

Redemption of shares in a German GmbH and remaining shareholders' contingent liability for compensation payments

Contingent liability of shareholders according to the BGH rulings dated January 24, 2012 and May 10, 2016 - Contingent liability of shareholders for compensation payments to exiting shareholder

When shares in a German GmbH are redeemed, the shareholder affected by such redemption can claim compensation. In case the Company cannot make the relevant payments because of German capital maintenance rules, the other shareholders can potentially be held liable for such compensation payment.

Collection of shares

Articles of Associations of German limited liability companies (GmbH) regularly stipulate that shares in the company held by individual shareholders can be redeemed by/on the basis of a resolution of the shareholders' meeting. The effect of the redemption of a share is that the share itself is cancelled and the respective shareholder is expelled from the company. Although shares can be redeemed with the consent of the shareholder, the background for such redemption is often to be found in that (a majority of) the shareholders wishes to exclude one specific shareholder from the company for cause.

Compensation from the company

The exiting shareholder is entitled to a compensation which is to be paid by the company. Originally, many renowned authors and several Higher Regional Courts were of the opinion that the redemption of shares is subject to the condition (precedent) of the payment of the (full amount of the) compensation to the exiting shareholder. The Federal Court of Justice (BGH – Bundesgerichtshof), however, in its decision dated January 24, 2012 (case no. II ZR 109/11) held that there is no such connection between the effectiveness of the redemption and the payment of the compensation. Rather than that, the redemption shall take effect as of the point in time when the respective shareholder is notified of the resolution of the shareholders' meeting to redeem its shares – even if and where the compensation cannot be paid by the company due to German capital maintenance rules applicable to GmbHs.

Liability of the fellow shareholders for acting in bad faith

According to the January 2012 ruling of the BGH, the interests of the exiting shareholder shall be protected by granting him/her a claim for compensation against those fellow shareholders who have taken part in the decision to redeem his/her share. That liability - which is not stipulated in the Limited Liability Company Act (GmbHG – Gesetz betreffend die Gesellschaften mit beschränkter Haftung) - is based on the reasoning that the remaining shareholders shall not be allowed to keep the value of the cancelled share for themselves as that would represent acting in bad faith. The remaining shareholders are obliged to either ensure that the company is able to pay the compensation or dissolve the company.

No automatic contingent liability of the shareholders in case the company becomes insolvent

Notwithstanding the above principles, even if the company is incapable of paying the compensation and/or becomes insolvent, the remaining shareholders shall not automatically become liable towards the exiting shareholder. As the BGH pointed out in its ruling dated May 10, 2016 (case no. II ZR 342/14), a claim against the remaining shareholders shall only arise if, where and as soon as „as the continuation of the company without ensuring to perform the obligation to compensate the leaving shareholder is to be regarded as acting in bad faith.“ Thus, the remaining shareholders can meet their obligation to act in good faith by filing for insolvency in time, i.e. not delay that filing in bad faith.

Consensual redemption of shares: The obligation to act in good faith remains but the shareholders can agree upon modifications

In its ruling dated May 10, 2016, the BGH clarified that also in case of a consensual collection of shares, the shareholders are still bound to the principle of good faith. Nevertheless, the shareholders are free to agree upon modifications or replacement of the contingent liability

in advance.

Practical advise

When contemplating to have another shareholder's shares redeemed, the other shareholders should take into consideration and ensure that the company will be able to make all compensation payments owed to the exiting shareholder when due. Otherwise, they may be subject to contingent liability. In anticipation of a possible redemption of shares the Articles of Association should provide for clauses pursuant to which compensation payments shall not fall due immediately and can be made in instalments; thereby reducing the likelihood that payments to be made conflict with German capital maintenance rules. Whenever shares are redeemed with the consent of the leaving shareholder, it is recommendable to reach an agreement on the conditions of payment, in particular regulating whether and under which conditions the remaining shareholders shall be liable for the compensation.

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