INSOL INTERNATIONAL

FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 6B Guidance Text

Germany

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INSOL INTERNATIONAL
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IN INTERNATIONAL INSOLVENCY LAW

CONTENTS

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1. INTRODUCTION TO THE ELECTIVE MODULE ON GERMANY

Welcome to **Module 6B**, dealing with the insolvency system of **Germany**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Germany's insolvency laws;
- a relatively detailed overview of the German insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in a German context.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2022**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2022 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of German insolvency law:

- the background and historical development of German insolvency law;
- the various pieces of primary and secondary legislation governing German insolvency law;
- the operation of the *Insolvenzordnung* and other legislation in regard to liquidation and corporate rescue;
- the operation of the *Insolvenzordnung* and other legislation in regard to consumer and corporate debtors;

- the rules of international insolvency law as they apply in Germany;
- the rules relating to the recognition of foreign judgments in Germany.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of German insolvency law; and
- be able to answer questions based on a set of facts relating to German insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO GERMANY

Before the unification of Germany in 1871, the country existed in a legally fragmented state which had particularly negative repercussions on trade. The most significant, territorially limited legal systems included: the General Prussian Common Law (1794), the *Codex Maximilianeus Bavaricus Civilis* (1756), the *Code Civil* (1804), and the Saxon BGB (1865). Roman law also had a subsidiary status (general law).

Following the unification of Germany, the conditions for legal standardisation were realised and in 1877 the *Reichsjustizgesetze* were approved and came into force throughout the whole country on 1 October 1879. These included the Judicature Act (*Gerichtsverfassungsgesetz*), the Civil Procedural Code (*Zivilprozessordnung*), the Criminal Procedural Code (*Strafprozessordnung*) and the Bankruptcy Act (*Konkursordnung*). Although the process for standardisation of the substantive private law began in 1873, it was only completed in the form of the Civil Code (*Bürgerliches Gesetzbuch*, BGB[1]) in 1896 (coming into force on 1 January 1900). The already applicable Roman law was used as a basis for the BGB, which has led to the outcome that the German Legal system has always been a Civil Law system. Following the reunification of Germany in 1990, this has also been applicable in the former German Democratic Republic (GDR).

Germany is a federal parliamentary republic and a representative democracy. Legislative competence is split between the Federation (Bund) and the individual states (*Bundesländer*). The passing of national laws is achieved through an application from the government, the parliament (*Bundestag*), or the Federal Council (*Bundesrat,* Chamber of the *Bundesländer*), a vote in the *Bundestag* and the *Bundesrat* and finally passed by the *Bundespräsident* (federal president).

[1] For an English translation of the German Civil Code see http://www.gesetze-im-internet.de/englisch_bgb/index.html.

Germany's economy is developed and the largest in Europe. The GDP amounts to $4.04 trillion and is primarily generated through the export of machinery, vehicles, chemicals and household equipment.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

All insolvency proceedings in Germany are regulated by the *Insolvenzordnung* (Insolvency Regulation, InsO[2]) which applies to all kinds of debtors and is applicable to liquidation as well as the restructuring of insolvent entities. Upon coming into force on 1 January 1999, the *Insolvenzordnung* repealed and replaced the previous *Konkursordnung* (1877) and the *Vergleichsordnung* (1935). In the former GDR states, the *Gesamtvollstreckungsordnung* (1990) remained in force until the German insolvency law was standardised through the *Insolvenzordnung*. The *Insolvenzordnung* underwent a comprehensive reformation which came into force on 1 March 2012 and through which procedures for restructuring were considerably improved.

The *Insolvenzordnung* is based largely on its predecessors. In turn, the *Konkursordnung* was modelled on the Prussian *Konkursrecht*. Thus, the German insolvency law has at no point in time been imported from another jurisdiction or been based on a model law. International insolvency law has been primarily reformed through the European Union and the European Insolvency Regulation (2015) (which had numerous previous incarnations) is the primary applicable norm in this context.

