

## The Digital Judiciary

### The Digitization of Restructuring Law as a Case Study

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The German and European legislators are pushing ahead with the digitization of more and more areas of the judicial system: Not by means of a single, comprehensive reform, but through a multitude of laws, legislative proposals and consultations. Obviously, there is a lot of dissatisfaction with the previous procedures, which have been perceived as inefficient and lengthy. Hopefully the legal system will become faster over the course of its digitization – better and more just. But for whom? That remains to be seen. In any case the question is no longer whether the judicial system will be digitized, but to what extent and whether this digitization will also transform the judicial system - for better or worse - into a kind of "new justice" 1

#### 1. Introduction

Some countries are further ahead than Germany. For example, electronic legal communications have been firmly established and stable in Austria since 1999. In the United Kingdom there are very concrete intentions to introduce an online court, and in U. S. court proceedings electronic online case files have been the standard in the federal courts for more than a decade, in particular in Bankruptcy Law. 2

Important areas of commercial law, as they relate to the judiciary system, are being digitized in many places simultaneously even if no comprehensive, overarching digitization strategy is yet discernible. This is also the case for restructuring law with its numerous corporate, tax and insolvency law angles which deal with substantial assets. Restructuring law has developed into a significant economic factor (cf. Paulus, ZIP, 2017, 910) because it is of major importance in commercial law transactions how quickly a judicial or out-of-court or pre-court restructuring solution is possible in the event of a crisis. 3

If this area of law is now also transformed by digitization, this will have a fundamental impact on general commercial law in practice. The development of restructuring and insolvency law towards e-Justice shall therefore be outlined below. 4

## 2. The Digitization of Restructuring Law as a Case Study

The digital status of German restructuring law so far presents a mixed picture. For example, the Federal Supreme Court (BGH, decision dated 10.10.2013 - IX ZB 229/11) has determined that the "misleading design of the search mask" of the nationwide insolvency case online platform "www.insolvenzbekanntmachungen.de" requires excessive operational effort and thus does not provide reliable and user-friendly access to the publications of the insolvency courts. This is a devastating statement for a state-run online service, and yet the situation remains unimproved by the German legislator. 5

On the other hand, in day-to-day restructuring practice, especially cases involving insolvency administrators, it has long been possible to carry out large-scale restructuring with a large number of participants using robust software solutions such as in the major cases of Prokon and AirBerlin. 6

In addition, there are systematic modernisation approaches underway, such as the ones spearheaded by the Association of Insolvency Administrators in Germany (Verband der Insolvenzverwalter Deutschlands - VID) under the slogan "Insolvenzverfahren 4.0" ("Insolvency Proceedings 4.0" - see Niering, INDat Report 04\_2016). This approach tackles issues such as the fact that German insolvency proceedings are still based on the model of the imperial insolvency code (Konkursordnung) of 1877, and that many formal procedures concerning reporting obligations, insolvency claim filing and maintenance of the claims register are outdated and require too many resources. The first meeting of the working group "Insolvency Proceedings 4.0" took place at the end of 2017 with governmental participation and one should definitely look forward to the results. 7

The current state of German insolvency proceedings does not yet permit effective participation by all parties involved. Thus, creditors' meetings may still not be held online, information in the proceedings is not delivered automatically electronically, and neither the court files of insolvency proceedings nor the entire claims register can be viewed directly online. However, much better online access, and thus justice, has been customarily available in other countries for a long time and should therefore also be possible in Germany - naturally after a discussion on the relationship between a high level of data protection and the justified requirements of insolvency and restructuring law. 8

## 2.1 Electronic Court File Soon Also in Insolvency Proceedings

Recently, the German legislature has indeed acted and, without much discussion, has also pushed ahead with the digitization of insolvency proceedings: The "Law on the Introduction of Electronic Files in the Judiciary and on the Further Promotion of Electronic Legal Communications" (Act of 05.07.2017 - Federal Law Gazette Part I 2017 No. 45 12.07.2017 p. 2208), which was adopted in May 2017, entered into force on 1 January 2018. By the year 2026 at the latest, the German rules of civil procedure will be fully converting to electronic files, including an online case file access portal. German insolvency proceedings are also affected by this because, pursuant to sec. 4 of the German insolvency code, the German rules of civil procedure apply generally to German insolvency proceedings.

