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KNOWLEDGE NUGGETS

LIABILITY RISKS ARISING FROM DE FACTO MANAGEMENT

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I. WHY THIS TOPIC IS IMPORTANT

The risk of liability as a “de facto managing director” (*faktischer Geschäftsführer*) is particularly elevated in small family businesses and medium-sized enterprises. This risk arises when an individual assumes management functions without having been formally appointed as a managing director or registered in the commercial register (*Handelsregister*). The consequences are significant: for all actions and decisions taken in that capacity, a de facto managing director is subject to the same duties and liabilities as a formally appointed managing director.

Such situations frequently arise during a corporate crisis — for example, when shareholders assume operational responsibilities and make decisions that fall within the exclusive purview of management, or when a financing bank effectively intervenes in corporate governance by deploying a representative with extensive decision-making authority.

II. PREREQUISITES FOR “DE FACTO MANAGEMENT”

The liability of the de facto managing director is not codified in statute but has been developed through case law. Courts apply a comprehensive assessment of all circumstances in the individual case, prioritizing “substance over form”. The boundaries are inherently blurred, but the following indicators are particularly relevant:

- Independent decision-making authority: Acting autonomously without being bound by instructions from the formally appointed management.
- External representation: Representing the company vis-à-vis third parties, such as in contract negotiations or by issuing operational instructions.
- Internal management function displacing formal management: Exercising influence over key business decisions (strategy, finance, personnel), or where formally appointed managing directors act only *pro forma* or under instruction—particularly common in matrix structures where management bodies of a parent company act on behalf of the subsidiary.
- Duration and continuity: Ongoing, systematic management activities rather than merely occasional or isolated involvement.

III. SCOPE OF LIABILITY

The de facto managing director is liable to the same extent as a formally appointed managing director. This includes liability for breach of the duty of care pursuant to Section 43 para. 1 of the German Limited Liability Companies Act, applied by analogy. In addition, he/she may face liability under tort law as well as under insolvency law, tax law, criminal law, and social security law.

IV. RECOMMENDATIONS FOR MINIMIZING RISK

The following measures are recommended to mitigate risk and avoid potential liability exposure:

- **Clear separation of roles and responsibilities:**
 - Avoid assuming any operational management functions without formal appointment as managing director.
 - Clearly define and document advisory roles as purely consultative, expressly excluding any decision-making authority.
 - Ensure and properly document that all material decisions are made by the formally appointed management.
- **Corporate Governance and Documentation:**
 - Maintain comprehensive documentation of decision-making processes, including resolutions of the management and shareholders.
 - Refrain from issuing direct instructions to employees or third parties outside clearly defined and documented areas of responsibility.
 - Establish clear reporting lines and organizational responsibility structures.
- **Formal Appointment in Cases of De Facto Management:**
 - Where management functions are effectively assumed, consider a formal appointment as managing director to ensure legal certainty and clarity of responsibilities.
- **Insurance coverage:**
 - Verify whether existing D&O insurance policies extend coverage to de facto managing directors; if not, consider expanding coverage accordingly.
- **Contractual safeguards:**
 - Define authorities and decision-making powers clearly in shareholder agreements, consulting contracts, or internal corporate guidelines.
 - Consider negotiating indemnification arrangements (to the extent legally permissible under applicable law).
- **Legal advice:**
 - Given the inherently fact-specific nature of de facto management determinations, engage specialized legal counsel at an early stage, particularly in ambiguous situations. This is the most effective means of avoiding significant liability exposure.

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