4.2 Institutional framework

The German legal system has three instances in civil proceedings: the *Amtsgericht / Landgericht* (Local / County Court), the *Oberlandesgericht* (Higher Regional Court / Court of Appeal) and the *Bundesgerichtshof* (Federal Court). While the *Bundesgerichtshof* is a federal court (and thus also a federal institution) the remaining two instances are both within the remit of their respective regions. Whether a case is heard in the first instance by the *Amtsgericht* or the *Landgericht* is decided on the monetary worth of the claim. If this lies below EUR 5,000, then the *Amtsgericht* has jurisdiction, otherwise the case is heard by the *Landgericht*.[3] However, there are numerous exceptions to this rule. One such exception is to be found in § 2 InsO, which prescribes that an insolvency case must be heard by the *Amtsgericht* in whose region a *Landgericht* has a seat, and that the *Amtsgericht* has sole jurisdiction for the region of the *Landgericht* in insolvency cases. In insolvency cases, the *Landgericht* is responsible for complaints or appeals (in fact or in law) and the *Bundesgerichtshof* is responsible for higher appeals (only on questions of law).

The *Bundesgerichtshof* has territorial jurisdiction over the whole of the federal republic. Every *Oberlandesgericht* (Higher Regional Court) is assigned to a region in which it has territorial

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[2] Translations of German statutes are available at http://www.gesetze-im-internet.de/Teilliste_translations.html. English text of the InsO is available at http://www.gesetze-im-internet.de/englisch_inso/.

[3] *Gerichtsverfassungsgesetz* (Judicature Act), §§ 23 and 71.

jurisdiction and within which there are one or possibly multiple *Landgerichte* which have territorial jurisdiction over respectively smaller regions. Finally, each region of a *Landgericht* contains at least one *Amtsgericht* with its own territorial jurisdiction. In insolvency cases, the *Amtsgericht* in which the debtor has his general place of jurisdiction (*allgemeiner Gerichtsstand*[4]), which is generally located at their registered place of residence, has jurisdiction.[5] When the centre of a self-employed debtor's economic activities lies at a different point to their registered place of residence, then jurisdiction is exclusively afforded to the court in the region in which the centre of the economic activities is located. International jurisdiction is determined similarly, being based on where the debtor has their centre of main interests.[6] More on this topic will be discussed below.

The fact that the competence is centred in the insolvency court which, despite being a local court (*Amtsgericht*) is responsible for the territory of the *Landgericht* in which it is situated, ensures that the court is competently staffed. The specific legal matters with which the insolvency court concerns itself requires a high threshold of specialised knowledge and experience – these are combined through this process. Furthermore, the parties have two higher appeals instances available to them, to determine whether, and to ensure that, the decisions of the *Amtsgericht* are correct. Unified jurisprudence is finally ensured through the *Bundesgerichtshof* being the second and final instance of appeal, with jurisdiction throughout the entire republic. Through this approach, both the rights of the debtor as well as the rights of creditors are effectively enforced.

The enforcement of the rights of both creditors and debtors outside of insolvency is also judged to be effective. The division of competence between the *Amtsgericht* and the *Landgericht* ensures that, in most cases, the more complex cases are heard by a *Landgericht*. These are more highly staffed and this generally has a positive effect on the quality of judgments. There are, furthermore, two levels of appeal to review any judgments.

It is possible for creditors to enforce claims outside of insolvency by acquiring an enforcement order against the debtor. If the debtor has not subjected itself to the immediate, compulsory enforcement of a claim, the creditor can best acquire an order through a claim in court against the debtor and an enforcement of the subsequent judgment. Once the order is deemed enforceable by a clerk of the court and it has been brought to the debtor's attention, the enforcement proceedings can commence. If the claim is for a monetary sum, then assets of the debtor can be seized by officers of the court (bailiff). The seized assets can subsequently be sold and the creditor's claims can be satisfied from the proceeds.

Creditors who do not have secured claims are able to enforce these in opened insolvency proceedings by filing their claims in the insolvency schedule (*Insolvenztabelle*).[7] All registered claims are subsequently verified at the so-called verification meeting (*Prüfungstermin*) and are deemed to be determined only if no objection is raised by the insolvency administrator or by a

4 InsO, § 3, sentence 1.
5 InsO, § 4 in connection with *Zivilprozessordnung* (ZPO) (Code of Civil Procedure), §§ 13 *et seq*.
6 Regulation (EU) 2015/848 – subsequently the EU Insolvency Regulation.
7 InsO, § 174.

creditor in the verification meeting.[8] If a claim is disputed, then court proceedings are initiated to determine whether to include it in the schedule or not. The insolvency practitioner (henceforth "insolvency administrator") satisfies the claims that have been registered to the schedule on a *pro rata* basis. Subsequent to the termination of insolvency proceedings, the creditors of these proceedings can enforce their claims against the debtor without restriction (see above). In this process, entry into the insolvency schedule acts as a title to enforce such claims, as far as they have not been disputed by the debtor in the verification meeting.[9]

German insolvency law does not provide for an insolvency regulator.

