INSOLVENCY PROCEEDINGS AND FREEDOM OF ESTABLISHMENT

Judgment of 10 December 2015, C-594/14, Simona Kornhaas v. Thomas Dithmar

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1. Introduction and facts

The Court of Justice of the European Union (CJEU) was called to decide whether freedom of establishment of nationals of a Member State in the territory of another Member State was infringed a a result of the application of national insolvency laws.

The relevant facts of the national procedure are as follows[1]: Mr Dithmar is the liquidator of the debtor company, in insolvency proceedings opened by the Amtsgericht Erfurt (Local Court, Erfurt, Germany). The debtor company was entered in the Companies Register in Cardiff (United Kingdom) as a private company limited by shares ('limited company'). A branch of the debtor company was established in Germany and, on that basis, was entered in the companies register administered by the Amtsgericht Jena (Local Court, Jena). Ms Kornhaas was the director of the debtor company. Contending that the debtor company had been insolvent, at the least, since 1 November 2006 and that, between 11 December 2006 and 26 February 2007, Ms Kornhaas had made payments borne by that company totalling EUR 110151.66, Mr Dithmar sought reimbursement of that sum from Ms Kornhaas on the basis of the first sentence of Paragraph 64(2) of the GmbHG (German Limited Companies Act). That action was upheld by the Landgericht Erfurt (Regional Court, Erfurt) and later by the Oberlandesgericht Jena (Higher Regional Court, Jena). An appeal was formed to the Bundesgerichtshof (German Federal Court of Justice), which is the referring court.

2. The legal questions arising out of the case

In his referral to to CJEU[2], the Bundesgerichtshof took the view that the action brought by Mr Dithmar was well founded under German law. The first sentence of Paragraph 64(2) of the GmbHG is, in essence, to prevent the assets of the insolvent estate being reduced before the opening of the insolvency proceedings and to ensure that those assets are available, so that the claims of all the company's creditors can be satisfied in the insolvency proceedings on equal terms. Therefore, that provision falls within insolvency law and is enforceable against a managing director of a limited company, although the provision is formally integrated in legislation on company law.

[1] Paras 6-7 Kornhass/Dithmar.
[2] Id. 8-13.

The Bundesgerichtshof was uncertain, however, whether such a provision is consistent with EU law. In that regard, pursuant to Article 4(1) of Regulation No 1346/2000, the law applicable to insolvency proceedings and their effects is German law, as the law of the Member State within the territory of which such proceedings are opened. There is no agreement in German commentaries on the question whether the first sentence of Paragraph 64(2) of the GmbHG may be enforceable against managing directors of companies established in accordance with the law of other EU Member States, but having the centre of their main interests in Germany. According to the referring court, the first sentence of Article 64(2) of the GmbHG does not govern the conditions in which a company established in accordance with the law of another EU State may install its administrative office in Germany, but only the legal consequences of such a decision and of wrongful conduct of its managing directors. Freedom of establishment would therefore not be affected.

In any event, the possible restriction of the freedom of establishment, entailed by the application of the first sentence of Article 64(2) of the GmbHG, would be justified on the grounds that (i) it is applied without discrimination, (ii) corresponds to an overriding reason in the public interest, namely to protect creditors, (iii) is suitable for preserving the assets of the insolvent estate or restoring them, and (iv) does not go beyond what is necessary in order to attain that objective.

The Bundesgerichtshof observed, however, that the case-law of the Court following from, inter alia, the judgments in *Überseering* (C-208/00, EU:C:2002:632) and *Inspire Art* (C-167/01, EU:C:2003:512) could also be interpreted as meaning that the internal affairs of companies established in one Member State but carrying on their main operations in another Member State are, in the context of freedom of establishment, governed by the company law of the Member State of formation. The application of the first sentence of Paragraph 64(2) GmbHG to managing directors of companies of another Member State could accordingly infringe freedom of establishment within the meaning of Article 49 TFEU and Article 54 TFEU.

