

## SCHULTZE & BRAUN INSOLVENCY LAW

### Self-administration by debtor's application

#### The legal concept of self-administration

In derogation of the regular insolvency proceedings, § 270 to § 285 of the insolvency code provide for the legal concept of self-administration. Although self-administration also presupposes the filing for insolvency and the opening of legal proceedings, there are some substantial differences in comparison with the regular insolvency proceedings which make self-administration particularly attractive for enterprises in financial crises. One of the essential features in self-administration is the fact that the debtor retains the right of disposition and the right of administration, with a creditors' trustee assisting and controlling the debtor's actions.<sup>1</sup>

Any reorganisation efforts initiated before the insolvency can therefore be continued by management under self-administration, while the powers of disposal and administration do not automatically pass to an insolvency administrator. The new regulations rely to a large extent on the provisions of the former court composition law which remained in force until 31 December 1998. The court composition law also provided for proceedings without the involvement of a (bankruptcy) trustee.

The systematic structure of the insolvency code, assigning to self-administration the character of special proceedings, results from the exceptional nature of self-administration. Actually enforcing the self-administration proceedings therefore requires particular efforts on the part of the legal officer acting on behalf of the enterprise applying for self-administration.

#### The significance of self-administration in practice

Judging from the initial experiences made with the insolvency code in force since 1 January 1999, self-administration has not obtained the practical significance which had been expected. This may also be due to judicial practices which in most cases tend to dismiss the debtor's application for self-administration. However, the true reason may be that the debtor himself and the legal department dealing with the matter fail to meet the requirements for the application.

#### Prerequisites and conditions for self-administration

The prerequisites and conditions for a successful application which the legal officer involved is expected to comply with will be discussed under their legal and tactical aspects.

#### Preparing the application

There is wide-spread agreement on the favourableness of prior reconciliation in another new legal concept of the insolvency code which has so far been more significant in practice: the insolvency schedule or the insolvency plan (usually known as the *pre-packaged plan*<sup>2</sup>). Similar attributes also apply to self-administration. Prior reconciliation is advisable under two aspects:

##### 1. Reconciliation regarding self-administration.

A mutual agreement among all parties involved, including the principal creditors, on the application for self-administration should precede any further steps. The question of which

---

<sup>1</sup> Cf. § 274 InsO.

<sup>2</sup> See also Braun in Nerlich/Römermann, InsO, before § 217 mn 203

principal creditors are to be involved in the preliminary reconciliation usually depends on the merits of the individual case. As a rule, these are the financial creditors (banks, savings banks) as title owners of the most substantial open debts. The reconciliation should aim to obtain declarations from these principal creditors that they have no objection to the self-administration and, if possible, that such self-administration is considered to be relevant for recovery.

## 2. Personal appearance

These declarations together with the order of self-administration are then to be submitted to the insolvency court.<sup>3</sup> Other reconciliation negotiations should be held with the insolvency court as the decisive organ of the administration of justice. The debtor submitting the application in writing cannot expect that self-administration is granted. It is advisable to submit the application documents to the insolvency court in person and to outline the specific circumstances of the case.

### **The essential order conditions of self-administration under § 270 Section 2 InsO.**

- Debtor's application.
- Under the circumstances it must be expected that the order will not result in delays of the proceedings or in other disadvantages for the creditors

### **Reasons for the application**

Presentation of particular circumstances.

By law, no reasons need to be given in the application for self-administration. However, if the application is to be successful, reasons are indispensable. Most persuasive are arguments which can be derived from the particular circumstances of the actual case. For instance, the question of whether the debtor's representative submitting the application has been responsible for the company's crisis, or whether such a person has only recently been entrusted with managerial tasks as reorganisation manager or board member, may be considered a crucial issue by the court.

Understandably, the insolvency court will show little inclination to grant the power of disposition and administration to a person who is alleged to be responsible for the debtor's crisis and the losses regularly suffered by the creditors.

### Reorganisation efforts

The debtors should also submit proposals which show that the self-administration will be part of an overall reorganisation concept which the debtor's management will implement via an insolvency plan.<sup>4</sup> Self-administration is unlikely to be denied in such cases, because insolvency courts tend to be open-minded when it comes to (promising) reorganisation efforts.<sup>5</sup> This may be supported by arguing that, to be successful, the reorganisation concept must be implemented without delay and that instituting an insolvency administrator (with the ensuing time required by the insolvency administrator to familiarise himself with the case) may cause the concept to fail.<sup>6</sup>

---

<sup>3</sup> These declarations have circumstantial significance for the court because the insolvency proceedings are determined by the autonomy of the creditors. Details hereto under Neumann, *Creditors' Autonomy in Future Insolvency Proceedings*, Bielefeld, 1995

<sup>4</sup> Details hereto in Braun/Uhlenbruck, *Corporate Insolvency*, 1997, 423ff.

<sup>5</sup> This presupposes that self-administration is plausibly presented as an essential element of the overall reorganisation concept.