Self-Assessment Exercise 1

Question 1

How many insolvency statues currently exist in Germany and what are their scope?

Question 2

Do the jurisdiction requirements encourage "good" decisions on the part of the courts within and outside of insolvency? Explain your decision.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

5.1 Introduction

Generally, under German law every type of asset of a debtor that has an economic value may be subject to a security right. German law distinguishes between two categories of assets: movables and immovables (real estate). Movables are sub-divided into tangibles and intangibles (rights). Rights can further be divided into different categories such as claims, land servitudes, trademarks, licenses, shares, patents, etc. Every object of security has rights available to it that are both of an accessory and non-accessory nature.

[8] *Idem*, § 178(1), sentence 1.
[9] *Idem*, § 201(2), sentence 1.

5.2 Real security

5.2.1 Movables

5.2.1.1 Tangibles

As far as tangible objects are concerned, German law provides two types of security rights; namely the pledge[10] and transfer of title by way of security / security ownership (*Sicherungseigentum*).[11]

Pledges over assets may be established by way of contract, by statutory provision[12] or as a mandatory consequence of enforcement proceedings against the immovable or movable assets of the debtor. The contractual agreement on creating the pledge as a matter of property law has to be firmly distinguished from the underlying security agreement as a matter of the law of obligations ("separation principle").The pledge is characterised by being of an accessory nature and subject to specific formal publicity requirements. "Being of an accessory nature" means that the pledge strictly follows the secured claim.[13] While a pledge agreement may be concluded to secure a future claim, the pledge as a right *in rem* will not come into existence before the secured claim is created, even though all other requirements for establishing a pledge (pledge agreement and transfer of possession of the collateral) may have been fulfilled previously.

The transfer of title by way of security, on the other hand, is a non-accessory security right. The secured creditor holds title to the ownership of the asset in a fiduciary capacity. The only connection between the security right and the secured claim is the contractual security agreement. Transfer of title by way of security means the transfer of ownership for security purposes. Ownership for the purposes of security is not restricted, which means that full ownership as the most comprehensive right is transferred. Transfer of title by way of security therefore follows the legal rules provided for the transfer of ownership. They require, aside from the power of disposal,[14] a contractual agreement between the previous owner and the new owner on the transfer of ownership as well as the factual transfer of possession of the object concerned from the previous owner to the new owner, adhering to the "Principle of Publicity" (*Publizitätsprinzip*) under German property law.[15] Because of the application of the "separation principle" (*Trennungsprinzip*) under German law, the contractual agreement on the change of ownership as a matter of property law must be firmly distinguished from the underlying security agreement as a matter of the law of obligations.

§ 930 BGB was the tool by which German legal practice could develop the concept of transfer of title by way of security, given its advantage of enabling the debtor to remain in possession of the collateral. It stipulates that the fact that the legal transfer of ownership is subject to the

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10 BGB (German Civil Code), §§ 1204 *et seq*.
11 *Idem*, §§ 929 and 930.
12 Eg landlords have a statutory pledge on the tenant's assets as security for claims resulting from the tenancy agreement, BGB, § 562.
13 *Idem*, § 1210.
14 *Idem*, § 185.
15 *Idem*, § 929.

transfer of possession does not necessarily require the new owner to exercise the possession as actual physical control (*unmittelbarer Besitz*) over the object concerned. However, a so-called constructive possession (*Besitzkonstitut*) suffices. If the previous owner continues exercising possession in terms of actual physical control, it is sufficient for the legally required transfer of possession that the new owner has the intention to possess the object concerned for himself and that the previous owner, despite having actual physical control, respects this intention and therefore exercises his actual physical control with the intention of possessing for the new owner rather than the intention of possessing for himself. Therefore, the former owner keeps direct possession "for someone else" (*unmittelbarer Fremdbesitz*) and is still able to use the object while the new owner acquires indirect possession "for himself" (*mittelbarer Eigenbesitz*). The change of intention between these two types of possession is expressed by agreement to the underlying security agreement by the parties involved.

