Insolvency & Restructuring - Germany

Reform Act improves creditor participation in selection of insolvency administrator

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Introduction

On March 1 2012 the Reform Act on insolvency law, which aims to facilitate the restructuring of companies within insolvency proceedings, entered into force. The main scope of the act is to strengthen the creditors' influence throughout preliminary insolvency proceedings, particularly by involving the creditors at an early stage in the selection of the insolvency administrator. Under the old regime, the appointment of the preliminary insolvency administrator vested in the sole discretion of the insolvency courts, which were not always willing to listen to the main creditors' proposals. Under the new law, creditors have more influence on the selection of the preliminary insolvency administrator, which brings major benefits for creditors: the appointment of a cooperative and experienced practitioner is the key factor in the successful implementation of restructurings within insolvency proceedings. In most cases, the preliminary insolvency administrator will also act as the main insolvency administrator for the main insolvency proceedings.

Formation of preliminary creditors' committee

When the insolvent debtor or a creditor files for the opening of insolvency proceedings, the court is obliged to set up a preliminary creditors' committee (if so applied for by the insolvent debtor or creditor). However, for the formation of the preliminary creditors' committee, two of the following thresholds must be met by the insolvent company (in each case for the preceding business year):

- a balance-sheet total of €4.84 million (after the deduction of negative equity);
- a revenue of €9.68 million; and
- 50 employees.

If two of these thresholds are not met, it is within the sole discretion of the insolvency court to appoint a preliminary creditors' committee.

Eligible members of creditors' committee

The formation of a creditors' committee can be expected to take place if eligible members are presented to the insolvency court together with consent declarations. The new insolvency regime foresees that the following creditor groups must be represented in the creditors' committee:

- secured creditors;
- creditors with the highest claims;
- creditors with smaller claims; and
- employee representatives.

The selection procedure can be time-consuming, delaying the appointment of the preliminary insolvency administrator. While the insolvent company and its creditors are free to propose individuals as representatives of creditor groups to the insolvency court, it is within the court's discretion to follow such proposals. The court is free to appoint more than four members, particularly in cases where the creditors pursue different interests (ie, senior and mezzanine lenders). Participation in the creditors' committee is

not obligatory for the court-selected members. The relevant candidates can still deny their consent to such participation.

The chairman of the creditors' committee takes responsibility for:

- invitations to the committee's meetings;
- the committee agenda; and
- other organisational matters.

Thus, main creditors should carefully consider whom to vote for the chairmanship in order to gain a certain amount of control over the process.

Creditors' unanimous proposal

The main duty of the preliminary creditors' committee is to make two different proposals to the insolvency court:

- for the appointment of a certain individual as the preliminary insolvency administrator; and
- for a certain profile of experience requirements for the preliminary insolvency administrator.

Only an unanimous decision of the creditors' committee is binding on the court. Under the act, the insolvency courts are no longer entitled to refuse an insolvency administrator only because the relevant candidate was proposed by the insolvent debtor or a creditor. In the past, insolvency courts used to argue that such candidates might not act independently in the performance of their duties. Even if the candidate has acted as adviser to the insolvent debtor prior to the opening of insolvency proceedings, this is no longer a criterion for exclusion, if the advice was limited to general guidance with regard to the course of insolvency proceedings.

Under exceptional circumstances, the insolvency court will still have the power to reject the proposed candidate, if he or she is considered unsuitable. In this case, the court will be obliged to give grounds for such rejection in writing. Such statements will be published online, although the name of the relevant candidate must not be mentioned due to data protection restrictions.

Grounds for refusal

The court may refuse to appoint a preliminary creditors' committee if:

- the business of the insolvent company has stopped;
- the appointment is considered to cause significant delays in the appointment of the preliminary insolvency administrator, which would adversely affect the financial situation of the insolvent company; or
- the appointment is considered too cost intensive with regard to the value of the expected insolvency estate.

The time aspect is the most important role of these reasons. The aim of preliminary insolvency proceedings is to preserve the value of the insolvency estate. Acting swiftly is necessary in order to prevent serious damage for the insolvent company, particularly in cases where the company is intended to continue in business. This is why in the ordinary course of things, the insolvency courts act very quickly (they generally appoint a preliminary insolvency administrator within a few days of receipt of the petition for the opening of insolvency proceedings).

In cases where the insolvency court refuses to appoint a preliminary creditors' committee on the grounds of urgency, it still remains obliged to constitute the creditors' committee at a later stage. Such committee will then be entitled to vote out the preliminary insolvency administrator appointed by the insolvency court without the court's involvement.

Preparation is key to success

The decisions taken by the insolvency court within preliminary insolvency proceedings largely depend on the information obtained from the insolvent debtor. If the debtor itself files for the opening of insolvency proceedings, it is obliged to provide information on the financial situation of the company – including information with regard to secured creditors, the highest unsecured claims, tax liabilities and pension claims. The debtor's petition for the opening of insolvency proceedings is inadmissible if it fails to submit the required information. As this exposes the managing directors to personal liability, this should serve as an initiative to provide such information.

Further information is also needed, such as information on the turnover, balance-sheet total and number of employees in the last business year. However, the provision in the new act which requires the debtor to deliver these details is only a recommendation –

no consequences are triggered if the information is not delivered at all or if it is incomplete or insufficient.

As long as the insolvent debtor is not forced and/or incentivised by applicable law to support the establishment of a preliminary creditors' committee, it is in the position to seriously undermine the entire process. It is therefore important that the process be thoroughly prepared from the outset, in cooperation with the main creditors and the insolvent debtor. When it becomes obvious that insolvency is a likely scenario, the main creditors should take the initiative and try to establish a pre-agreed process with other creditor groups and the insolvent company. Ideally, this should start at an early stage, before the application for the opening of insolvency proceedings is even filed. Creditors should try to ascertain that all relevant information can be made available to the insolvency court. An early pre-agreement on the preferred candidate would also be beneficial to the process.

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