

GERMAN SHARE PLEDGE ENFORCEMENT: GERMAN FEDERAL SUPREME COURT FINALLY PROVIDES CLARIFICATION ON WHO IS ENTITLED TO ENFORCE

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Since the beginning of the 21st century and the first big wave of security enforcements in Germany, who holds the entitlement to enforce a share pledge has caused countless disputes between pledgees and insolvency administrators. This issue has now been resolved by a recently released judgment of the German Federal Supreme Court of 27 Oct 2022 (case no.: IX ZR 145/21), which has now held that pledged shares as well as pledges over certain other non-movable rights such as trademarks or patents can be enforced by the pledgee (only) and not by the administrator.

BACKGROUND TO THE UNCERTAINTY AND COMMERCIAL PRACTISE TO DATE

In the insolvency of a German debtor, the German insolvency administrator takes control of the assets with a view to liquidating them to the benefit of the creditors. Shares in subsidiaries held by the debtor naturally form part of such assets. Prior to the new decision, if the assets had been granted as collateral, by nature a conflict between the collateral holder and the administrator arose as to who could control the enforcement and realization of the collateral.

The law was clear as to who holds that right in respect of some securities but not all. For example, movables that are subject to a security transfer remain with the administrator, whereas receivables that have been assigned for security purposes may be asserted by the assignee. However, the law was not clear in respect of the enforcement of share pledges. In a 2016 Federal Supreme Court decision, re. Mobilcom, it was decided that the administrator was obliged to enforce pledged securitized bearer shares of a stock corporation which were physically held in custody.

However, that judgment was unclear as to whether, in the court's view, the principle was limited to the physical holding of shares or should extend to the enforcement right for non-securitized shares of a German limited liability company (GmbH).

In light of this uncertainty, in most cases, it was agreed that the administrator would take control of the shares in order to, as the case may be, sell or restructure the group as a whole, thereby potentially preserving value which would be in the creditors' best interests, but the administrator's approach would not always be accepted by the pledgee as being in the creditors' best interests.

In practise therefore, the pledgee and the administrator negotiated and entered into a so-called realization agreement, setting out the agreed enforcement process. Notably, this takes time and typically includes a negotiated fee for the estate.

CLARIFICATION PROVIDED BY THE FEDERAL SUPREME COURT

Fortunately, the Federal Supreme Court has now clarified the situation. Although the case related to trademarks, the Court confirmed that neither trademarks nor certain other non-movable rights, such as shareholdings, trademarks or patents, can be enforced by the administrator.

In particular, the Court found that the relevant section 166 of the German Insolvency Code does not provide for a right of the administrator to enforce a share pledge. It distinguished the Mobilcom case and dismissed it as being authority for a general application to GmbH shares which are not physically possessed by either party and held further that, unlike with movables in the administrator's possession, the sale of shares by an administrator is not *per se* better for creditors than a sale following an enforcement by the pledgee. There may be a scenario where a sale by the administrator could lead to higher enforcement proceeds but this alone would not justify a general rule.

The Federal Supreme Court's thorough and detailed judgment will provide clear authority to the lower courts and the insolvency administrators to follow in practise. This will be received favorably by secured lenders.

PRACTICAL CONSEQUENCES

This decision will be welcomed in German financing transactions and international financings which include German guarantors. Often, share pledges are the only German collateral which do not contain enforcement restrictions, such as "limitation language" preventing a payment obligation if it leads to personal liability of the German guarantor's management. Thus, share pledges are highly valuable for the overall structure. The decision should now do away with the need for pre-enforcement negotiations and realization agreements with the administrator, leading to a faster process run by the pledgee and higher returns for creditors. This in turn may factor favourably in the cost of German finance generally.

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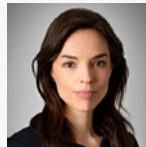
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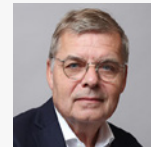
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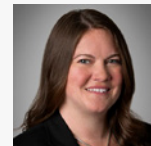
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