ALLEN & OVERY

September 2017

Restructuring Across Borders

Germany: corporate restructuring and insolvency procedures

Contents

Introduction

The German Insolvency Code encompasses a standard procedure and several alternative procedural options. The default procedure is liquidation of the assets, with the estate being managed by a court-appointed administrator. The main alternative options are (i) an insolvency plan instead of liquidation and (ii) self-management by the debtor instead of an administrator. In the latter case, the debtor is supervised by a custodian.

German insolvency proceedings always go through two phases: first, preliminary proceedings which run from the filing for insolvency until the opening of main proceedings are used to establish, among other things, whether the estate has sufficient funds for an in-court procedure. Debtors may use this stage to apply for a protective “umbrella” or “shield” (*Schutzschirm*) in order to prepare an insolvency plan (“German pre-pack”). Second, if there are sufficient assets and other requirements are met, then the court will order the opening of main proceedings.

Consensual out-of-court restructuring is possible unless there is a mandatory reason to file for insolvency. Corporations and companies are obliged to file for insolvency if they are either unable to pay their debts as they fall due or over-indebted. They may also apply for insolvency if they are threatened by an inability to pay their debts as they fall due.

German insolvency law aims to satisfy all creditors on a pro rata basis according to their claims, ensuring the equal treatment of all (unsecured) creditors. It tends to be creditor-friendly, giving creditors various rights to information and voting, and thus giving creditors the opportunity to influence the procedure.

The Insolvency Code is subject to constant improvement. Changes of particular note have been, inter alia:

- the addition of conflicts of law rules in 2003 (which are based on those in the EC Regulation on Insolvency Proceedings);
- in 2008 the “Act to reform the laws of limited liability companies and to combat misuse” (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen – MoMiG*);
- the introduction in 2012 of the “Act on the Simplification of the Restructuring of Enterprises” (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* (***ESUG***)), which strengthened creditors’ rights, in particular in the period between the filing for insolvency proceedings and the opening of insolvency proceedings; and
- most recently the 2017 reforms introducing a section on insolvency proceedings for members of the same group, both on a national and on an international level, as well as placing greater restrictions on challenges of certain transactions (claw back/avoidance actions).

Outlook: A new law regarding taxation privileges for book gains resulting from any haircut has been passed by the German legislator and is waiting for approval by the European Commission.

Liquidation (*Liquidation*)

Liquidation results in a compulsory distribution of the company's assets. After the commencement of the main insolvency proceedings, the creditors' assembly resolves either to liquidate the company or to continue its business. Liquidation proceedings involve selling either the assets of the company, the entire company, or part of its business (*übertragende Sanierung*) in order to satisfy creditors' claims on a *pari passu* basis. The competent insolvency court (*Insolvenzgericht*) appoints the (preliminary) insolvency administrator (*Insolvenzverwalter*) who supervises the management through the preliminary proceedings and, upon commencement of the main proceedings, takes control of the company and collects, realises and distributes its assets, including challenging pre-insolvency transactions detrimental to the estate.

Insolvency plan (*Insolvenzplan*)

An alternative to liquidation proceedings is to establish an insolvency plan. The model for the insolvency plan was the reorganisation plan under Chapter 11 of the US Bankruptcy Code. This legal structure offers the debtor, its shareholders and its creditors a legal instrument for the mutually agreed management of the insolvency estate (*Insolvenzmasse*). Thus, the insolvency plan – in the shape of a reorganisation, transfer, liquidation or other plan – offers comprehensive reorganisation proceedings. Within a regulatory framework (ie preservation of minority rights and compliance with certain procedural steps), the creditors may decide to reorganise, rescue or liquidate the insolvent company or may indeed choose a route lying somewhere between these alternatives.

Following the implementation of ESUG, the shareholders may also participate (or may be forced to participate) in the insolvency plan proceedings. They will usually form a separate voting group. The consequence of shareholder involvement is that claims and rights of the shareholders, in particular voting rights and other participation rights, can also become the subject of an insolvency plan and may be modified pursuant to the insolvency plan. The rights of the existing shareholders may, for example, be reduced and, at the same time, the creditors may become shareholders of the debtor pursuant to a debt-to-equity swap, though no creditor can be forced to become a shareholder.

Creditors and shareholders can only veto a proposed insolvency plan if that insolvency plan would put them in a less favourable position than they would otherwise have been or if they do not adequately share in the economic value which would accrue to them on the basis of the insolvency plan. It is assumed that a shareholder receives an adequate share of the economic value if no creditor receives more than the full amount of its claims and no shareholder that would otherwise rank equally with the other shareholders is put in a better position as a result of the plan.

Self-management (*Eigenverwaltung*)

In standard insolvency proceedings, the insolvency administrator takes possession of the insolvency assets and is entitled to dispose of them. The management of the insolvent company is prohibited from possessing and disposing of the insolvency assets. There is one exception to this rule, which is the “self-management” procedure (*Eigenverwaltung*) set out in the Insolvency Code. This procedure was influenced by the US model of “a debtor in possession”.

