

# International Corporate Rescue



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## Liability Claims against Managing Directors Pursuant to Sec. 64 Sentence 1 of the German Limited Liability Companies Act

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### Introduction

German insolvency proceedings aim for the utmost satisfaction of all creditors. This goal can only be achieved through the preservation of the debtor's (insolvency) estate prior to the initiation of insolvency proceedings. Thus, in order to ensure that the debtor's (insolvency) estate is maintained, sec. 64 sentence 1 of the German Limited Liability Companies Act ('GmbHG') provides a limited liability company ('GmbH') with the right to make a liability claim against its managing director(s) for payments made after the company has become illiquid (*zahlungsunfähig*)<sup>1</sup> and/or over-indebted (*überschuldet*)<sup>2</sup>.<sup>3</sup> Such liability claims are often initiated by insolvency administrators against the managing director(s) after the opening of insolvency proceedings and can – in a worst case scenario – result in financial disaster for the former managing director(s).

According to established German case law of the Federal Court of Justice ('BGH'), a managing director cannot be deemed liable pursuant to sec. 64 sentence 1 GmbHG where an equivalent compensation was received in direct relation to the payment that caused a reduction of the debtor's (insolvency) estate.<sup>4</sup> In this regard, 'directly' is to be read in a rather broad way. It is sufficient for the compensation to have originated from the same legal relationship as the payment. A (synallagmatic) contract is not required.

Moreover, the BGH has already ruled that the equivalency of payment and compensation is not to be

determined at the time of the insolvency proceedings but rather at the time when the compensation was received by the company.<sup>5</sup> The further standards to which the compensation must adhere in order to constitute an 'equivalent' compensation were, until now, heavily disputed in German case law and legal literature. A recent decision of the BGH dated 4 July 2017 brought greater clarity to this important practical issue.

### Opposing standpoints of the Higher Regional Courts of Duesseldorf and Munich

In a case held at the Higher Regional Court of Duesseldorf,<sup>6</sup> the defendant (a managing director) made various payments for employees and other services after the company had become illiquid. The court had to decide if such (work) services constituted an equivalent compensation for the payments made and whether the liability of the managing director pursuant to sec. 64 sentence 1 GmbHG could therefore be dismissed.

The court held in its judgment that the legal rules/principles developed in connection with German insolvency claw-back (*Insolvenzanfechtung*), in particular the so-called 'cash transaction privilege' (*Bargeschäftsprivileg*), should be applied.<sup>7</sup> According to this privilege, the equivalency of compensation has to be determined on a purely economic basis. It is sufficient, therefore, if the payment and compensation have the same objective market value. In order to establish equivalence it is

### Notes

- 1 Illiquidity under German insolvency law is defined as the debtor's inability to honour its payment obligations (now) due. This is generally indicated by the fact that the debtor has ceased to make payments. The debtor's illiquidity cannot be presumed if there is only a temporary delay in payments, for example, when the debtor's gap in liquidity can be closed to at least 90% by expected payments, new loans or the liquidation of assets within a short period of time (usually no more than two weeks).
- 2 The principal prerequisite for over-indebtedness is that the debtor's assets no longer cover its liabilities. This is determined by assessing a pre-insolvency balance sheet and valuing assets at their present liquidation values (*Überschuldungsbilanz*). Even if it turns out that on the basis of the pre-insolvency balance sheet that the assets do no longer cover the liabilities, the company is not over-indebted if, under the given circumstances, a continuation forecast demonstrates that the company's financial strength is sufficient to ensure its economic survival at least for the current and the following business year (positive *Fortführungsprognose*).
- 3 There is a similar rule for German stock corporations, see sec. 92 para. 2 sentence 1 of the German Stock Corporations Act.
- 4 BGH [NZG] 2017, 1034, 1035 para. 10.
- 5 BGH [NZG] 2015, 149, 150 para. 11.
- 6 OLG Duesseldorf [2016] NZI 642.
- 7 OLG Duesseldorf [2016] NZI 642, 645.

not required that the compensation received in return for the payment is directly realisable (*verwertbar*) for the creditors of the insolvent company (e.g. funds on a bank account, money in a box, etc.).