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It is interesting to note that, in accordance with the new § 299 (3) sentence 1 of the German rules of civil procedure, inspection or review of case files must then be granted "if the court records are kept electronically, the administrative office shall grant inspection of files by making the contents of the files available for [online] retrieval", free of charge. This will make German insolvency proceedings already appear more modern in an international comparison. At present, international stakeholders find it incomprehensible that the insolvency proceedings court files, even if there is a statutory right to inspect the court files, cannot be viewed directly online, but can only be viewed in a cumbersome procedure by either requesting copies via mail or actual inspection of the (paper or locally electronically saved) files at the administrative office of the insolvency court.

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In addition, in the area of public administration, there will soon be an online case file review portal (see the new regulations introduced in the summer of 2017 in Art. 91c para. 5 of the German constitution on "comprehensive access to administrative services in the field of information technology" and the Online Access Improvement Act - Onlinezugangverbesserungsgesetz - OZG), according to which all administrative services must also be offered electronically via administrative portals within five years at the latest. The extent to which this is also suitable (or not) as a model for publicly appointed German insolvency administrators will also have to be discussed.

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With the electronic insolvency court file or completely digitized insolvency proceedings, however, new data traces are also created which may be in high demand or of particular value and interest for some. For this reason, it is particularly important in such an economically relevant area as restructuring and insolvency law in which the protection of business and trade secrets is paramount, to ensure that these data traces are not used illegally or illegitimately. Stakeholders and other interested parties might want to know, for example, who has been given access to the files of insolvency proceedings or who has been notified and when.

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It is also necessary to protect against the dangers of "legal analytics" in relation to public and impartial court proceedings. For the independence of insolvency judges, for example, it must be ensured that the available data, such as how often an insolvency judge has opened on its computer the respective online insolvency case file and worked with it, cannot be used to deduce how much attention an insolvency judge pays or does not pay to the respective insolvency proceedings. Other data that will soon also be available may also be sensitive, because such data may show how often insolvency courts and certain parties or stakeholders involved communicate with each other, which distribution quotes and procedural settlements someone achieves across court procedures Germany-wide, and so on. Access to and evaluation of this data must be regulated or limited. One way of doing this would be for the courts to keep this data in a separate IT structure and not to leave it to the German executive branch to organize the courts' IT backbone. 13

## 2.2 EU Proposal on Preventive Restructuring Framework

In November 2016, the EU presented a draft directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures. It is currently expected that once comprehensive feedback from science, politics and practice has been digested, it will be followed by a formal EU legislative process in 2018. 14

One interesting aspect of this is Art. 3 Para. 1 of the draft that aims for the introduction of early warning systems:

### *Early warning*

*1. Member States shall ensure that debtors and entrepreneurs have access to early warning tools which can detect a deteriorating business development and signal to the debtor or the entrepreneur the need to act as a matter of urgency.*

According to the official reasoning provided with the proposal, these early warning systems should lead to more restructurings being initiated at an early stage: "Possible early warning mechanisms should include accounting and monitoring duties for the debtor or the debtor's management as well as reporting duties under loan agreements. In addition, third parties with relevant information such as accountants, tax and social security authorities could be incentivised or obliged under national law to flag a negative development." 15

This regulation is thankfully formulated in a technologically neutral way. However, it is clear that such a financial early warning system can currently only function digitally if it is fast and efficient. However, this can only succeed if the corresponding financial data is 16

available electronically and in high quality, and if the companies' financial software has corresponding interfaces. It would be conceivable, for example, to have systems that automatically issue warnings to management when a liquidity crisis or shortfall is imminent or more likely than not. What might also be introduced could be that breaches of important conditions in loan agreements (like covenants, minimum revenues, liquidity reserves, dismissal of managing directors, etc.) would be automatically determined and communicated to the responsible creditors, other stakeholders and, if necessary, the managing directors - e.g. via a "computable contract" or even a "smart contract".