One of the aims of ESUG was to promote self-management as a standard procedure for insolvency proceedings. It appears that ESUG has had some success in promoting self-management and making it popular as a restructuring tool. If the court approves self-management, then the management of the insolvent company will continue to possess and dispose of the insolvency assets under the supervision of an insolvency monitor (*Sachwalter*). Typically, in self-management proceedings the debtor will prepare, with the help of insolvency experts, an insolvency plan, which will be voted on by the creditors. The debtor may also use the protective shield procedure (*Schutzschirmverfahren*), a pre-insolvency procedure, to allow the debtor to prepare properly for insolvency proceedings and develop an insolvency plan. Upon the plan’s approval by the creditors and the court, the debtor’s management will implement the restructuring set out in the plan with the help of insolvency experts. To the extent there is criticism voiced of self-management procedures, it has been said that they have been misused, facilitating (and shielding) the administration of assets by the debtor to the detriment of the creditors.

Out-of-court restructuring or liquidation (*Außergerichtliche Sanierung oder Liquidation*)

Out-of-court restructuring by consensual agreement or solvent liquidation is relatively common in practice. As there is no formal procedure, the company, its shareholders and its creditors are free to agree upon financial restructuring measures, reorganisation, liquidation, or anything in between. Such voluntary measures will only be successful if no creditor files a petition for insolvency proceedings. On the other hand, if an insolvency court has denied a petition for the opening of insolvency proceedings as a result of insufficient assets (*Abweisung mangels Masse*), a consensual restructuring or liquidation are the only alternatives.

European Insolvency Regulation

The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the **Recast Regulation**) applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the **Original Regulation**) continues to apply to all proceedings opened before 26 June 2017. Two of the key changes in the Recast Regulation are (i) that it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation, and (ii) it introduces a coordination and cooperation regime for insolvency proceedings of several entities within the same group. The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding up proceedings – secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to terminal proceedings) in Annex B.

The introduction of a coordination and cooperation regime for insolvency proceedings within the same group under the Recast Regulation coincides with the introduction of a similar regime in German national law that will come into force April 2018.

Of the above restructuring and insolvency regimes, liquidation (*Liquidation*), insolvency plan (*Insolvenzplan*) and self-management (*Eigenverwaltung*) were available as main and secondary proceedings under the Original Regulation on Insolvency Proceedings.

Under the Recast Regulation these same procedures are listed under Annex A. Despite the Recast Regulation allowing for the inclusion of pre-insolvency rescue proceedings, no such proceedings yet exist in Germany. They are expected to be introduced once the proposed EU Directive on Preventive Restructuring Frameworks (current proposal COM(2016) 723 final) is passed, though this is not likely before 2020.

Further information

For further information on German restructuring and insolvency procedures, we would refer you to the Sweet & Maxwell book "European Cross Border Insolvency" edited by Allen & Overy. To purchase a copy of this book, please visit www.sweetandmaxwell.co.uk.

Allen & Overy has launched an online service for clients focusing on debt restructurings and insolvency issues. Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy to use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe and the US.

To request access for your organisation, please contact your usual Allen & Overy contact, or email rab@allenovery.com

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.

Peter Hoegen
Partner
Tel +49 69 2648 5905
peter.hoegen@allenovery.com

Asmus Mihm
Partner
Tel +49 69 2648 5796
asmus.mihm@allenovery.com

Sven Pruefer
Partner
Tel +49 69 2648 5381
sven.pruefer@allenovery.com

Helge Schaefer
Partner
Tel +49 172 912 25 07
helge.schaefer@allenovery.com

Walter Uebelhoer
Partner
Tel +49 69 2648 5608
walter.uebelhoer@allenovery.com

Oliver Waldburg
Partner
Tel +49 69 2648 5825
oliver.waldburg@allenovery.com

Franz Bernhard Herding
Partner
Tel +49 69 2648 5712
franz-bernhard.herding@allenovery.com

Stefan Henkelman
Partner
Tel +49 69 2648 5997
stefan.henkelmann@allenovery.com

Hans Peter Low
Partner
Tel +49 69 2648 5440
hans-peter.loew@allenovery.com

Olaf Meisen
Partner
Tel +49 69 2648 5648
olaf.meisen@allenovery.com

Thomas Ubber
Partner
Tel +49 69 2648 5430
thomas.ubber@allenovery.com

Ian Field
Partner
Tel +44 (0)20 3088 2671
ian.field@allenovery.com

Jennifer Marshall
Partner
Tel +44 (0)20 3088 4743
jennifer.marshall@allenovery.com

Lucy Aconley
Senior PSL
Tel +44 (0)20 3088 4442
lucy.aconley@allenovery.com

Nicola Ferguson
Senior PSL
Tel +44 (0)20 3088 4073
nicola.ferguson@allenovery.com

Allen & Overy LLP

Bockenheimer Landstraße 260306, Frankfurt am Main, Germany

Tel +49 69 2648 5000

Fax +49 69 2648 5800

Allen & Overy LLP

One Bishops Square, London E1 6AD, United Kingdom

Tel +44 20 3088 0000

Fax +44 20 3088 0088

www.allenovery.com