

Directors' liabilities - Germany

1. Obligation to file?

- i) Is there an obligation on directors to file for formal insolvency proceedings ?

Insolvency proceedings are never instituted ex officio, but always upon application filed by the debtor or creditor. This disposition principle, i.e., the right to file, is defined in the Insolvency Code (§ 13 Section 1 InsO). If a creditor files for insolvency proceedings, he must prove that he has a legal interest in the commencement of the insolvency proceedings and furnish prima facie evidence of his claims and his reason for commencement. The director's duty to file for insolvency exists in the event of inability to pay and over-indebtedness for incorporated firms and for unincorporated firms in which no personally liable partner is a natural person. This is stipulated in the appropriate special laws, i.e., in § 64 Section 1 GmbHG (Law on Limited Liability Companies), § 92 Section 2 AktG (Stock Corporation Law), § 130a Section 1 HGB (Commercial Code) and § 177a HGB. If a GmbH is expected in the long run to be incapable of repaying its due debts from ready funds, we talk of inability to pay. Over-indebtedness, on the other hand, prevails if the liabilities are no longer covered by the company's assets.

- ii) If so, when does this arise?

If the duty to file for insolvency applies, the management must immediately – at the latest within three weeks after the reason for the insolvency arises – file for insolvency. In the event of inability to pay, the three-week period commences upon its occurrence. Knowledge is, however, a pertinent factor when it comes to over-indebtedness. This duty attaches to each and every person responsible, irrespective of any representation provisions stipulated in the articles.

2. Who can be held liable?

- i) In addition to directors, which other persons involved in a company's affairs may be held personally liable for their acts, e.g., shadow directors, de facto directors, non executive directors?

Anyone who holds the power of representation in terms of controlling/controlled companies and in legal relations may be designated as a person responsible. This means, first and foremost, the following natural persons: in the "Aktiengesellschaft" (stock corporation), the "Genossenschaft" (co-operative) and the "rechtsfähiger Verein" (association having legal capacity), it is the Vorstand (board), in the GmbH (and therefore also in the GmbH & Co. KG), it is the Geschäftsführer (managing director). An internal allocation of duties does not release the person responsible from its filing duty. The person appointed as the agent (Organ) of the company is not exonerated by the fact that he/she is merely nominally shown to be the person responsible, with, in truth, another person managing the business transactions. A distinction is drawn at this point between "factual agent position" and the "nominee or straw-man position". Factual directors are persons who have not been effectively appointed to their office, although they, in fact, perform the functions of their office, whereas, vice versa, the appointed agents will also be

considered to be liable if they are straw-men. The role of the person responsible is to be seen as a straw-man position if the business partners are clearly aware that the director is merely acting as an extended arm of the person behind the scenes. The insolvency filing duty and the liability when infringing this duty also attaches to the person who, without being appointed as a person responsible, in fact manages the business transactions of the company similar to a person responsible or as a co-responsible person. The total elimination of the persons responsible in law is not required.

3. Sanctions?

i) What are the possible sanctions/restrictions against directors of insolvent companies?

Delayed filing for insolvency carries substantial dangers and risks for the person responsible, both in terms of criminal law and in civil law.

Aspects of criminal law

If the person responsible fails in its insolvency filing duty, he renders himself liable to prosecution (§ 84 Section 1 No.2 GmbHG, § 401 I No.2 AktG, §§ 130b, 177a HGB). A criminal offence is also deemed to have been committed if the director fails to file for insolvency within the 3-week period. In this context, anyone acting negligently is also under threat of prosecution.

There are also other criminal offences which are often realised by directors in connection with insolvency proceedings:

- Bankruptcy offences pursuant to § 283 ff StGB (criminal code)
- Retaining and misappropriation of pay pursuant to § 266 a) StGB
- Tax offences pursuant to §§ 370 ff. AO (Fiscal Code)

Aspects of civil law

For delayed insolvency filing, the person responsible is liable under civil law in external relations from tort pursuant to § 823 Section 2 BGB (Civil Code) in conjunction with the appropriate special law (§ 64 Section 1 GmbHG, § 92 Section 2 AktG, § 130a Section 1 HGB), both in relation to the company and to the company's creditors. The entities deemed to be creditors are both those persons who have acquired claims even before the insolvency (so-called "old creditor") and those persons who have become creditors after the occurrence of the insolvency ("new creditors"). Regarding both the objective precondition of the infringed insolvency filing duty and fault, the onus of proof is reversed, i.e., the person responsible must exculpate itself. As to the amount, the "old creditor" receives only the differential damage, whereas the new creditor is compensated for his entire damage/losses. Differential damage is the difference between the quota which the "old creditor" would receive in case the manager has fulfilled his obligations to what he receives now without this fulfillment. However, in practice, it is very seldom that the person responsible must pay because of this claim.

There are also other special rules and regulations which define the capital liability of the persons responsible. For instance, they are personally liable to the company for payments which have been made without equivalent consideration after the occurrence of the inability to pay or after over-indebtedness has been determined. The liability of the person responsible for failing to pay the employees' share of the

social insurance contributions results from § 823 Section 1 BGB in conjunction with § 266a StGB. Pursuant to § 69 of the Fiscal Code, these persons are liable to the extent that claims from the fiscal relations resulting from the duties incumbent upon them have not been determined or not been determined in good time.

ii) Are any of these sanctions/restrictions imposed automatically?

By virtue of the principle according to which the prosecution of an offence is mandatory (§ 152 Section 2 StPO; Code of Criminal Proceedings), the public prosecutor's office is obliged ex officio to intervene in case of any punishable offences for which reasonable factual aspects or facts are available, unless the law stipulates otherwise. The public prosecutor's office must therefore act ex officio if it gains knowledge of a criminal offence. Beyond its wording, the above principle not only applies to the public prosecutor's office, but also to the judiciary and the police. It prevails throughout the entire proceedings, from their inception and commencement to the completion of execution.

4. Proceedings against the directors?

i) Who can bring the proceedings against the directors?

New creditors can assert their claims against the person responsible directly and outside the insolvency proceedings for reasons of failing to file for insolvency. On the other hand, the assignor's claims is asserted by the insolvency administrator for the estate in insolvency as total losses (§ 92 InsO). If, in spite of the occurrence of the inability to pay or over-indebtedness, a person responsible makes payments from the subsequent assets/estate, the company itself and, during the insolvency, the insolvency administrator asserts these claims pursuant to § 92 InsO. The claims regarding the withholding of social contributions are pursued and asserted by the health insurance funds themselves.

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