Germany's enforcement shift: bypassing the estate to realise alpha

Dagmar Gold, managing partner at Deutsche Pfandverwertung, argues that structured credit markets must rethink recovery timing

Three years post-ruling, the operational reality of the German Federal Court of Justice (BGH) ruling IX ZR 145/21 is finally hitting home. For secured creditors, the delayed recognition of independent enforcement rights is creating a divergence between modeled LGDs and actual realised value.

For structured credit investors modeling exposure to German corporates, the insolvency process has long been priced as a drag on performance. Models typically assume a 'black box' scenario: once a borrower files for insolvency, collateral realisation drifts into the control of an administrator, resulting in significant time lags and heavy cost leakage due to estate fees.

However, for deals secured by pledged shares or intangible rights (such as IP, patents and trademarks), this assumption has been legally obsolete for three years. BGH IX ZR 145/21 fundamentally altered the enforcement landscape. It clarified that the administrator's right to realise moveable assets does not extend to *rights*.

Consequently, pledged shares and IP fall outside the insolvency estate. They are effectively 'bankruptcy remote' regarding realisation authority.

Despite this clarity, market uptake has been slow. Only now, amid accelerating insolvencies and weakened borrower reporting, are the operational consequences fully materialising. For the structured credit market, this delayed recognition is creating a dangerous gap between legal theory and enforcement reality.

The cost of inertia: the 'consent trap'
The most significant drag on recoveries today is not the law, but habit. In many workout scenarios, creditors inadvertently allow value to leak back into the estate because they fail to operationalise their independence fast enough.

This occurs primarily through the 'Consent and Realisation Agreement' (*Zustimmungs- und Verwertungsvereinbarung*). In the chaotic 'twilight zone' between covenant breach and filing, administrators often persuade pledgees to sign agreements permitting the estate to sell the pledged assets.

From a recovery perspective, signing this is effectively a voluntary 'haircut'. It triggers:

1. Fee leakage: it subjects proceeds to estate fees (typically 9% plus VAT) and advisor costs.
2. Loss of control: realisation becomes tethered to the estate's slower timeline.
3. Allocation risk: in bundled asset deals, Purchase Price Allocation (PPA) becomes opaque, often disadvantaging the secured creditor.

The operational shift: 'hybrid M&A' via statutory auction
To close the gap between potential and realised recovery, creditors must embrace a new enforcement pathway. The most robust mechanism under German law is the Statutory Public

Auction (*Öffentliche Versteigerung*) integrated into an M&A framework - a process best described as ‘hybrid M&A‘.

This is not a liquidation fire sale. It is a sophisticated process executed by a publicly appointed and sworn auctioneer (*Allgemein öffentlich bestellter und vereidigter Versteigerer*), comprising:

1. The marketing phase (the M&A component)
   The process mirrors a distressed M&A deal. The asset is marketed internationally to strategic investors in a discreet, competitive environment. Due diligence is performed and market pricing is established.
2. The closing mechanism (the sovereign component)
   This is where the model diverges from a private treaty sale. Instead of a Share Purchase Agreement (SPA) with its negotiation risks, the transaction concludes with a Sovereign Award (*Zuschlag*).

Implications for credit risk and finality
The Sovereign Award offers distinct structural advantages:

- Elimination of execution risk: The award combines signing and closing into a single, instantaneous act. There is no gap, removing the risk of deal collapse.
- The ‘valuation shield‘: One of the biggest risks in enforcement is the post-closing challenge. The Sovereign Award creates a non-negotiable price determination. Legally, the hammer price *is* the fair market value. This provides a liability shield against ‘under-value‘ claims that a private sale cannot offer.
- Clean title: The award extinguishes lower-ranking liens and provides the buyer with original title instantly.

Recalibrating LGD models
The persistence of ‘old fashioned‘ enforcement suggests that recovery models need updating.

- Timing: Models assuming 18-24 months for estate realisation should be adjusted to 4-8 weeks for creditor-led enforcement by statutory public auction.
- Costs: Estate cost deductions should be removed from LGD branches where independent enforcement is viable.

The legal framework in Germany has shifted from estate-driven management to creditor-led enforcement for key collateral classes. However, this alpha is only realised if creditors actively bypass the estate.

As insolvencies accelerate, the window to prepare independent enforcement is narrowing. Lenders that rely on estate-led processes will find their recoveries lagging behind those who operationalise their rights early.

Biography
Dagmar Gold *is a managing partner at Deutsche Pfandverwertung. As a publicly appointed and sworn auctioneer and a certified restructuring and reorganisation advisor (IfUS), she specialises in the intersection of legal enforcement and distressed asset recovery. She advises international credit funds on realising pledged collateral via statutory auctions and hybrid transaction models.*

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