The reversed case (security for the owner) is the retention of title. Retention of title clauses ensure that in case of a sale of goods the seller remains the owner of the goods until the buyer has paid the whole purchase price for the goods. These clauses normally go hand in hand with an instalment payment agreement which makes up its financing function. Since no money but goods are "advanced", the sale under retention of title is referred to as a credit on goods (*Warenkredit*). The possibility of retention of title clauses is recognised by the law.[16] Legally, the retention of title is construed by making the agreement on the transfer of ownership as an act of property law subject to the condition precedent that the full purchase price is paid.

Besides this simple form, there are two other forms of retention of title clauses, namely the extended retention of title (*verlängerter Eigentumsvorbehalt*) and the expanded retention of title (*erweiterter Eigentumsvorbehalt*), the latter one often occurring in the form of current account clauses. The extended retention of title permits the buyer to resell the delivered goods in the ordinary course of business while the future claim arising from this resale is assigned by way of security to the seller, replacing the retained ownership as a security for the delivery payment. Therefore, it is rather a combination of retention of title (simple or expanded) with a regular security assignment of future claims than a security device of its own. Under an expanded title of ownership, the seller remains owner of the goods not only until the claim arising from the particular sales contract is met, but until all or certain open claims arising from the business relationship between the seller and the buyer are fulfilled.

5.2.1.2 Intangibles

As far as intangibles are concerned, German law also provides the pledge[17] and the assignment by way of security.[18] Pledges on intangibles require notification of the third party (obligor) to become effective,[19] which enforces the principle of publication in German security rights law. The assignment by way of security in its legal effect is similar to the transfer of title by way of security. The creditor acquires the ownership of the claim but is bound by the security agreement as a fiduciary. Because of the application of the "separation principle"

16 *Cf*, BGB, § 449.
17 BGB, §§ 1273 *et seq*.
18 *Idem*, §§ 398 and 413.
19 *Idem*, § 1280.

(*Trennungsprinzip*) under German law, the contractual agreement on the assignment as a matter of property law must be firmly distinguished from the underlying security agreement as a matter of the law of obligations.

Very popular in Germany is the assignment by way of security of all current and future receivables stemming from the debtor's business (so-called *Globalzession*). As far as future claims against customers are concerned, such claims are not affected by the assignment before they are created (for example, by concluding the sales contract between the debtor and the buyer) as a security right cannot exist without a security object (collateral). As a result, claims created within the suspect period of three months prior to the application for insolvency proceedings are subject to transactions avoidance under §130 InsO. Further, claims created after the opening of the insolvency proceedings are not covered by the security right at all, since it comes into existence after the opening of the proceedings and §91 InsO hinders the improvement of a creditor's position after the opening of the proceedings. Hence, all receivables created after this point in time are part of the estate and are not covered by the security right.

5.2.2 Immovables

German real estate property law provides for two different kinds of mortgages over real estate. The first one has the effect of a common pledge with its typical accessory character (*Hypothek*).[20] The second one grants the same right to the creditor (satisfaction out of the proceeds of the forced sale or sequestration of the land) without having an accessory character (*Grundschuld*).[21] The *Grundschuld* is the common security right in German legal practice having replaced the *Hypothek* entirely. It can secure different claims without the need to repeat its registration in the Land Register every time. The implementation of all-monies clauses is easier, whereas such clauses in relation to accessory security rights are considered to be problematic. It is therefore more flexible and cheaper than the *Hypothek*. Since the *Grundschuld* is non-accessory, the connection to the secured claim is established by the fiduciary character of the security agreement.

A transfer of title by way of security in the field of real estate would be legally possible but would cause huge expenses without having any advantages compared to the *Grundschuld*.

A *Hypothek* may also be established as a mandatory consequence of enforcement proceedings against immovable assets of the debtor, whereas the *Grundschuld* can only be established contractually. Here as well, the contractual agreement on the creation of the security right as a matter of property law must be distinguished from the underlying contractual security agreement ("separation principle").

[20] *Idem*, §§ 1113 *et seq*.
[21] *Idem*, §§ 1191 *et seq*.

