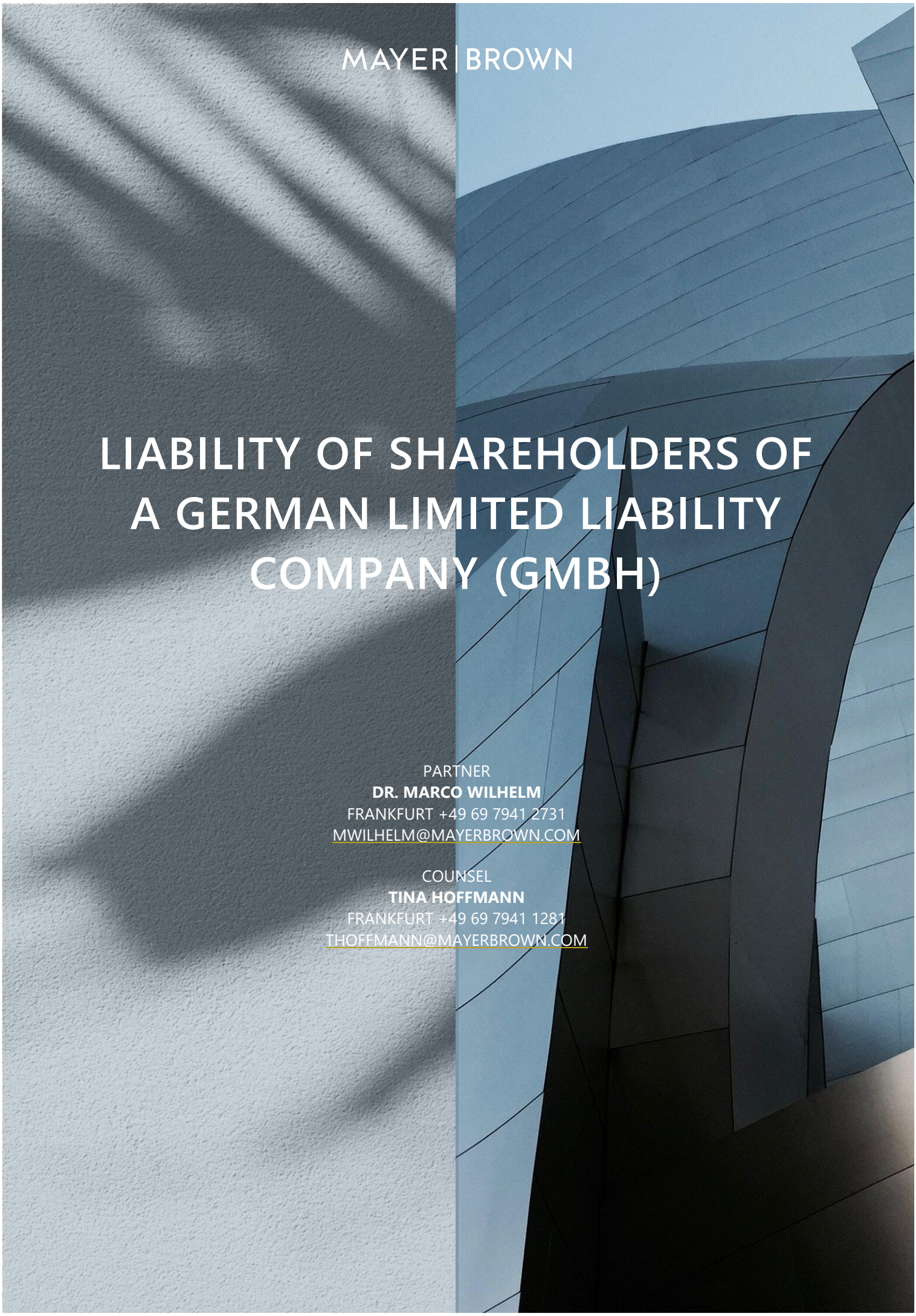

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LIABILITY OF SHAREHOLDERS OF A GERMAN LIMITED LIABILITY COMPANY (GMBH)

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I. OVERVIEW

The limited liability company (GmbH) is one of the most popular legal forms in Germany due to the limited liability of its shareholders. It is in the nature of a GmbH to limit the liability of its shareholders to the company's assets (liability privilege). Nevertheless, the GmbH does not completely exclude the personal liability of its shareholders. As the name "limited liability company" already makes clear, liability is not waived, but merely limited.

In the following, the basic exemptions from liability for shareholders and the most important exceptions to this principle are described. The descriptions refer exclusively to the liability of the shareholders of an existing GmbH, i.e., one that is already entered in the commercial register.

II. GENERAL LIMITATION OF LIABILITY

According to Section 13 para. 2 German limited liability Act (**"GmbHG"**), generally only the company's assets serve as collateral for the creditors of a GmbH. This limitation to the company's assets applies from the time the GmbH is entered in the commercial register and generally leads to an exclusion of the personal liability of the shareholders. This enables entrepreneurship with calculable risk; in return, creditors are protected, in particular by means of capital contribution and capital maintenance provisions, in that the company's assets are to be provided and maintained as a liability substrate.

