Duties of a Managing Director of a German GmbH

A short summary

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The following memorandum provides a brief overview of the role, duties, and responsibilities of a managing director of a German limited liability company ("GmbH").

1. Representation of the Company

The GmbH is represented vis-à-vis third parties by one or several managing directors. If several managing directors have been appointed, they jointly represent the company. The shareholders may deviate from the principle of joint representation. In this case, they may extend the power of representation of the individual managing directors so that each managing director, or one or several specific managing directors, are entitled to represent the company acting solely. They can also be entitled to represent the company acting jointly with one or several other managing directors, or to represent the company acting jointly with one or several managing directors or holders of proxy, a special power of representation ("Prokura").

In contrast to an extension, a limitation of the statutory authority of the managing directors to represent the company will have no effect vis-à-vis third parties.

In order to avoid conflicts of interests, German law prohibits anybody to act on both sides of a transaction, unless specifically authorized to do so (prohibition of self contracting; Sec. 181 German Civil Code). Such prohibition is also applicable in the case of a GmbH, and any exemption must be granted to the managing director and needs to be filed for registration in the Commercial Register.

Generally, the right of representation, and any extension thereof, of managing directors must be filed for registration in the Commercial Register and must then be published in the appropriate publications. The registration is only a declaration to give notice to third parties. The power of attorney and the authorization to represent the company becomes legally effective by the granting of such power and authorization.

The managing director is appointed and approved by way of shareholders’ resolution.

2. Service Agreements with Managing Directors

The managing directors generally perform their services on the basis of service agreements, which may be written or oral, express or implied. Such agreements are subject to the general rules of contract law and in particular to the rules governing service agreements ("Dienstverträge"). A typical managing director is not an employee ("Arbeitnehmer") as this term is used
in German labor law, and therefore in principal, the complex employee protection rules of German labor law are not applicable to managing directors.

Usually, service agreements with managing directors are set up in writing (especially if the company has more than one shareholder). The provisions specify inter alia the term of service, the obligations and compensation of the managing director, the right to paid vacation, the right to continued payment of salary in case of illness, and pension benefits, if any. Frequently, they also contain confidentiality requirements and occasionally set out requirements that the managing director shall not engage with a competitor of the company after expiration of this service agreement.

3. Internal Management Structure

The shareholders may, either through the company’s articles of association (the “Articles”) or by shareholders’ resolution, extend or restrict the scope of responsibility of the managing directors. The shareholders can decide that certain types of transactions usually within the power of the directors are subject to the requirement of the prior consent of the shareholders, such as entering into loan contracts and guarantee agreements above certain amounts, employing personnel etc. However, these restrictions will have no effect vis-à-vis third parties, but their violation by the managing director can cause a claim for damages of the company towards the managing director.

4. Compliance with Instructions of Shareholders

In addition to complying with the Articles and their service agreements, the managing directors are obliged towards the company to comply with the instructions given to them by the shareholders unless those instructions are illegal. The negligent or intentional violation of this obligation renders the managing directors liable to the company for damages and may in certain circumstances justify their dismissal for cause.

5. Duties and Responsibilities of Managing Directors

The managing director of a GmbH has to fulfill a considerable variety of duties and responsibilities vis-à-vis the company itself, to its shareholders and to third parties such as the tax authorities and the company’s creditors. These duties and responsibilities are based on law, the Articles, and on the managing director’s service agreement with the company.
The sanctions applicable if a managing director violates the manager’s duties vary depending on the obligations violated, to whom they were owed and whether they were imposed by law, the Articles or by the service agreement. In principle, any violation of obligations owed to the company may give rise to a claim for damages by the company and may justify a dismissal of the managing director for cause.

The following is a general summary (not complete) of the main duties and responsibilities of managing directors.

a) General Obligation of Diligent Management

For all matters concerning the company, the managing directors must employ the diligence of a prudent business man (Sec. 43 para. 1 Limited Liability Companies Act (“GmbHG”)).

This obligation of diligent management includes in particular the obligation of the managing director to use best efforts to promote the purpose of the company, to comply with and ensure the company’s compliance with all applicable statutory and other legal obligations and requirements, to ensure that the company keeps proper books of account and records (Sec. 41 para. 1 GmbHG), that the company does not effect or accept improper payments, to obtain from competing with business opportunities of the company and the disclosure of trade or business secrets or other confidential information belonging to the company (Sec. 85 GmbHG provides for criminal sanctions).

b) Special Obligation Regarding Contribution and Preservation of Share Capital

If incorrect statements were made for the purpose of forming the company or increasing its share capital, managing directors who acted negligently or intentionally are jointly and severally liable to the company to contribute the missing sums, to reimburse money to the company which should have been included in formation expenditures but was not, and to cure any other damage they have caused.

The managing directors are neither allowed to repay the statutory share capital to the shareholders (Sec. 30 para. 1, Sec. 43 para. 3 GmbHG) nor to use the statutory share capital in order to grant loans to managing directors or other authorized representatives (Sec. 43 a GmbHG).
c) Loss of Share Capital

If the annual or any interim balance sheet of the company shows that one half or more of its share capital has been lost, the managing directors must arrange for a shareholders’ meeting without undue delay (Sec. 49 para. 3 GmbHG). Managing directors who negligently or intentionally fail to do so are jointly and severally liable for damages to the company and are also subject to criminal penalties (Sec. 43 para. 1, 2; Sec. 84 para. 1, para. 2 GmbHG).

d) Over-Indebtedness, Insolvency

In case of the company’s over-indebtedness or insolvency, each managing director regardless of whether authorized to represent the company singly or jointly with others, is – as a principle – obliged to file for insolvency proceedings without undue delay but in no event later than three weeks from the date on which the over-indebtedness was ascertained or the insolvency arose (Sec. 15a para. 1 Insolvency Code ("Insolvenzordnung")). Managing directors who negligently or intentionally fail to meet this obligation commit a criminal offense (Sec. 15a para. 4, para. 5 Insolvency Code) and are liable for damages both to the company and its creditors.

However, the obligation to file for insolvency proceedings in case of over-indebtedness is temporarily suspended if a positive forecast for the continuation of the legal entity can be presented, for which certain formal and substantive requirements have to be fulfilled.

e) Payment of Taxes

Pursuant to their general obligation to ensure that the company complies with all laws, the managing directors are in particular obliged to ensure that the company is complying with tax laws and they become liable to the company for damages if they negligently or intentionally fail to ensure such compliance. Therefore, the managing directors have to file tax returns and withhold – among others – dividend and wage taxes on behalf of the company.

f) Payment of Social Insurance Contributions

Similar obligations and liabilities are imposed on managing directors to ensure payment of the statutory social insurance contributions owed with respect to compensation paid to the company’s employees. Failure to do so may trigger criminal sanctions.
g) **Financial Statements and List of Shareholders**

On an annual basis, the managing directors have to submit the financial statements of the company (Sec. 325 German Commercial Code) for publication, and, in case of any change in the shareholdings, an up-to-date list of the shareholders to the Commercial Register (Sec. 40 Limited Liability Companies Act). In case they fail to meet the obligation for annually submitting the financial statements to the Commercial Register, penalties are imposed for violating these obligations.

6. **Compliance with formalities**

Except for correspondence relating to matters where the company has an on-going business relationship, all company correspondence (including emails) shall identify the legal form of the company, the domicile of the company, the name of the Commercial Register as well as the company’s registration number, and the full name of the managing directors.

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