5.2.3 Dealing with secured assets upon insolvency

Nearly all the security rights discussed provide for a so-called right to separate satisfaction (*Absonderungsrecht*) in insolvency proceedings.[22] Firstly, this means that the security right does not prevent the asset to which it is related from being legally part of the insolvency estate. Therefore, the secured creditor is not entitled to claim its separation from the insolvency estate. Secondly, the secured creditor is granted the right to demand the preferential satisfaction up to the amount of the secured claim out of the proceeds of the specific asset`s realisation. Only a realised surplus exceeding the amount of the secured claim belongs to the insolvency estate. Since in Germany insolvency proceedings are frequently aimed at liquidation, the collateral has to be realised eventually unless different arrangements have been made in an insolvency plan. Another question not prejudged by the classification as a right to separate satisfaction, is whether the insolvency practitioner or the secured creditor is responsible for carrying out the realisation. The answer to this question depends on the kind of asset and the kind of security right in question, as well as on whether the debtor (insolvency practitioner) or the secured creditor is in direct possession of the asset. If it is the insolvency administrator who is responsible for the realisation, the secured creditor is no longer able to enforce the security right.

§ 89 InsO stipulates that insolvency creditors may not pursue enforcement proceedings against the insolvency estate or the debtor's other property during insolvency proceedings. On the other hand, enforcement proceedings are generally possible in preliminary insolvency proceedings unless the court orders otherwise.[23] However, § 89 InsO applies only to "insolvency creditors",[24] that is, unsecured ordinary creditors with obligational claims against the debtor at the time insolvency proceedings are opened. While secured creditors, being insolvency creditors in regard to their secured claim, are therefore no longer able to enforce their secured claims, it follows from §§ 49 *et seq* and 165 *et seq* InsO that § 89 InsO does not affect the enforcement of security rights which provide for a right to separate satisfaction, since these are not obligational rights but rights *in rem*. The enforcement of rights to separate satisfaction are governed by the specific provisions of §§ 165 *et seq* InsO, which actually govern the realisation of the assets which are subject to those rights and not their enforcement. However, enforcement proceedings by secured creditors in relation to such assets are legally possible only to the extent to which these provisions enable the creditor to realise the value of their security.

The disposition of secured goods is regulated by §§ 165 *et seq* InsO and is, in part, one of the responsibilities of the creditor[25] and, in part, the responsibility of the insolvency administrator.[26] This approach intends to avoid a scenario in which a creditor disposes of assets which form an important part in the debtor's business and the disposition of which makes the continuation of business activities unfeasible. If the insolvency administrator transfers an object or a claim, then

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22 InsO, §§ 49, 50 and 51(No 1).

23 *Idem*, § 21(2) (sentence 1) (No 3).

24 *Idem*, § 38.

25 In the case of immovables, pursuant to InsO, § 49 - if the contracting party does not partake in its auctioning, then the insolvency administrator can dispose of it. With respect to movable objects in the creditor's possession, InsO, § 173.

26 In respect of movables in his possession, under InsO, § 166(1) and claims assigned by way of security under § 166(2).

he can contribute an amount covering the costs of determination and disposal as well as turnover tax (VAT) in advance to the insolvency estate using the proceeds gained.[27]

A different result only arises for the (simple) retention of title. The retainer of the title has a right to separation of the retained goods from the insolvency estate if the insolvency administrator rejects satisfaction of the contract and the price is therefore not paid.[28] The right to separate satisfaction and the right to separation are to be conceptually differentiated from one another. The latter does not consist in the satisfaction of a claim in the law of obligations. Instead, an asset or object that does not belong to the insolvency estate or the debtor's estate is removed from this, which leads to the creditor's claim being satisfied in its entirety. This is indicated in § 47 InsO.

However, note that all these rules only apply to security rights which are validly created under substantive law before the opening of insolvency proceedings[29] and which are not subject to transactions avoidance law.[30] Under German law, security rights can be challenged by the insolvency practitioner under §§130, 131 InsO if they have been created within the relevant suspect period of three months prior to the application for insolvency proceedings. As opposed to this, the mere realisation of a security right is not voidable under transactions avoidance law, since it does not disadvantage the general body of creditors (they have been disadvantaged, albeit outside the suspect period and therefore not challengeable, by the creation of the security right and cannot be disadvantaged again by its realisation).

5.2.4 Publicity of security interests

5.2.4.1 General

There is no central collateral registry but publicity is addressed in different ways. The establishing of security rights generally follows the rules provided by the law governing the transfer of ownership of the specific kind of asset. Apparently, this applies as well for the security ownership / assignment, since these are "normal" transfers of ownership of the asset, albeit in a fiduciary capacity. Since the legal rules on the contractual transfer of ownership of assets vary depending on the nature of the asset, the rules on the creation of security rights do so as well. The rules may vary in relation to the requirements set by the "publicity principle" as well as the required form of the contractual agreement.