<sup>6</sup> Cf. Häsemeyer, *Insolvency Law*, 2nd edition 1998, 156; Riggert in Nerlich/Römermann, *InsO*, 270 mn 23

### **Statutory order preconditions**

§ 270 Section 2 InsO presupposes that the debtor applies for self-administration and that, under the prevailing circumstances, the order does not result in delays in the proceedings and in other disadvantages for the creditors. For the insolvency court, this is actually a forecast decision in which the court will compare the expected course of the insolvency proceedings with the course proceedings would take with and without ordering self-administration. The court will be able to decide in favour of the debtor only if the decision-making facts of the case are presented with sufficiently good reasons in the debtor's application.<sup>7</sup>

### **The course of the self-administration proceedings**

The self-administration proceedings mirror US law in analogy with the so-called principle of *debtor in possession*. This involves an administrator-less course of action because the power of disposition and administration is held and exercised by the debtor and/or its corporate agents.

### **Provisional insolvency administrator**

The differences between the self-administration proceedings and the regular liquidation do as yet not show their effect in the opening proceedings. Once the application has been filed, the insolvency court will (even if it is not averse to the self-administration solution) normally appoint a provisional insolvency administrator.<sup>8</sup> The decision regarding self-administration will eventually be taken in the ruling by the insolvency court on the opening of the insolvency proceedings (cf. § 270 Section 2 Sentence 1 InsO).

### **Accompanying measures to bring about self-administration**

1. Preliminary reconciliation and agreement with the principal creditors on the issue of self-administration.
2. Submission of written confirmations to the insolvency court to the effect that self-administration is advocated by the creditors.
3. Presentation of reorganisation measures to be implemented with the help of self-administration
4. If applicable: Presenting the activities of a reorganisation manager and/or reorganisation board.
5. Plausible presentation that the familiarisation period required by an insolvency administrator may impair the chances of reorganisation.

### **Annulment of self-administration**

Self-administration is not necessarily final. Pursuant to § 272 InsO, self-administration is to be subsequently rescinded if the creditors' meeting so resolves or if a creditor's application is filed in which prima facie evidence is provided that the conditions for ordering self-administration no longer prevail. If the debtor is no longer interested in self-administration and submits the appropriate application, self-administration will also be withdrawn (§ 272 Section 1 No. 3 InsO).

---

<sup>7</sup> Regarding the circumstances which may give rise to delays in the proceedings and/or disadvantages to the creditors, see Riggert in Nerlich/Römermann, *InsO*, § 270 mn 23ff.

<sup>8</sup> However, the court is more likely to appoint a so-called „weak provisional insolvency administrator“ to whom the power of disposition and administration does not pass after the preliminary proceedings already. If this were the case, the power of administration and disposition would otherwise need to be re-transferred back to the debtor for the opened proceedings if self-administration is applied for.

### **The legal position of the creditors' trustee**

The continued course of the self-administration proceedings is determined by the interplay between the debtor and the supervisory organ, normally the creditors' trustee. Although the debtor retains the power of disposition and administration, the creditors' trustee holds certain rights of information, control and collaboration which are more explicitly defined by law. Depending on the case in hand, the legal position of the creditors' trustee may differ.

§ 277 InsO stipulates that an order is passed by the insolvency court upon application by the creditors' meeting to the effect that certain legal transactions by the debtor become effective only if they have been approved by the creditors' trustee. Other duties are obligatorily assigned to the creditors' trustee. In particular, only the creditors' trustee is permitted to contest the insolvency (§ 280 InsO). The basic rule is as follows: Certain tasks are incumbent upon the creditors' trustee only if they are expressly laid down in law. If no appropriate regulation is found, responsibility will rest with the debtor.

To clarify matters, the law expressly assigns certain duties to the debtor, e.g., utilising security collateral (§ 282 Section 1 InsO) and distributions (§ 283 Section 2 Sentence 1 InsO).

### **Preparing an insolvency plan**

The most sensible approach is to link the self-administration proceedings and the insolvency plan proceedings. For the debtor, it is usually not very desirable to use self-administration to break up his own enterprise and to distribute the proceeds among the creditors. On the other hand, the insolvency plan is the appropriate means in many cases to continue the enterprise and to envisage satisfying the creditors from the revenues.<sup>9</sup>

### **Summary**

In practice, self-administration proceedings have as yet not obtained the significance they deserve. This is not merely due to a certain reticence on the part of the courts, but mainly to the application for order being inadequately prepared by the debtor. This is disadvantageous to the debtor, because self-administration offers a number of significant advantages.

In particular, the power of disposition and administration remains with the debtor and its corporate agents, and the insolvency proceedings are not controlled by an external insolvency administrator. The challenge to successfully assert the self-administration proceedings rests with the debtor's legal department.

*Dr. Rainer Riggert*

---

<sup>9</sup> The permissibility of linking the self-administration proceedings and the insolvency plan proceedings results from § 284 Inso; see also Buchalik, NZI 2000, 296.