

German Federal Court (BGH) bolsters creditor's rights in debtor in possession proceedings by ruling on director's liability vis-à-vis creditors

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In its April 2018 decision, the BGH ruled on the question whether the directors of a company that has been granted debtor in possession status by the respective insolvency court can become personally liable for a breach of a duty of care vis-à-vis the creditors like an insolvency administrator. The underlying legal question was the subject of a controversial academic discussion in the past. Now the BGH found that the directors of an insolvent company that is acting as a debtor in possession can be held personally liable vis-à-vis the creditors based on the statutory liability provisions applicable for insolvency administrators insolvency under the German Insolvency Code (*Insolvenzordnung*).

Background

The insolvent debtor company, acting as debtor-in-possession, ordered certain goods from the plaintiff a few days after the creditors' meeting had approved an insolvency plan in relation to the restructuring of the company. The goods were delivered after the company exited from insolvency proceedings. The respective invoice remained unpaid and approximately five weeks after the delivery of the goods, the company had to file again for insolvency. Against this background the plaintiff sued the CRO for damages to recover the losses from the unpaid invoice.

In September 2017 the Court of Appeals in Düsseldorf held that the managing directors of a limited liability company (*GmbH*) would not be liable vis-a-vis the creditors of the company even if they managed the company as a debtor in possession during an in-court restructuring process. The Court of Appeals reasoned that the directors could only be held liable according to general civil law rules and corporate director's duties.

In practice, the view taken by the Court of Appeals on director's liability has occasionally added to the neglect of creditor's interests in debtor in possession proceedings usually to the benefit of the respective debtor company or even its shareholders.

Key message of the decision

In the aforementioned decision, the BGH clearly refused the view taken by the Court of Appeals and clarified that the directors of a debtor in possession can be held personally liable vis-à-vis any party involved in the insolvency proceedings for violation of their insolvency related obligations pursuant to an analogous application of secs. 60, 61 of the German Insolvency Code.

The decision of the BGH is mainly based on the grounds that (i) the directors of a debtor in possession factually assume the same obligations and make use of the same authorities as an insolvency administrator in regular insolvency proceedings; and (ii) therefore, the same protective obligations apply for such directors vis-à-vis the creditors of the company. Given that the directors, in addition to their general corporate director's duties are entrusted with the duties and obligations that are originally assigned to insolvency administrators, the BGH held that it is necessary to inflict a respective personal liability on the directors in case of violations of their duties. The BGH further stated that the directors, while managing the business, have to take into account the interest of the creditors.

The BGH reasoned that the general liability for directors vis-a-vis the corporate entity for which they are acting is not sufficient to protect the legitimate interests of the parties involved in a debtor in possession process. In order to treat a debtor in possession company equal to a company in regular insolvency proceedings the directors of the debtor in possession have to be made subject to the same liability regime applicable to insolvency administrators.

Accordingly, the BGH overruled the decision of the Court of Appeals Düsseldorf and referred the case back for a new hearing and decision.

First assessment of the implications of the BGH's decision

The decision (i) provides a helpful clarification as regards the liability regime for the directors of a debtor in possession; and (ii) as a result, strengthens creditors' rights in debtor in possession proceedings. It is worth noting that the BGH clearly stated that directors should not interpret the debtor in possession status in a severe financial crisis of a company as a *carte blanche* with respect to their personal liability.

From the creditors' perspective, it has been clarified that a solvent third party other than the debtor in possession can be held liable for damages if the directors breach their respective duties. Against the background of this clarification going forward directors of a debtor in possession company have to take into account the creditors' interests – even in their own interest to avoid personal liability.

The personal liability requires the directors (and in particular chief restructuring officers) to exercise their competences with particular care and in compliance with their duties towards the parties involved in debtor in possession insolvency proceedings. Accordingly, the management of a debtor in possession needs to ensure that the process is set up in a professional manner and provide for the necessary skills e.g. by appointing a chief restructuring officer who has experience in insolvency proceedings and take professional advice. The BGH has clearly illustrated that the directors of a debtor in possession – in addition to their corporate director's duties – assume the same rights and obligations that originally apply to insolvency administrators in regular insolvency proceedings. These include, for example, the careful business planning as regards the option to fulfil or terminate existing bilateral contracts or the incurring of administrative expenses of the insolvency estate. Accordingly, in addition to the strengthening of the creditors' rights, the present decision should also strengthen the professional handling of debtor in possession insolvency proceedings.

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