5.2.4.2 Publicity requirements

As far as **security ownership / assignment** is concerned, an act of publicity is not required. In the case of security ownership, the necessary transfer of possession is construed by constructive

[27] InsO, § 170.
[28] *Idem*, § 47.
[29] After this point in time, § 91InsO hinders security rights coming into existence unless they are created by the insolvency administrator.
[30] *Cf* below at 6.2.11.

possession (*Besitzkonstitut*).[31] The assignment of claims does not require any act of publicity.[32] One exclusion is made for registered inland waterway vessels. Here the valid establishment of security ownership would require the creditor to be registered in the Ship Register as the new owner.[33] Inland waterway vessels of a certain size have to be registered.[34] The registration of smaller ones is voluntary.

As far as **pledges** are concerned, the necessary act of publicity required for the validity of the security right in the case of tangibles is the transfer of possession.[35] In the case of claims, it is the notification of the debtor.[36] As far as claims are concerned, the "publicity principle" is stricter with pledges than with the assignment, which does not require any notification. The pledge of rights other than claims, on the other hand, does not require any specific acts of publicity, since the assignment of rights also does not require any such act.[37] For some types of intellectual property rights, specific registers are provided in which, aside from ownership, pledge rights may also be registered (for example, patents, utility patents, commercial designs). However, such registration would merely have a declaratory value and is not required for the valid creation of the pledge.

As far as immovables are concerned, publicity is guaranteed by the validity requirement of the mortgage being registered in the Land Register.[38] The same applies for ships and planes.[39]

5.2.4.3 Form requirements of the contractual agreement

As far as movables are concerned, there are generally no formal requirements. However, according to § 1274(1) BGB the pledge over rights follows the rules governing the transfer of the right, which leads to an important exclusion of the general rule. According to § 15(3) GmbHG,[40] the assignment of shares of a GmbH (Limited Liability Company) requires a notarised agreement.[41] According to § 1274(1) BGB, the pledge over GmbH shares requires this form as well. However, as the form requirement of § 15(4) GmbHG only catches obligations to assign shares of a GmbHG and not to pledge such shares and § 1274(1) BGB governs only the agreement to create the pledge as a matter of property law, the underlying obligational security agreement would not require a notarised form. Nevertheless, since the parties would have to appear before the public notary anyway, there is usually in practice one notarised contract containing (at least by implication) both the obligational security agreement and the agreement on the actual creation of the security right as a matter of property law.

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31 BGB, § 930.
32 *Idem*, §§ 398 *et seq*.
33 SchiffRG (*Schiffsregistergesetz* - Ship Register Code), § 3(1).
34 SchiffRegO (*Schiffsregisterordnung* - Ship Register Regulation, § 10(2).
35 BGB, §§ 1204 and 1205 (exclusion: ships and airplanes where registration in a specific register is required).
36 *Idem*, § 1280.
37 *Idem*, §§ 398 and 413.
38 *Idem*, § 873.
39 SchiffRG, §§ 24 *et seq*, LuftFzG, § 5.
40 *Gesetz betreffend Gesellschaften mit beschränkter Haftung* (Limited Liability Companies Act).
41 The underlying obligational security agreement requires the notarised form as well – GmbHG, § 15(4).

As far as immovables are concerned, mortgage agreements do not require any stricter formal requirements either. However, in banking practice, mortgage agreements are usually concluded before a public notary (notarisation) for two reasons. First of all, § 873(2) BGB stipulates that contractual agreements on transferring or granting rights over real property become immediately binding only if they are notarised or if they are concluded before the Land Registry. Otherwise the agreement becomes binding at the moment it is submitted by the parties to the Land Registry (which requires a written form) or when the entitled party delivers its approval of the registration to the other party. The approval has to be officially certified.[42] The second reason is that a notarial deed in which the debtor submits to immediate levy of execution constitutes a legally enforceable document.[43] If enforcement proceedings become necessary, the creditor (typically a bank) does not have to file court proceedings in order to obtain an enforceable judgement but can commence the enforcement proceedings immediately.

5.3 Personal security

There are numerous different personal securities available.

Suretyship is regulated in §§ 765 *et seq* BGB. The surety puts him- or herself under a duty to the creditor of a third party to be responsible for discharging that third party's obligation if the creditor has attempted without success to obtain execution of judgment against the debtor.[44] The nature of suretyship is strongly accessorial so that the nature of the obligation within the suretyship never deviates from the main obligation.

