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# Focus on ESUG – Part 4: New Set of Rules Enhancing the Participation of Creditors in Germany

In 2012, the so-called ESUG was introduced in Germany to legally ease financial restructurings and insolvencies. A working knowledge of the new restructuring arsenal is beneficial for international investors in order to achieve successful distressed transactions in Germany. With the fourth and last part of our new series "Focus on ESUG" we sum up the new set of rules that extend the possibilities for the creditors to participate in restructurings under the insolvency code in an early stage.

Under German law the bankruptcy court traditionally does not play as important a role as in the common law hemisphere. In fact, its only real time to shine comes early on with the appointment of the insolvency administrator/custodian. Apart from that its influence on the development of a restructuring case is mainly limited to mere supervisory functions.

However, this situation has such a big influence on insolvency proceedings (because of the comprehensive powers given to the administrator or the management in collaboration with the custodian) that the lack of creditor and/or debtor involvement in the appointment has been one of the main reasons for international investors to shun the German distressed debt market.

The pivotal group of changes to the rules relating to creditor participation consequentially clears the way for creditors and/or debtors to elect the person to become (preliminary) administrator/custodian. The other important alteration relates to the general right of participation through the newly established preliminary creditor's committee.

## Appointment of administrator/custodian

*> Independence of the insolvency administrator:* under German insolvency law the (preliminary) insolvency administrator/custodian needs to be an individual, independent of the creditors and the debtor/company as well as suited in general for the respective case at hand.

*Before* ESUG this meant automatic deviation by the court from appointing persons involved – in any way – in the pre-insolvency restructuring process.

*> New leeway to rule out a conflict of interest and debtor/creditor proposition: After* ESUG a lack of independence can not solely be established on the grounds that a person had advised the debtor/company before the filing for insolvency (e.g. on the process of the proceedings in general and its implications for the debtor/company). Neither does the proposition of an administrator by the creditors and/or debtor/company itself automatically constitute such conflict of interest.

The court has to decide on the basis of the given circumstances in each individual case.

*> Creditor involvement in the appointment of the (preliminary) insolvency administrator/custodian:* the (preliminary) creditor's committee shall be given the opportunity to express themselves regarding the requirements that the (preliminary) administrator/custodian should meet; insofar as this would not lead to a detriment to the debtor's/company's financial status. The competent court shall deliver its judgement on these grounds.

Also, the court shall only deviate from an unanimous proposal by the (preliminary) creditor's committee if the proposed individual is obviously not qualified.

*> Protection of the debtor's/company's financial status:* the competent insolvency court can refrain from hearing the creditors in connection with the appointment of the insolvency administrator if it finds that the deferral in the process would lead to a detriment to the debtor's/company's financial status.

However, even in such cases the creditors have the right to vote on a different person as (preliminary) administrator/custodian (as the one appointed by the court without consultation) in the first meeting after the (preliminary) creditor's committee has been set up.

*> Discharge of the (preliminary) insolvency administrator/custodian:* the (preliminary) creditor's committee can file a request for the discharge of the (preliminary) insolvency administrator/custodian at any time. The court has to decide on such request; the decision is subject to appeal by the committee.

## Participation in the initial phase through the preliminary creditor's committee

*> The preliminary creditor's committee:* the new insolvency law regime adds new chances for participation of creditors early on in the proceedings.

Right after the filing of a bankruptcy petition by the company, the court can decide on the establishment of a preliminary creditor's committee (representing the most important creditor groups, i.e. creditors with secured claims, creditors with the highest valuation of claims and creditors with low valuation claims).

*> Obligatory appointment and creditor's request:* in cases involving companies of a certain economic importance (e.g. sales revenues of at least € 9,680,000 for the last 12 months before the filing) the court has to appoint a preliminary creditor's committee.

In all other cases the creditors, the debtor/company or the preliminary administrator can file a request for the appointment of a preliminary creditor's committee jointly with the debtor's/company's petition in bankruptcy. The court cannot deviate from such request if the requested committee is constituted in accordance with the law and the designated members have declared their willingness to participate.

*> Advantages of participation in the preliminary creditor's committee – at a glance:*

- Participation in the insolvency proceedings early on.
- Right to veto any decisions on the sale of important assets or the company itself.
- Major influence on the appointment of the (preliminary) administrator or custodian.
- Participation in all major decisions in the preliminary proceedings.
- Right to vote on the substitution of a court appointed administrator/custodian.
- Right to comment on the decision of the opening of DIP-proceedings.

## Conclusion

German insolvency law may expect further changes in the near future, e.g. concerning the handling of groups of companies in insolvency proceedings.

Meanwhile ESUG and its aim to strengthen participation rights of creditors in insolvency restructurings can already claim to have enhanced – significantly – the transparency of German insolvency law. Especially from an international investor's point of view, embracing the new leverage for extending participation in the proceedings, this will lead to increasingly more use of DIP-proceedings, insolvency plans, debt-to-equity swaps and other tools already provided by the insolvency code for restructurings and investments involving German companies.

## About WELLENSIEK

WELLENSIEK is a German law firm that develops and coordinates viable solutions for overcoming corporate crises – both from a financial and an operational perspective.

The scope of the services that WELLENSIEK can provide extends far beyond legal advisory; as a sparring partner we act as a facilitator for strategic issues for business owners, supervisory board committees, management teams, creditors and other stakeholders in crisis-ridden companies.

WELLENSIEK has more than 50 years' experience in insolvency administration. This wealth of knowledge forms the basis of our restructuring advisory services including trusteeship services.

Dr. Ruediger Theiselmann (Attorney/Executive Partner, right) and Dr. Alexander Verhoeven (Attorney, left) from WELLENSIEK Frankfurt focus on international restructurings with a German angle.

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