only if the payments were in line with the diligent conduct of a prudent businessperson – that is, the payments were necessary to prevent major losses for the company's assets in view of possible insolvency proceedings or represented an attempt to save the company within the three-week term.

The court first examined the question of whether Section 64, Paragraph 2 of the act applies to directors of foreign companies. According to the court, Section 64 aims to preserve the assets of an insolvent company in order to allow for an equal distribution of such assets to all creditors in subsequent insolvency proceedings. Therefore, the court ruled that Section 64, Paragraph 2 is applicable to directors of foreign companies, irrespective of whether the company law of the state of the companies incorporation (in the case of BG Ltd, the United Kingdom) contains a similar provision.

In addition, the court addressed the issue of whether the application of Section 64, Paragraph 2 to a director of a limited liability company is contrary to the freedom of establishment set forth in Article 49 of the Treaty on the Functioning of the European Union. The court ultimately decided that it is not.

Further implications

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The issue of the extent to which duties under German insolvency law affect directors of foreign companies has another fundamental aspect. German insolvency law requires the director of a limited liability company to file for insolvency proceedings within three weeks of the company's becoming insolvent (cash-flow insolvency) or over-indebted (balance-sheet insolvency). If a director fails to do so, he or she risks personal and penal liability. The German courts have assumed that directors of foreign companies which have their COMIs in Germany are also subject to that provision. Thus, directors of foreign companies which have their COMI in Germany must file for insolvency even if they have realistic prospects of saving the company, but require more than three weeks to ascertain whether this is possible. By contrast, UK law provides that a director must try to save his or her company and not need file for insolvent liquidation until such time as he or she knows, or ought to conclude, that there is no reasonable prospect of the company avoiding going into insolvent liquidation. Such a 'point of no return' would generally be reached after a much longer period than the three-week term applicable under German law.

Furthermore, under UK law there is no automatic liability for payments made after cash flow or balance-sheet insolvency has occurred. A director may be liable for wrongful trading if, after the point of no return, he or she does not take every possible step to minimise potential losses to the company's creditors. Liability for fraudulent trading requires that aspects of the company's business have been carried out with the intent to defraud creditors or for a fraudulent purpose.

Comment

Until this issue has been finally decided by the Federal Court of Justice or the ECJ, in cases of cash flow or balance-sheet insolvency, directors of foreign companies with a COMI in Germany would be well advised to comply with the requirements of Section 64 and adhere to the three-week timeframe to file for insolvency.

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