III. EXCEPTIONS

There are a few exceptions to this liability privilege in favor of the shareholders, which lead to direct external liability towards third parties or internal liability towards the company. A distinction must be made between the liability of the shareholders towards third parties (III.1) and towards the company (III.2).

1. Liability of shareholders towards third parties (direct claims by third parties, external liability)

A shareholder's direct liability towards company creditors may arise in particular from the following constellations:

1.1 Liability based on special obligations

A shareholder's direct liability may, for example, result from the fact that a shareholder assumes such liability in the context of a legal transaction, for example, through (co-)assumption of debt, guarantee, suretyship, or other contractual obligations.

1.2 Legal appearance liability

Liability under general principles of legal appearance liability may be considered if an actively acting shareholder – who is usually also the managing director of the limited liability company – gives a third party acting in good faith the impression that he will personally vouch for the legal transaction entered into. This may be the case, for example, if the shareholder acts under the company name but does not use the legally

required legal suffix "GmbH" (limited liability company), thereby giving the impression of personal liability.

According to case law, the same applies if the company name of a limited liability entrepreneurial company (UG) appears in legal transactions with the incorrect suffix "GmbH".

1.3 Liability for culpa in contrahendo

A direct claim against a shareholder may also be considered within the framework of so-called "trustee liability" pursuant to Section 311 para. 3 BGB.

According to this, a shareholder who is significantly involved in the company's contract negotiations is liable for *culpa in contrahendo* if, in the course of contract negotiations between the company and a third party, he has claimed a particular degree of trust with regard to the completeness and accuracy of his statements and has thereby significantly influenced the contract negotiations or the conclusion of the contract.

1.4 Liability for tortious acts

If the shareholder uses the GmbH to cause unlawful damage to third parties or if he himself violates tortious duties of conduct, he is liable for damages under tort law. In particular, the following may be considered:

- Liability for fraud, for example, in the case of deceiving a business partner about the GmbH's willingness/ability to perform;
- liability for intentional, immoral damage (e.g., violation of disclosure obligations by way of intentional deception, use of the GmbH as an instrument to obtain unfair advantages (e.g., bribes), deliberate exploitation of the GmbH for the purpose of harming creditors, liability for destruction of livelihood); or
- liability for delaying insolvency.

1.5 Piercing the corporate veil pursuant to Section 128 HGB analogously

Piercing the corporate veil to access the private assets of the shareholder is only recognized in narrowly defined exceptional cases that are treated restrictively in case law and literature.

Cases which are being discussed concern the behavior of a shareholder which is not compatible with the purpose of the liability privilege. Here, a shareholder's invocation of the legal independence of the GmbH is to be considered a breach of good faith (Section 242 BGB) and therefore a personal (external) liability of the shareholders for the debts of the company applies. Cases of piercing the corporate veil include, for example, the commingling of assets (see section 1.5.1), the commingling of spheres (see section 1.5.2), and material undercapitalization (see section 1.5.3), whereby the latter is only considered to constitute piercing of the corporate veil according to some legal literature, while case law regards it as intentional, immoral damage within the meaning of Section 826 BGB and thus as a case of internal liability vis-à-vis the company (see section 2.6).

1.5.1 Commingling of assets

In the case of commingling of assets, the private assets of the shareholder are commingled with the company's assets (e.g., through incorrect or inadequate accounting, if the inflows and outflows of assets and the separation of the company's assets and the private assets of the shareholders can no longer be traced on the basis of other available documents). This makes it impossible to distinguish between the two types of assets and thus to comply with the capital maintenance requirements.

However, piercing the corporate veil due to commingling of assets only applies to a shareholder if they are responsible for the commingling of assets due to the influence they exert, i.e., the shareholder must have a certain influence on bringing about or maintaining a commingling of assets. As a rule, therefore, it only applies to sole or majority shareholders and the economic owner of a limited liability company (GmbH), but not to minority shareholders, unless the minority shareholder can determine the fate of the company due to special factual or legal circumstances.

1.5.2 Commingling of spheres

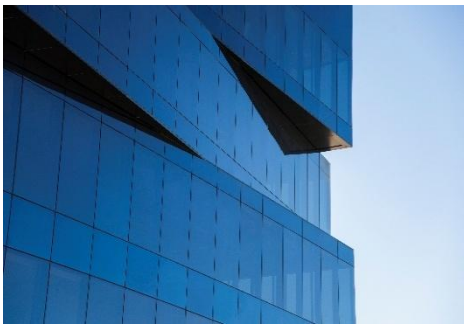
The commingling of spheres is often considered in the context of the commingling of assets, although this is not actually a case of piercing the corporate veil as such, but rather a case of legal appearance liability. In the commingling of spheres, the separation between the limited liability company and the shareholder is obscured, for example, by the use of similar company names, the same business premises, and/or the same staff. In these cases, the shareholder does not sufficiently separate the company, as the represented legal entity, from his own sphere when conducting business transactions. In the event of sphere mixing, the shareholder must therefore take responsibility for the transactions carried out and cannot claim that it is not he, but the GmbH that is the contractual partner and thus also the debtor.

