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German Tax and Legal News

Brexit: "German" Limited – unlimited? Liability risks for shareholders in a „German" Limited

The Brexit may lead to significant liability risks for shareholders of a UK Limited in Germany.

Shareholders of a UK Limited headquartered in Germany face liability risks because of the Brexit. Those concerned should be vigilant as to further developments.

Shareholders of a UK Limited which is headquartered in Germany face liability risks because of the Brexit. Those concerned should be vigilant as to further developments and take timely steps to safeguard themselves.

Based on landmark decisions established by the ECJ around 15 years ago, the "private company limited by shares" according to UK law (in short: Limited) has become a standard item in the German corporate landscape. Due to the fact that its foundation is quicker and requires less capital than the German GmbH, the Limited was – in particular until the introduction of the German entrepreneurial company (Unternehmergesellschaft, UG) in 2008 – a popular legal vehicle for small and medium-sized companies in Germany. Meanwhile, the trend towards the Limited in Germany is negative (2007: 14.000, 2013: 12.000). Nevertheless, there still exists a substantial number of these companies.

The Limited having its headquarters in Germany (in short: German Limited) is now threatened with severe legal uncertainty. Under the freedom of establishment which is provided in articles 49, 54 TFEU and on the basis of the so-called foundation theory which is applied by the ECJ in landmark decisions such as "Centros" (ECJ, 5 November 2002 – C-212/97) or "Überseering" (ECJ, September 30, 2003 – C-208/00), provisions of the national law concerning EU-foreign companies are recognized by German courts (Cf. German Federal Court of Justice, March 13, 2002 – VII ZR 370/98). This means that even if an EU foreign company operates exclusively in Germany, the company can "take along" its domestic corporate law. This results in particular in the unconditional recognition of German Limited companies as legal persons by German courts and in the application of shareholders' liability limitations as provided for by British statutory law.

But the foundation theory, which means the reference to the legal convictions of the country of foundation, is not the only possible way to treat foreign companies. In the absence of EU influence, German courts predominantly apply the so-called corporate domicile theory. According to this theory, the applicable law is not determined by the jurisdiction of a company's foundation but based on where its headquarter is located – generally, this will be the place where the board meetings and the supervisory board meetings take place. Under the corporate domicile theory, the legal nature of a foreign company is exclusively determined in accordance with German corporate law if the company's head office is located in Germany. Since a foreign company is not established according to the incorporation provisions applicable to the GmbH or another German limited liability legal form and was therefore not registered as such with the German Commercial Register, it is typically classified as a German general partnership (offene Handelsgesellschaft, OHG) or as a German civil law company (Gesellschaft bürgerlichen Rechts, GbR). In both legal forms, the shareholders are personally and without limitation liable for the company's obligations.

By its commitment to the foundation theory, the ECJ has barred the application of the corporate domicile theory to EU foreign companies having their head office in Germany. However, German courts still apply the corporate domicile theory to foreign companies from non-member states: In the case "Trabrennbahn" (October 27, 2008 – II ZR 158/06), the German Federal Court of Justice has treated a stock company founded in Switzerland and having its head office in Germany as a partnership. To justify its decision, the court pointed out that the fact that Switzerland is neither a member of the EU, nor that it has ratified the EEA agreement, would represent a "conscious decision against the European freedom of establishment opened to EEA member states which cannot be ignored by German courts".

If the United Kingdom becomes a non-member state after the Brexit, the German Limited is threatened with a similar fate: In the event of disputes between creditors of a German Limited and its shareholders, a German court could, on the basis of the corporate domicile theory, affirm the personal and unlimited liability of the shareholders for the company's obligations. It appears unlikely that this will be applied to liabilities incurred before the Brexit since such a retroactive effect will not be permitted in the vast majority of cases. Meanwhile, it is certainly conceivable that liability limitations will be waived for liabilities which have been assumed after the Brexit.

Therefore, shareholders of a German Limited should be advised to keep a close watch on the developments of the following months and, if necessary to safeguard themselves by converting the German Limited in a GmbH or into another limited liability company type. Those who want to do so by way of merger should not wait for the Brexit to happen: The admissibility of a cross-border merger from the United Kingdom to Germany will likely be affected by the Brexit as well.