3. The answer of the CJUE

The answer of the CJEU requires a two step analysis: a) Confirming that the action before German courts falls within German applicable law as a matter of conflicts of laws, b) Deciding that German applicable law does not illegally hinter freedom of establishment of nationals of a Member State in the territory of another Member State.

a) The action before German courts falls within German applicable law as a matter of conflicts of laws. The insolvency proceedings were opened in Germany and according to Article 4 of Regulation No 1346/2000 German law is applicable governing *inter alia* “the rules relating to the voidness, nullity, voidability or unenforceability of legal acts detrimental to all the creditor” (Article 4(2)(m). Must Article 4 of Regulation No 1346/2000

be interpreted as meaning that falls within its scope an action against the managing director of a company established under the law of England and Wales, forming the subject of insolvency proceedings opened in Germany, brought before a German court by the liquidator of that company and seeking, on the basis of a national provision such as the first sentence of Paragraph 64(2) of the GmbHG, reimbursement of payments made by that managing director before the opening of the insolvency proceedings but after the date on which the insolvency of that company was established?

The CJEU answered in the positive[3]: "In that context, the Court has previously held that Article 3(1) of Council Regulation No 1346/2000 must be interpreted as meaning that the courts of the Member State in the territory of which insolvency proceedings regarding a company's assets have been opened have jurisdiction, on the basis of that provision, to hear and determine an action brought by the liquidator in the insolvency proceedings against the managing director of that company for reimbursement of payments made after the company became insolvent or after it had been established that the company's liabilities exceeded its assets (judgment in *H*, C-295/13, paragraph 26)."[4]

"The Court has based that decision on the view, in particular, that a national provision, such as the first sentence of Paragraph 64(2) of the GmbHG, under which the managing director of an insolvent company must reimburse the payments which he made on behalf of that company after it became insolvent, derogates from the common rules of civil and commercial law, because of the insolvency of that company. It infers therefrom that an action based on that provision, brought in the context of insolvency proceedings, is an action deriving directly from insolvency proceedings and closely connected with them (see, to that effect, judgment in *H*, C-295/13, paragraphs 23 and 24). Consequently, even if, in the judgment in *H*, the Court's answer to the request for a preliminary ruling concerned Article 3 of Regulation No 1346/2000 and the international jurisdiction of a national court to rule on an action based on a provision of national law such as the first sentence of Paragraph 64(2) of the GmbHG, it nevertheless clearly categorised such a provision of national law as being covered by insolvency law. It follows that Paragraph 64(2) of the GmbHG must be regarded as being covered by the law applicable to insolvency proceedings and their effects, within the meaning of Article 4(1) of Regulation No 1346/2000. As such, that provision of national law, one of the effects of which is to require, if necessary, the managing director of a company to reimburse any payments which he made on behalf of that company after it became insolvent, may, in accordance with Article 4(1) of Regulation No 1346/2000, be applied by the national court hearing the insolvency proceedings as the law of the Member State within the territory of which the insolvency proceedings are opened ('the *lex fori concursus*').

It should be added in that regard that the first sentence of Paragraph 64(2) of the GmbHG must be read in conjunction with Paragraph 64(1) which provides that, in the event of a company becoming insolvent or over-indebted, the members of the representative body are required to apply forthwith, and at the latest three weeks after the insolvency or over-indebtedness was established, for insolvency proceedings to be opened. Accordingly, the first sentence of Paragraph 64(2) of the GmbHG in particular, makes it possible for the managing directors of an insolvent or over-indebted company who have failed to apply for insolvency proceedings to be opened, to be found personally liable in infringement of Paragraph 64(1) of the GmbHG, in fact, once such proceedings have been opened, as a general rule, it is no longer for the managing director of the insolvent company, but for its

[3] Id. 15-20.

[4] See in this webpage "Insolvency Regulation and Regulation 44/2001 (Brussels I) Judgment of 4 September 2014, C-157/13, Nickel & Goeldner Spedition GmbH v "Kintra" UAB Judgment of 4 December 2014, C-295/13, H v HK"

liquidator, to make or authorise payments on behalf of that company. As a result, if the managing director of an insolvent company has complied with the obligation under Paragraph 64(1) of the GmbHG, the penalty, in essence entailed by the first sentence of Paragraph 64(2) of the GmbHG will not apply. Article 4(2) of Regulation No 1346/2000 provides, in particular, that the *lex fori concursus* determines the 'conditions for the opening' of the insolvency proceedings. In order to ensure the effectiveness of that provision, it must be interpreted as meaning that, first, the preconditions for the opening of insolvency proceedings, second, the rules which designate the persons who are obliged to request the opening of those proceedings and, third, the consequences of an infringement of that obligation fall within its scope. Consequently, national provisions such as Paragraph 64(1) and the first sentence of Paragraph 64(2) of the GmbHG, which have the effect, in essence, of penalising a failure to fulfil the obligation to apply for the opening of insolvency proceedings, must be considered, from that perspective, too, to fall within the scope of Article 4 of Regulation No 1346/2000.

