

## German Federal Court Rules on Insolvency Administrators' Right to Use Certain Secured Assets Within Insolvency Proceedings

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### At a Glance

The German Federal Court has ruled<sup>1</sup> on the highly controversial issue of German insolvency administrators' statutory right to use secured assets in insolvency proceedings for the benefit of the insolvency estate. Until now, it was unclear whether administrators in Germany were entitled to use and dispose of secured assets (save for movable assets in the administrators' possession and security assigned receivables, where it was already clear that such assets *could* be used by administrators).

In holding that administrators do *not* have the right to use other secured assets, the German Federal Court ruled in favour of secured creditors' right to enforce collateral even within insolvency proceedings.

This ruling significantly mitigates the risk of share pledge enforcement being challenged. In particular, insolvency courts can no longer order secured creditors to "stand still" on a share pledge enforcement following an insolvency filing.

As a result, secured creditors may now consider the enforcement of German share pledges more often, especially if enforcement of a share pledge at a Luxembourg holding company is unavailable.

German Insolvency Code clear on administrators' powers over movable assets in administrators' possession and security assigned receivables

The German Insolvency Act expressly permits administrators to dispose of pledged movable assets in their possession as well as security assigned (trade) receivables. This permits administrators to continue to operate the debtor's business and use such pledged assets in the course of the insolvency process as the administrators see fit, preserving the ability to restructure and safeguard as many jobs as possible.

The relevant proceeds are then paid to the relevant secured creditor, following deduction of a realisation fee for the benefit of the estate (which is c.9% of the realised proceeds).

German Insolvency Code unclear on administrators' powers over other pledged assets

The German Insolvency Act is silent in relation to other secured assets, in particular intellectual property and shares in (operating) subsidiaries. Such assets are not necessarily required to continue operations in the same way as inventory and collection of trade receivables. However, shares in operational subsidiaries may be the most important and valuable asset of a borrower that is a holding company.

Previously, certain administrators claimed that only the administrator of a holding company is entitled to use the (secured) shares in its subsidiary/ies. German insolvency courts tended to grant so-called "protective orders" to prevent secured creditors from enforcing their collateral following an insolvency filing.

Share pledge enforcements after insolvency filings have therefore been particularly challenging in Germany

Against this backdrop, enforcement of share pledges was particularly cumbersome in Germany after any insolvency filing (given insolvency courts and/or administrators could act to frustrate enforcement action). Such uncertainties in the enforcement process could even result in third party investors not acquiring an asset with clean title in an auction or sales process if the sales process was challenged.

In many cases, therefore, only the secured creditors effectively credit bid to acquire the distressed business and subsequently restructure the operating entities. However, secured creditors also ran the residual risk that administrators or junior lenders might claim that transfer of title in an auction process was invalid. This is one reason why there were only a few share pledge enforcements within German insolvencies and secured creditors preferred to enforce share pledges at Luxco level (if available).

German Federal Court ruling provides clarity on all “other pledged assets” including (non-securitised) shares

As noted, the German Federal Court has now held that insolvency administrators have no right to use pledged assets other than movable assets in their possession and security assigned (trade) receivables – i.e., they have no right to use/dispose of pledged shares.

The flipside is that secured creditors remain entitled to enforce share pledges (or other pledges) under and in accordance with the terms of the security agreements.

## Impact

As noted, this ruling significantly mitigates the risk of share pledge enforcement being challenged. In particular, insolvency courts can no longer order secured creditors to “stand still” with a share pledge enforcement following an insolvency filing. As a result, secured creditors may now consider the enforcement of share pledges more often, especially if enforcement of a share pledge at a Luxembourg holding company is not available (or, even if available, likely to be subject to German insolvency proceedings).

The increased certainty has the potential to encourage third party bidders to participate more actively in auction/sales processes in respect of secured assets.

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1. BGH, judgment IX ZR 145/21 [↔](#)

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