Case Note

German Federal Supreme Court decides on German Based "British" limited companies' future post-Brexit: Order of the German Federal Supreme Court (Bundesgerichtshof) 16.02.2021 – II ZB 25/17

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Abstract

In 2021 the German Federal Supreme Court, the Bundesgerichtshof (BGH), decided how British Limited Companies (Ltd), which were well recognised in Germany because of the freedom of establishment pursuant articles 49 and 54 of the Treaty of the Functioning of the European Union, would be treated in the future. The limited liability of the shareholders with a small share capital was unknown in the German legal system before and increased its popularity compared to German company forms such as the GmbH which required a minimum share capital of €25.000. The BGH decided that due to Brexit the British Ltd established in Germany would no longer recognised by the German Company Registry and that the freedom of establishment would no longer be applicable. This decision has the effect that existing Ltds in Germany are automatically transformed into German company forms which changes the liability of the shareholders as well. The two possible German company forms that Ltds can be transformed into are now the OHG which is a partnership that aims to conduct commercial trade, and the Außen-GbR which is a company form constituted under civil law. In both company forms, the shareholders are personally liable which constitutes a tremendous difference to the British Ltd. In this case commentary the considered German company forms are assessed with the result that another German company form, similar to the British Ltd, which might be more appropriate for shareholders. The UG is a relatively new company form which was created as a counterpart to the Ltd and can be established for the cost of only €1. However, the decision of the BGH leaves some space for interpretation since existing Ltds might be protected by the grandfather clause. This clause protects rights that were asserted in the past and are no longer compliant with the law due to changes. Nevertheless, practice will show how existing Ltds will be treated in Germany.

Keywords: Limited, Liability, Partnership, Germany, Brexit

The private limited company, known simply as 'limited', had gained popularity in the European Union (EU), and especially in Germany. One reason was the limited liability of shareholders with

a small share capital which was unknown to the German legal system before. In Germany, the most common company forms which limited the liability of shareholders were the *Gesellschaft mit beschränkter Haftung* (GmbH) and *Kommanditgesellschaft* (KG). The main difference to the British limited company is that the shareholders are liable for the amount they contribute to the company financially. Hence, the company form GmbH is liable with its company assets and to establish this company form shareholders must contribute at least €25,000.

This is similar to a KG where shareholders must contribute a certain amount of money, which is determined by the company agreement. Furthermore, there must be two different kinds of shareholders; one is the fully liable partner, who is personally liable, and the other one is the limited partner, who is liable for the amount of money s/he has contributed to the company. In contrast to that, British limited companies are more simple when it comes to liability since establishing a one is possible with only £1 as share capital, making it quite popular. This avoids personal liability and is cheaper than establishing a German company form. Additionally, founding a German company form can take several weeks, whereas founding a Limited usually takes only a day. Articles 49 and 54 of the Treaty of the Functioning of the European Union (TFEU) created new possibilities for companies. TFEU allowed entrepreneurs to establish limited companies in other EU member states, which resulted in many of these being established in Germany. However, United Kingdom's withdrawal from the European Union changed the simplicity of using the advantages of limited companies as demonstrated in the present case.

The legal matter in the present case was merely a moot regarding the record of a British limited company into the German Company Registry (Handelsregister). A handelsregister is conducted by a Registry Court, which is administrated by a District Court (Amtsgericht (AG)). The claimant, All in One Star ltd, applied on 12th of March 2014 for a record, which was denied by an interim order due to missing documents and information, such as a translated and legally attested articles of association (Frankfurt am Main 11/06/2014 – 72 AR 692/14). Furthermore, a share capital, which is required pursuant to s.13g (3) Handelsgesetzbuch (HGB) (The German Commercial Code) in connection with s.10 (1) Gesetz über Gesellschaft mit beschränkter (GmbhG), was not stated.

The limited company's director challenged the decision of the Registry Court and argued that a translation of the company agreement was not necessary because it was a model contract in accordance with Schedule 2 of the Companies Model Articles 2008. These regulations are in legal terms similar to English company law and comparable to a statutory instrument. Therefore, it is a matter of foreign legal provisions and consequently it is the duty of the Registry Court to determine these within the scope of its official duty. Additionally, according to the claimant, the contribution

of a share capital was not needed in the case of a British limited company. The Registry Court, however, upheld their original decision.

The complainant appealed against this decision which led to the jurisdiction of the Higher Regional Court or Oberlandesgericht (OLG). The OLG rebuffed the appeal and approved the view of the Registry Court regarding to the necessity of a translated and legally attested articles of association which is the legal position pursuant to s.13g(2) HGB (Decision of Higher Regional Court Frankfurt am Main from 08.08.2017 – 20 W 229/14). The OLG distinguished between model articles and memorandum of association stating that the model articles constituted English Law and were therefore not to be translated; though they held the view that the memorandum of association was not English Law, and thus needed translation as requested by the Registry Court. The OLD held that All in One Star Ltd had failed to satisfy this requirement.