Furthermore, a provision such as the first sentence of Paragraph 64(2) of the GmbHG contributes to the attainment of an objective which is intrinsically linked, mutatis mutandis, to all insolvency proceedings, namely the prevention of any reduction of the assets of the insolvent estate before the insolvency proceedings are opened, so that the claims of all the company's creditors may be satisfied on equal terms. Accordingly, such a provision appears at least similar to a rule laying down the 'unenforceability of legal acts detrimental to all the creditors' which, under Article 4(2)(m) of Regulation No 1346/2000, comes within the *lex fori concursus*."

b) Application of Paragraph 64(2) of the GmbHG in the case does not infringe European law granting freedom of establishment of nationals of a Member State in the territory of another Member State. In other words Article 49 TFEU and Article 54 TFEU do not preclude the application of a provision of national law, such as the first sentence of Paragraph 64(2) of the GmbHG, to a managing director of a company established under the law of England and Wales, which is the subject of insolvency proceedings opened in Germany.

The CJUE explains why[5]: "[I]t follows from the case-law of the Court that, in some circumstances, the refusal by one Member State to recognise the legal capacity of a company formed in accordance with the law of another Member State in which it has its registered office on the ground, in particular, that the company has moved its actual centre of administration to its territory may constitute a restriction of freedom of establishment incompatible, in principle, with Article 49 TFEU and Article 54 TFEU (see, to that effect, judgment in *Überseering*, C-208/00, paragraph 82). The Court has also found before that, to the extent that national provisions concerning minimum capital are incompatible with freedom of establishment, as guaranteed by the Treaty, the same must necessarily be true of the penalties attached to non-compliance with those obligations, such as the personal joint and several liability of directors where the amount of capital does not reach the minimum provided for by the national legislation or where during the company's activities it falls below that amount (see, to that effect, judgment in *Inspire Art*, C-167/01, paragraph 141).

[5] Paras 22-28 Kornhass/Dithmar.

However, as regards a provision of national law such as the first sentence of Paragraph 64(2) of the GmbHG, it is clear that the latter concerns neither the refusal by a host Member State to recognise the legal capacity of a company formed in accordance with the law of another Member State and having transferred its actual headquarters into the territory of that first Member State, nor the personal liability of administrators where the capital of that company has not reached the minimum amount laid down by the national legislation. First, it follows from the order for reference that the legal capacity of the debtor company is in no way called into question in the context of the case in the main proceedings. The wording of the first sentence of Paragraph 64(2) of the GmbHG even seems to exclude such questioning as the application of that provision presupposes the existence of a 'company'. Second, the personal liability of the managing directors of a company on the basis of the first sentence of Paragraph 64(2) of the GmbHG is related, not to the fact that the capital of that company does not reach the minimum amount laid down by the German legislation or by the legislation in accordance with which that company has been established, but only to the fact that, in essence, the managing directors of such a company have made payments at a stage when they would have been required, under Paragraph 64(1) of the GmbHG, to apply for the opening of insolvency proceedings.

In the light of the above, the application of a provision of national law such as the first sentence of Paragraph 64(2) of the GmbHG in no way concerns the formation of a company in a given Member State or its subsequent establishment in another Member State, to the extent that that provision of national law is applicable only after that company has been formed, in connection with its business, and more specifically, either from the time when it must be considered, pursuant to the national law applicable under Article 4 of Regulation No 1346/2000, to be insolvent, or from the time when its over-debtedness is recognised in accordance with that national law. A provision of national law such as the first sentence of Paragraph 64(2) of the GmbHG does not, therefore, affect freedom of establishment."