German ESUG:
An official look back

In 2012 the German legislator enacted a landmark reform of the German Insolvency Code aiming at three main goals:

1. The influence of creditors on the selection of office holders in corporate insolvencies should be increased.
2. Where the restructuring of viable enterprises was at risk because of shareholder dissent, the reform was introduced to involve shareholders, dilute their position by debt-equity-swaps, diminishing or even relieving them of their position by a Chapter 11 type of process (*Insolvenzplanverfahren*).
3. The introduction of a so called protective shield proceeding (*Schutzschirmverfahren*), a preliminary proceeding aiming at incentivising early filing by allowing the debtor to choose the office holder and maintain control in a debtor-in-possession ("DIP") process, in specific circumstances.

At enactment the legislator already ordered that after five years the law should be subject to review. As a consequence, in 2017 the German parliament appointed a team of professors to review the application of the law and to make suggestions for changes. The approach the team took was threefold:

1. Firstly, they submitted a questionnaire to the 'usual suspects' in insolvency proceedings (creditors, judges, debtors, consultants, office holders and directors). The return rate was at 41% – extremely high for such a mailing.
2. In addition, all of the DIP proceedings of enterprises since 2012 were reviewed. 1,690 files plus court files for some 15 proceedings were looked at in detail.
3. Thirdly, the team reviewed jurisdiction literature and added own reflections on the law that had been subject to a wider ranging discussion.

The report is some 325 pages strong accompanied by a 20-page summary. It has been subject to commentary by interest groups as well as professional journals. And no surprise, while there is only one report, the range of interpretations may leave you with a different impression.

The overall verdict is positive. The change seen necessary is marginal. They did not find evidence of creditors impacting the choice of the office holder to the disadvantage of others.

The reform has significantly increased Chapter 11 like *Insolvenzplanverfahren*. Also positive is the impact on shareholder rights. In practice these are predominantly transfers of shares and reductions of share capital. The debt-equity-swap introduced with the law is of no major relevance.

The protective shield proceedings have encountered the same fate. Application has been well below expectations. The contemplated far earlier filing has as of yet also not occurred. The authors are tempted to say that to have an impact on actual practice it takes more than five years. Also, institutional lenders and professional stakeholders are reluctant when it comes to breaking new ground and risk aversion does result in significant lead time for new tools to become common in actual practice.

The researchers find it may be of use to more precisely define circumstances and prerequisites appropriate for DIP. The criticism on the still widely varying practice of the courts is strong. The aim should be to increase the professionalism of the courts and to assure a more consistent application of the law.

The legislator has begun to discuss the results of the study with interest groups. Action will likely not be taken in the short term. Likely the legislator will wait for expected release of the preventive restructuring framework directive to deal with the results of both. Looking into the rear view mirror at the history of the German legislator dealing with a directive which is not well received, it may happen that legislative changes, if any, are faraway. ■

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