Although the OLD agreed with the claimant on this issue of the contribution of share capital, they did state that a limited company's share capital required a fixed normative value in line with s.542(1) Companies Act 2006. This meant that the share capital assumed by the shareholders had to be mentioned in the statement of share capital. Under s.10 of the Companies Act 2006, every company with a share capital, including limited companies, had to provide such a statement towards the registrar of companies when formed. For the enrolment to the German Company Register it is mandatory to specify the issued share capital and as this did not happen, the OLG rejected the appeal and upheld the decision of the Registry Court.

The case was further appealed to the Bundesgerichtshof (BGH) (the German Federal Supreme Court). On 14th of May 2019 the BGH discontinued proceedings and sought a preliminary ruling from the European Court of Justice (ECJ) pursuant of article 267 TFEU to determine whether s.13g (1)-(3) HGB in connection with s.10 (1) GmbHG were compatible with Articles 49 and 54 of TFEU, which state the freedom of establishment (Order of the Federal Supreme Court from 14.05.2019 – II ZB 25/17). It is important to re-state that under s.13g (1), (3) HGB in connection with s.10 (1) GmbHG rules that a share capital must be stated. The United Kingdom's withdrawal from the European Union was the reason for the decision of the BGH to continue the proceeding on 16th of February 2021 without waiting for a decision by the ECJ (Order of the Federal Supreme Court 16.02.2021 – II ZB 25/17).

Held, dismissing the appeal, that the claimant was required to provide information regarding the share capital pursuant to s.13g(1)-(3) HGB in connection with s.10(1) GmbHG. The Bundesgerichtshof determined that United Kingdom's final withdrawal from the European Union by 31st of December 2020 impacted the application of TFEU laws and therefore, Articles 49 and 54 TFEU, which contained the freedom of establishment no longer applied to British limited

companies. As a result, an interpretation in conformity with EU-Laws was not necessary anymore and ltd companies from the United Kingdom were to be treated as companies from third countries.

Commentary

It must be emphasised that the freedom of establishment and EU Law would not have been under scrutiny had the claimant fulfilled the requirements which were asked by the Registry Court in the first place. However, the appeal led to wide consequences, not only for this claimant but for others in future. Since the United Kingdom's withdrawal from the European Union the inapplicability of the TFEU is consistent. Therefore, the revocation of the preliminary ruling proceeding pursuant article 267 TFEU is not to be criticised. Henceforth, shell companies from the United Kingdom within the EU are no longer recognised, which was the case before Brexit; though, this does not apply to companies with their head office inside the United Kingdom ('Keine "Briefkastenfirmen" nach dem Brexit' (Tagesschau, 11.07.2017)). The inapplicability of the TFEU is irrelevant for those companies since they did not claim these rights to establish.

Entrepreneurs wishing to establish a company in Germany have to fulfil all conditions which are required under German company law. British company forms are no longer recognised because of their inability to fulfil these conditions and the advantages of the TFEU are no longer an aid for a simple establishment. However, there is a distinction between the incorporation doctrine which is used in common law jurisdictions, and the real seat theory which is practised in civil law jurisdictions. In United Kingdom's company law, the incorporation doctrine is applied and according to this theory the governing company law equals the law where companies have been registered or incorporated. This doctrine goes back to the colonial era and made it possible for British businessmen to establish companies abroad based on British company law (Horst Eidenmüller, 'Shell Shock: In Defence of the 'Real Seat Theory' in International Company Law' (Oxford Business Law Blog, 25.03.2022)).

The real seat theory is applied in German company law and determines that the place of the head office is decisive for which jurisdictions laws take precedent. However, it was superseded by the ECJ to favour company forms from member states of the EU. As a consequence of Brexit, the ECJ decision cannot protect limited companies anymore and all in all, it can be determined that Brexit made establishing companies more complicated for foreign businessmen (Marcel Hagemann and Arian Nazari-Khanachayi, 'Karlsruhe locuta causa finita? Der BGH zu den Folgen des Brexit' (CMS Deutschland bloggt, 20.04.2021)). However, this means that German entrepreneurs will also suffer from this decision since they can no longer incorporate British Limited's anymore.

Due to the decision of the BGH some Registry Courts have already begun erasing ltds from the German Company Registry (Jens Eggenberger, 'Ende der UK Limited mit Verwaltungssitz in Deutschland?' (Flick Gocke Schaumburg, 23.06.2021)). Concerns are now being raised regarding how existing limited companies are going to be treated in the future. There is a presumption that these limited companies will be transformed into one of two possible German company forms: the offene Handelsgesellschaft (OHG) and Außen-GbR ('Brexit – Das Aus für die Limited' (IHK München und Oberbayern)).