1.5.3 Material undercapitalization

The case group of so-called "material undercapitalization" has long been highly controversial. Such material undercapitalization is said to exist if the equity capital of the GmbH (taking into account existing financing methods) is insufficient to cover the medium or long-term financial requirements of the GmbH based on the nature and scope of its intended or actual business activities (i.e., the GmbH is completely undercapitalized, so that it could become insolvent at any time and at the slightest economic difficulties).

Some legal literature considers material undercapitalization to be a case of piercing the corporate veil. The legal consequence would therefore be personal liability of the shareholders towards the creditors. Case law, on the other hand, does not resolve liability for material undercapitalization as piercing liability, but rather through internal liability, i.e., in rare exceptional cases, it

affirms liability vis-à-vis the company (see section 2.6).



1.6 Liability in the absence of management

Personal (criminal and civil) liability of the shareholders may also be considered if the company has no authorized managing directors in office (absence of management). According to section 15a para. 3 InsO, the obligation to file for insolvency of a GmbH without management lies with the shareholders, unless the respective shareholder had no knowledge of the insolvency and over-indebtedness or lack of management.

1.7 Liability for compensation payments in the event of redemption

In the event of the redemption of a shareholder's shares, the shareholder concerned is entitled to compensation from the company for the redeemed shares. According to case law, the remaining shareholders may be personally liable under their duty of loyalty if they fail to ensure that the compensation can be paid from unencumbered assets and this prevents the compensation claim from being satisfied.

2. Liability of shareholders vis-à-vis the company (internal liability)

In contrast, a shareholder may also be liable vis-à-vis the company itself in certain circumstances in the sense of internal liability. This may be the case in the following situations in particular:

2.1 Claim for payment of the contribution (Section 19 GmbHG)

As long as the shareholders have not yet paid their capital contributions in full, they are liable vis-à-vis the company for payment of the outstanding contributions they have undertaken to make.

2.2 Liability for shortfalls (Section 24 GmbHG)

The shareholders are liable for shortfalls in proportion to their shares, insofar as a capital contribution cannot be collected from the shareholders liable for payment or covered by the sale of the share.

2.3 Claim for payment of additional contributions (Section 26 GmbHG)

If the articles of association provide for an obligation to make additional contributions and there is a valid shareholder resolution, the company may demand additional contributions from the shareholders.

2.4 Claims for breach of capital maintenance provisions, Sections 30, 31 GmbHG

According to Section 30 para. 1 GmbHG, the assets of the company required to maintain the share capital may not be paid out to the shareholders. If these capital maintenance provisions are violated, the company has a claim for repayment against the shareholders. This claim may exist in addition to any other claims, in particular any claim arising from destruction of the company's existence (see 2.5 below).

2.5 Liability for destruction of the company's existence

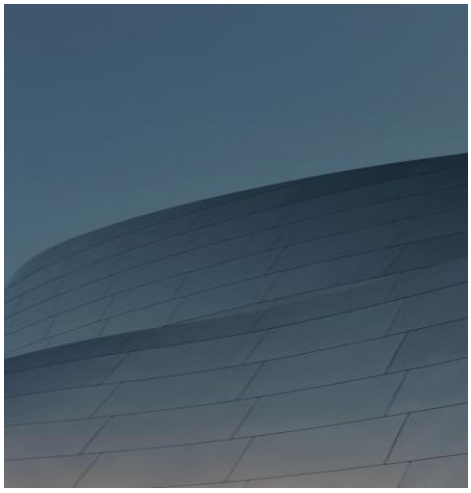
Liability for destruction of existence is a special case of intentional immoral damage developed by case law. The prerequisite for liability for destruction of existence is, first of all, an immoral, abusive, uncompensated intervention in the company's assets, which serves the purpose of satisfying the company's creditors as a matter of priority, and which leads to or exacerbates the insolvency of the GmbH. Such interference occurs in the case of the planned withdrawal of company assets in the sense of reducing the assets available to creditors and for the shareholder's own benefit.

Furthermore, liability for destruction of existence requires that the shareholder in question has acted culpably. Such culpability exists if the acting shareholder is aware that measures initiated by him or with his consent will cause immoral damage to the company's assets. Knowledge of facts that make the interference unethical is sufficient; awareness of the unethical nature is not required.

2.6 Liability for intentional, immoral damage (Section 826 BGB)

In addition to the liability for destruction of existence described above, a shareholder may also be liable to the company for other immoral damage, for example if claims collected by a shareholder were part of the company's assets and the shareholder "diverted" them to himself.

2.7 Liability for the appointment of unqualified managing directors (Section 6 para. 5 GmbHG)



The shareholders are also liable to the GmbH for damage caused to the company by intentionally or grossly negligently appointing a managing director who is not suitable to manage the business of the GmbH.

IV Summary

The liability of shareholders of a GmbH is characterized and limited by the liability privilege, but is relativized by narrowly defined exceptions. It is therefore crucial for shareholders to be aware of the scope and limits of the liability privilege, to maintain clear distinctions between the corporate and private spheres, to avoid legal appearances, to strictly observe capital contribution and capital maintenance regulations, and to avoid personal liability by acting with due care.

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