Characterising The Liability of Directors of an Insolvent English Limited having its Real Seat in Germany: German Federal Court of Justice Requests a Preliminary Ruling from the CJEU

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1. Introduction

In a recent request for a preliminary ruling by the CJEU, the German Federal Court of Justice (*Bundesgerichtshof, BGH*) proposes to apply a German provision of the code on limited liability companies (*GmbHG*) to an English Limited having its real seat in Germany, against whose assets insolvency proceedings have been instituted in Germany (BGH, decision of 2 December 2014 – II ZR 119/14, available – in German – here).

The relevant provision, § 64 sent. 1 GmbHG, holds directors of a GmbH liable for any payments effected after the company has become overindebted or unable to pay upcoming obligations, unless such payments are compatible with the due diligence of an orderly director. Even though this kind of liability does not formally require that insolvency proceedings have been initiated, the BGH tends to classifiy it as a "*law applicable to insolvency proceedings*" within the meaning of Art. 4(1) of the Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings (*Insolvency Regulation*). Thus, the company's Centre of Main Interest (COMI) – and therefore generally the real seat of the company – would determine the applicable law.

Hence, the CJEU is confronted with the questions, (1) whether § 64 sent. 1

GmbHG falls under the scope of Art. 4(1) Insolvency Regulation and (2) whether this characterisation violates the company's freedom of establishment pursuant to Articles 49, 54 TFEU

2. Facts of the Case

The K. Montage- und Dienstleistungen Ltd was founded under the laws of England and Wales in 2004, but mainly operated in Germany. While the company became unable to pay upcoming obligations in 2006 (at least from a legal perspective), it continued its business activities until November 2007, effecting payments during that period of around 110,000.00 EUR to creditors.

Once the company entered into insolvency proceedings in November 2007, the insolvency administrator requested the director of the K. Montage- und Dienstleistungen Ltd to recompense 110,000.00 EUR on the grounds that § 64 sent. 1 GmbHG in conjunction with Art. 4(1) Insolvency Regulation had been violated. The regional court (*Landgericht*) and the higher regional court (*Oberlandesgericht*) have both awarded this claim. In its request for a preliminary ruling, the BGH now suspends court proceedings and refers the case to the CJEU, indicating that it shares the view of the lower courts.

3. The Reasoning of the BGH: § 64 sent. 1 GmbHG as Insolvency Law

The BGH favours the classification of § 64 sent. 1 GmbHG as an insolvency provision – regardless of its formal embedding in German corporate law and despite the fact that an insolvency proceeding is not a technical requirement for triggering this liability –, arguing *inter alia* that

- the provision aims at protecting the insolvency estate in anticipation of upcoming insolvency proceedings;
- all effected payments have to be refunded by the director of the company – even though the payments served to fulfill legally valid claims – with the damage of "prospective insolvency creditors" in view;
- in practice (with rare exemptions) it is the insolvency administrator who asserts the claims arising from § 64 sent. 1 GmbHG;
- from a German point of view, the provision would be regarded as insolvency law.

The BGH further points out that, in its opinion, this interpretation is compliant

with Articles 49, 54 TFEU because it does not prevent companies from establishing a real seat in Germany, but merely checks the "misbehavior" of their directors in cases of insolvency.

4. Open Questions

In its request for a preliminary ruling, the BGH shortly summarizes years of a controversial discussion in German legal literature, somewhat abbreviating the current state of the debate. Just to mention a few additional aspects: Even though it is true that in practice any liabilities of directors under the GmbHG are asserted by the insolvency administrator, it remains possible for creditors to directly sue directors, (1) when insolvency proceedings are not initiated or terminated (massive bankruptcy or formal closure of insolvency proceedings after an insolvency plan has been implemented), or (2) before proceedings have been instituted. If § 64 sent. 1 GmbHG is characterised as insolvency law, how should one classify this provision outside the scope of the Insolvency Regulation? Does the Insolvency Regulation leave room for a "German insolvency law" in terms of private international law? In this context, conflicts rules have to be aligned with the international civil procedural law. In general, once the Insolvency Regulation is applicable, Art. 1(2)(b) of the Brussels Ia-Regulation (No. 1215/2012) precludes the jurisdiction in civil matters. Therefore, the characterisation of the German rule on directors' liability as insolvency law would – at least in theory – interfere with the synchronization of procedural and substantive law. With these difficulties in mind, one could consider alternative routes, e.g. characterising § 64 sent. 1 GmbHG as tort law or using the concept of lack of rules (*Normenmangel*) as the English law provides for a functionally similar liability of directors during insolvency of the company in Sec. 214 Insolvency Act 1986 (*wrongful trading rule*) a rule which is supposedly, however, regarded as insolvency law and not applicable in German insolvency proceedings.

Still, these and other questions have been discussed in German legal literature extensively for years without any definite results. Therefore, any lid on this discussion – at least before the courts – is highly welcomed as well as any specification of CJEU rulings.

In this respect, the CJEU can build on a number of rulings, for example in the cases *Gourdain./.Nadler* (22 February 1979, C 133/78) – in which an early form of the French *action en comblement du passif* was regarded as a provision relating

to bankruptcy proceedings – and *Seagon./.Deko Marty* (12. February 2009, C 339/07) – in which an action by the insolvency administrator to set a transaction aside was treated accordingly. According to settled CJEU case law, the insolvency regulation applies to "*actions which derive directly from insolvency proceedings and are closely connected with them*" (see recently *ÖFAB,* 18 July 2013, C?147/12, para. 24). However, all legal rules mentioned so far make it a mandatory requirement that insolvency proceedings have already been initiated. On the contrary, in a quite recent case the CJEU did not apply the Insolvency Regulation on the grounds that the action in question – a Swedish liability for piercing the corporate veil during undercapitalization – did "*not concern the exclusive prerogative of the liquidator to be exercised in the interests of the general body of creditors*" (*ÖFAB,* 18 July 2013, C?147/12, para. 25). Taking this into account, it remains doubtful whether the CJEU is willing to accept common practice and the purpose of the law as a sufficient link to the "*law applicable to insolvency proceedings and their effects*" within the meaning of Art. 4(1) Insolvency Regulation.