

German Federal Court of Justice Endorses Distressed Debt Traders and Confirms Unrestricted Right to Inspect Insolvency Files

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The German Federal Court of Justice (Bundesgerichtshof - BGH) confirmed in a decision on May 7, 2020 (file number IX ZB 56/19) that distressed debt traders have the unrestricted right to inspect insolvency files.

In the case at hand, a distressed debt fund had acquired several claims against the insolvent company from various insolvency creditors. The fund requested to inspect the insolvency files at the insolvency court. By reviewing the files, the debt fund's aim was to obtain further information from the table of claims, seeking to identify further appropriate creditors who might be willing to sell their claims. The insolvency administrator, on the other hand, opposed such request for inspection. Many insolvency administrators try to avoid that professional, and often aggressive, distressed debt investors gain significant influence in insolvency proceedings. For insolvency courts, such inspection requests are often a nuisance, and therefore, some inspection requests are rejected based on the argument that an inspection by a professional debt trader is "legally abusive," as the Munich local court did in this case.

So far, there was no clear case law, and for distressed debt investors, the request for the inspection of files resembled a game of chance with different outcomes from one local court to another.

The Federal Court of Justice has now clarified the following:

- Insolvency creditors, unlike third parties not involved in the proceedings, do not need to assert a legitimate interest in the inspection of files.
- The request for inspection of the files is not abusive, merely because the insolvency creditor may wish to use the inspection for its own benefit to identify creditors who are interested in selling their claims.
- Debt trading does not contradict the objectives of insolvency proceedings. It can help to reduce the insolvency damage suffered by creditors – because it is by no means certain that the liquidation quota received at the end of an often very long insolvency proceeding will be higher than the purchase price paid by the investor.

The Federal Court of Justice now clearly sets limits for insolvency administrators and insolvency courts; it is not their job to effectively prevent debt trade, and thereby influence whether or not creditors participate in insolvency proceedings.

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From the perspective of distressed debt investors, this decision is to be welcomed as it removes great uncertainty and practical obstacles.

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