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Kirkland Alert

Wirecard: German District Court Rules Shareholder Damages Claims Are Effectively Subordinated in an Insolvency of the Issuer

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At a Glance

The Munich District Court last week delivered a first-instance verdict in the multi-billion euro *Wirecard* insolvency¹, that shareholder damages claims arising from (in particular) a breach of capital markets law rank as equity in German insolvency proceedings, behind all creditors' claims.

The ranking of shareholder damages claims is an important building block for any downside analysis of investors in public companies with their centre of main interest (COMI) in Germany. This judgment establishes that shareholders' damages claims would rank behind creditors' claims; accordingly, such claims would be unlikely to obtain a recovery in any insolvency proceedings and would not operate to "dilute" creditors' recoveries.

Judgment

Wirecard was a German DAX 30 fintech star that filed for insolvency in June 2020 after disclosing that the existence of €1.9 billion in cash, about one quarter of Wirecard's balance sheet, could not be confirmed. Wirecard shareholders have filed about 40,000 claims in the insolvency proceedings, seeking damages of roughly €7 billion for capital markets fraud and similar breaches.

The Munich District Court dismissed a shareholder's claim for recognition of his claims as general unsecured claims in the insolvency and held as follows.

- Shareholder damages claims are economically equivalent to a claim for the reimbursement of equity contributions. Therefore, in the insolvency waterfall, shareholder damages claims are to be treated like equity, ranking behind general unsecured and subordinated insolvency claims.
- Shareholder damages claims need to be distinguished from fraud-related damages claims by debt investors which the German Federal Court of Justice (*Bundesgerichtshof*) treats as general unsecured claims in an insolvency.
 - In 2006 (and again in 2022), the Federal Court ruled that investors who subscribed to subordinated profit participation rights (*Genussrechte*) after being misled about the issuer's financial situation have a general unsecured claim in the insolvency of the issuer. Profit participation rights are (hybrid) debt capital.
 - According to the Munich District Court's judgment in *Wirecard*, misled equity investors and misled debt investors need to be treated differently in an insolvency: it is not relevant that both are capital markets participants who have been misled. Equity investors consciously opt for the risk of subordination in an insolvency in return for a (potentially unlimited) participation in the issuer's profits, while debt investors accept a limited upside in return for priority in the event of insolvency.
- The treatment of shareholder damages claims in an insolvency further needs to be distinguished from their treatment outside an insolvency and the related case law of the Federal Court.
 - In *EM.TV* (2005), the Federal Court ruled that, at least in cases of intentional misconduct, capital markets law takes precedence over corporate law, so that shareholder damages claims are enforceable even if such enforcement otherwise violates capital maintenance requirements under German corporate law.
 - According to the Munich District Court's judgment in *Wirecard*, in the event of insolvency, the purpose of issuer liability for misinformation can no longer be realised, so that insolvency law takes precedence over capital markets law, and capital markets law no longer takes precedence over capital maintenance restrictions. Shareholder damages claims are subject to capital maintenance restrictions (which protect the company's equity capital in the interest of its creditors), i.e., they are to be treated like equity, and cannot be general unsecured claims in an insolvency.

Implications

The ranking of shareholder damages claims is an important building block for any downside analysis of investors in public companies with their centre of main interest (COMI) in Germany. This judgment establishes that shareholders' damages claims would rank behind creditors' claims; accordingly, such claims would be unlikely to obtain a recovery in any insolvency proceedings and would not operate to "dilute" creditors' recoveries. However, the parties to the *Wirecard* litigation are expected to take the matter all the way to the Federal Court. Until the Federal Court has rendered a final decision on the ranking of shareholder damages claims, no definitive guidance can be given, and caution is advised.

This judgment is the first to provide guidance on a fundamental question of German insolvency law that has, somewhat surprisingly, remained unresolved for decades. It comes at a time when German public companies are increasingly being targeted by investors and regulators for their capital markets communications.

The judgment was obtained by an affiliate of Kirkland & Ellis, acting as common representative of all holders of the €500 million bond issued by Wirecard AG and co-defending the insolvency estate against competing shareholder damages claims.

1. LG München I, judgment dated 23 November 2022 - 29 O 7754/21. [↩](#)

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