Thus, although the employment and other services provided in exchange for the payment were not directly realisable by the creditors, the managing director was not liable for those payments as the compensation received in return was of equal value from an economic perspective. Further, the court argued that the payments did not lead to a loss of assets for the company. Instead, the court held that the payments made were generally to the company's benefit as they generated a workforce and should only, therefore, be deemed a shift of assets (*Vermögensumschichtung*).<sup>8</sup>

Interestingly, the Higher Regional Court of Munich<sup>9</sup> had to decide on a similar case. This case saw the managing director of an illiquid GmbH making payments to various suppliers, public authorities and employees of the company. Contrary to the Higher Regional Court of Duesseldorf, the Munich Court held that the legal rules/principles applicable with insolvency claw-back should not be applied to sec. 64 sentence 1 GmbHG. According to the Munich Court, the cash transaction privilege aims to give the debtor the opportunity to continue its business operations. Without the cash transaction privilege third parties would not be willing to continue trading with the debtor, as they would fear the claw-back of the debtor's payments to them. The cash transaction privilege is, therefore, primarily to the benefit of the third parties.<sup>10</sup> In contrast, the sole purpose of sec. 64 sentence 1 GmbHG is to preserve the (insolvency) estate of the debtor for the benefit of the debtor's creditors as a whole.<sup>11</sup> Due to their differing purposes, the legal rules/principles applicable in insolvency claw-back situations may not, therefore, be applied to sec. 64 sentence 1 GmbHG.

Against this background and according to the Higher Regional Court of Munich, compensation may only be deemed equivalent to the issued payment if the compensation is directly realisable by the creditors. This line of argumentation would, therefore, not deem employment and other services to be equivalent as such services can never be directly realised by the debtor's creditors.<sup>12</sup>

## Recent ruling of the BGH dated 4 July 2017

The BGH agreed with the view and argumentation of the Higher Regional Court of Munich.<sup>13</sup> After illiquidity or over-indebtedness has occurred, compensations can only be deemed equivalent to the payments made by the managing director(s) if they are directly realisable by the creditors. In other words, the assets attained in return for a payment must result in a measurable increase to the value of the (insolvency) estate. Employment services, as well as other services, are not typically directly realisable by the creditors and do not lead to an increase of the (insolvency) estate.<sup>14</sup> As a consequence, they cannot (usually) be deemed equivalent to the payment.

## Conclusion

The cases discussed highlight the controversial nature, as well as the practical importance, of determining which compensations qualify as equivalent to the payment. It is clear that there is a practical need for a uniform set of rules for the determination of equivalency with regard to a payment and its respective compensation.

In our view, the rules/principles developed in the context of insolvency claw-back are, in principle, best suited to bring legal clarity to this area of law, as they would make the complex distinctions between different kinds of compensations redundant. It would, therefore, seem that the decision of the Higher Regional Court of Duesseldorf was a step in the right direction. However, to simply apply a purely economic perspective to all matters concerning equivalency would also be a step too far. Insolvency proceedings aim to preserve the (insolvency) estate for the best satisfaction of all creditors. Against this background, the compensation received must always lead to a direct/indirect increase in the value of the debtor's (insolvency) estate. Whether the creditors of the debtor can directly realise this increase in the value to their benefit should, however, not be decisive.<sup>15</sup>

From a practical perspective, it is now even more crucial for the managing director(s) of a GmbH to attentively monitor its financial situation at all times. Therefore, if illiquidity or over-indebtedness seem imminent, further payments should only be made following close consultation with a legal advisor.

## Notes

8 OLG Duesseldorf [2016] NZI 642, 645.

9 OLG Munich [2017] NZI 2017, 723

10 OLG Munich [2017] NZI 2017, 723, 725

11 OLG Munich [2017] NZI 2017, 723, 725

12 OLG Munich [2017] NZI 2017, 723, 725

13 BGH [NZG] 2017, 1034, 1035 para. 12 et seqq.

14 BGH [NZG] 2017, 1034, 1035 para. 18.

15 Contra A. Commandeur/G. Utsch, 'Aktuelle Entwicklungen im Insolvenzrecht – Neues zur Geschäftsführerhaftung bei Zahlungen nach Eintritt der Insolvenzreife gem. § 64 S. 1 GmbHG [2017] NZG 2017, 1138, 1140.

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