It is helpful in this regard that the new European Insolvency Regulation (Regulation (EU) 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings) already enables the European insolvency registers to be improved, connected, digitized and harmonized. Even then it would still be a long way to the utopia (or dystopia, depending on how one sees it) in which companies would be subject to a computer-controlled automatic filing of a bankruptcy petition or a motion for the opening of insolvency proceedings, including the automatic selection of an insolvency administrator or trustee by an algorithm. That will be reserved to the courts and human judges and human restructuring professionals working in the judicial system.

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### 2.3 EU Consultation on the Digitization of EU Company Law

The EU has also launched a consultation on the digitization of European company law in 2017 ([http://ec.europa.eu/newsroom/just/item-detail.cfm?item\\_id=58190](http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=58190)). In the Commission's work programme for 2017, an initiative on company law was announced to promote the use of digital technologies throughout the lifecycle of a company. The results will also be of considerable relevance for restructuring law. At present, a number of restructuring solutions, which would or should actually be feasible, are only failing because the formal processes of German corporate law have not yet been really digitized (i.e. transformed and accelerated), and this means that considerable time is lost, which can be crucial or even devastating in the event of a corporate crisis.

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The consultation was generally concerned with the use of online tools throughout the entire life cycle of companies, as can be seen from the following statements by the EU Commission (emphasis by the author) among others:

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The new company law initiative would **aim to make the best use of digital solutions in companies' interactions with public authorities but also with companies' shareholders**, and to provide efficient rules for cross-border mobility of companies which could include mergers, divisions, conversions and uniform conflict-of-law rules for companies.

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We seek your views as to whether current company law rules need to be modernised to ensure that everyone involved in the lifecycle of a company could benefit from digital technologies. We would also like to know which safeguards would be needed to ensure that digital procedures are secure and do not lead to fraud. 21

Digital tools (such as e-mail, messaging applications, audio and video conferencing software, digital information exchange platforms, electronic signature, blockchain voting facilities) could make the interaction between companies (listed and non-listed) and their shareholders significantly easier. Such tools could reduce costs and improve the efficiency of voting and the exercise of other shareholder rights, in particular in a cross-border context. 22

In particular, the notarization requirements under German company law would come under pressure if the EU were to come to the conclusion that they should be replaced by equivalent digital solutions and that company law should operate entirely without notaries or other intermediaries such as the commercial register, etc. Whether the EU would come to this conclusion is anybody's guess at this point; the likelihood is unclear. But it would be possible for the EU to do away with the statutory need for a notary or other intermediaries such as the commercial register, if digital equivalents or improvements are really available (which is up for debate of course). All this remains to be seen. However, the way in which the EU works, it can be presumed in principle that after such a consultation and the evaluation of its results, a legislative procedure will be prepared and implemented by EU, leading to some kind of digitization of German and EU company law in one way or other. Thus, this much is clear: we will see the digitization of company law within the EU soon. 23

It remains to be seen what will become possible, whether the online founding of German limited liability companies (GmbHs), online registration in the commercial register, or even the digital assignment and pledging of GmbH company shares, perhaps even without a notary, or even the automatic realization and transfer of pledged GmbH in an event of default. However, since all of this is more than relevant in the context of restructuring, the digitization of corporate law will also significantly accelerate and transform restructuring and insolvency law. 24

### 3. Evaluation and Outlook

Restructuring/insolvency law as a fundament of commercial law is in the grip of the digitization of law in many places - both in legislative and practical terms. It can be expected that there will soon be new and better software solutions and online platforms that will enable more, better and earlier opportunities for reorganisation, restructuring and swift insolvency proceedings, with better outcomes for creditors, employees, the economy and the companies themselves. Legislators are also called upon to modernize the laws and improve the digital restructuring architecture. Online public insolvency 25

proceedings and an online claims register, such as the one that has been available in the USA for years, can facilitate the self-organization of insolvency creditors and their early and broad representation in creditor committees, and can make trading in non-performing loans - which is definitely desirable from an economic policy point of view - more efficient, while of course safeguarding data protection and privacy law.

Online creditors' meetings would allow for genuine equal treatment and democracy of creditors and effective and faster control of insolvency administrators and insolvency courts. The digitization of company law will hopefully also enable new and rapid restructuring options. In all these developments, however welcome they may be, it is to be hoped that the legislature and the courts will always seek to strengthen and safeguard (and not reduce) the rule of law, and indeed uphold it.

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