The OHG is a partnership which aims to conduct commercial trade (under s.105(1)HGB) and in which partners are personally liable under s.128 HGB. An Außen-GbR is a relatively new company form and the prevailing doctrine and like the OHG, partners are personally liablie under s.128 HGB. This was not always the case since the Außen-GbR was constituted under civil law and not under commercial law. Therefore, the Außen-GbR's only difference to an OHG is that it is formed for the purpose of carrying any business except commercial businesses (Jürgen K. Wittlinger, 'Gesellschaft bürgerlichen Rechts/4.2 Haftung der Gesellschafter' (Haufe)). For example, in Germany many lawyers or tax consultants establish an Außen-GbR because, in German law understanding, these professional fields deal in intellectual work rather than conducting commercial business. This means that if a limited company works on commercial business, it will be likely to be transformed into an OHG, otherwise it will take the form of an Außen-GbR. The reason for those possible transformations is that British ltds do not fulfil all necessary requirements to establish a corporation, such as a GmbH or KG, in Germany. Though, this outcome would have disastrous impacts on the liability of shareholders of existing limited companies.

However, there might be alternative solutions which are preferable. One possibility could be deduced from Article 14(1) Grundgesetz (German Constitution) (GG) which safeguards the protection of property, with business enterprises being protected under this article too (Order of Federal Administrative Court from 22.08.2014 – 4 B 6.14). Some basic laws in Germany are usable for Germans only, such as the freedom of assembly pursuant article 8 GG; yet article 14 GG is not one of them. Furthermore, basic laws are also applicable for corporate bodies according to article 19(3) GG. Nevertheless, this article states that it does not apply for foreign companies, but companies from member states from the European Union enjoy this right likewise due to a decision of the EJC (Mike Wienbracke, 'EU-Recht geht Art. 19 Abs. 3 GG vor' (Publicus, 15.10.2011)). As a result of Brexit, the United Kingdom and its companies cannot claim this right anymore; so that, article 14(1) GG is no longer an option. Yet, a protection might emerge due to the grandfather clause, which is an acknowledged right in German jurisprudence, based on article

14 GG. This clause protects rights which are alleged in the past and are no longer in conformity with the law due to changes in the law.

Another possible prevention from the negative effects of a forced transformation is to change a British limited company into an Irish limited company. Both company forms are very similar and have minor and not noteworthy differences (Sinead Floody, 'The differences between Irish and UK Companies' (CompanyBureau, 13.10.2017)). A major advantage of an Irish limited is that the freedom of establishment pursuant articles 49 and 54 TFEU are still applicable. Therefore, this might be an attractive solution; although, company owners need to actively change the company form by their own.

Another plausible way of treating limited companies in the future, which seems more equitable, would be the use of the Unternehmergesellschaft (UG). Rather than transforming limited companies into an OHG or an Außen-GbR, the UG, which was created in 2008 as a counterpart for the British limited company, can be established for only €1 and is enjoying increased recognition and popularity in Germany ('Die Unternehmergesellschaft – UG (haftungsbeschränkt)' (IHK Aachen)).

Nevertheless, the decision of the BGH states that the freedom of establishment is principally no longer applicable. This opens up the possibility for existing limiteds to assert a right under the grandfather clause. If the grandfather clause cannot be applied, the most equitable solution would be a transformation of existing Limiteds into UGs, which virtually constitutes a German limited company. Because of the changed liability of shareholders, a transformation into an OHG or Außen-GbR presents major consequences, such as insolvency of many companies. A change of existing limited into an UG would represent, the grandfather clause, in a broader sense, because the company in general stays subsistent. Nevertheless, it remains to be seen how limited companies will be treated in German jurisprudence and in Germany in general, which will be determined by practice.

The decision of the BGH is essentially appropriate and consequent and leads to the result that future businessmen cannot establish British limited companies in Germany under the application of articles 49 and 54 TFEU. They must establish German company forms, such as an UG instead. The consensus that existing limited companies might be automatically transformed into an OHG or an Außen-GbR, presents a significant problem since there are so many limited companies in Germany. This could lead into a mass insolvency for many business people who own a limited companies. Nevertheless, the inapplicability of the freedom of establishment pursuant to articles 49 and 54 TFEU needs to be respected. The United Kingdom's withdrawal from the European Union leads to an inadmissibility of the European Law for limited companies.

It is, however, desirable that these companies receive the protection of the grandfather clause or at least, if a transformation is mandatory, they change into a German UG. This would avoid negative impacts regarding the liability of shareholders and would be less cost intensive. Another possibility for entrepreneurs could be the transformation into an Irish limited company due to the similarity they have to their British counterparts. Yet, practice will show how existing limited companies will be treated in Germany; and the future will reveal which company type is the preference for business persons looking to establish a company in Germany.