The surety can furthermore join the obligation of the debtor as a joint and several debtor (*Schuldbeitritt*). In that scenario, it becomes possible for the obligation against the main debtor and the obligation against the joining debtor to develop differently. There is no strong accessory nature.

The guarantee is totally abstracted from the main obligation. The guarantor has the duty to fulfil the obligation. This does not depend on why the main debtor did not satisfy the main obligation or whether this obligation exists at all.

In the case of a comfort letter (*harte Patronatserklärung*), the patron (often a parent company) obliges itself to provide the means for the debtor (generally a subsidiary company) to fulfil its obligations.

There are also multiple other, but very specialised, forms of personal securities, such as the documentary letter of credit (*Dokumenten-Akkreditiv*). Each type of personal security can also be modified through the drafting of the contract.

The insolvency of the main debtor does not affect these securities. The creditor can request the satisfaction of the claim from the provider of the security. If insolvency proceedings are opened

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42 BGB, § 873(2), GBO (*Grundbuchordnung* - Land Register Regulation), § 29.
43 ZPO, § 794(1) (No 5).
44 BGB, §§ 765 and 771.

over the estate of the provider of the security, then – as always – all claims that existed before the opening of proceedings are insolvency claims.[45]

Self-Assessment Exercise 2

Question 1

How would you secure your claim if you had the free choice from the position of the creditor? Choose one personal and one real security and explain your reasoning.

Question 2

Why was the concept of ownership by way of security developed, when pledges already provide a real security for movable objects?

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

6.1.1 Unified or fragmented legislation?

Historically, liquidation and restructuring proceedings were regulated in separate statutes by the *Konkursordnung* and the *Vergleichsordnung* respectively. Following the introduction of the *Insolvenzordnung*, this has been reformed and there is only one single and unitary insolvency proceeding, irrespective of whether its aim is liquidation or restructuring and irrespective of whether the debtor is a natural or a legal person, a consumer or a trader.

However, within these proceedings certain elements are specifically designed for restructuring. That is most notably true for the so-called "Protective Umbrella Procedure" (*Schutzschirmverfahren*), governed by § 270d InsO which lays the groundwork for a restructuring preparation procedure within the application stage of insolvency. The objective is to give the debtor who has to apply for formal insolvency proceedings on the basis of (mere) likely inability to pay debts or balance-sheet insolvency (overindebtedness), if he asks for it, up to three months, under the umbrella of the protection of the court and the preliminary Insolvency Practitioner (insolvency monitor, *Sachwalter*), to prepare the restructuring in self-administration, so that it can be executed quickly upon the opening of proceedings in a pre-packaged fashion.

[45] InsO, § 3.

§§ 304-311 InsO contain specialised prescriptions for consumer insolvency proceedings. For proceedings to be opened, a debtor has to prove that he or she has been sufficiently legally advised prior to the application for opening of insolvency proceedings.[46] Following that, and with few exceptions, the insolvency proceedings then follow the normal trajectory and processes described above.[47]

If the debtor is a natural person, then he or she is able to apply for a discharge of any residual debts through the specialised regulations contained in §§ 286 *et seq* InsO.

6.1.2 Debtor-friendly or creditor-friendly insolvency system?

It is not possible to describe the *Insolvenzordnung* as either wholly debtor- or wholly creditor-friendly. The aim was rather to establish a fair and equitable balance between the interests of the involved parties. Nonetheless, all of the measures throughout an insolvency proceedings fall under the aim stated in § 1 (sentence 1) InsO: to ensure the best possible collective satisfaction of a debtor's creditors. The passing of the *Insolvenzordnung* significantly improved the fairness of the final insolvency dividend (compared to the creditors' satisfaction under the *Konkursordnung*). Furthermore, the InsO reduced the number of cases in which insolvency proceedings could not be opened or continued because the estate was either insufficient to cover the costs of the proceedings or because it was insufficient to cover the debts incumbent upon it.

According to § 1(sentence 2) InsO, "honest debtors shall be given the opportunity to achieve a discharge of residual debt". This is achieved, in particular, through *Restschuldbefreiung* (discharge of residual debt) to the benefit of the debtor, whose time frame (compliance period) was shortened with effect from 1 December 2001 by a year from seven to six years and again with effect from 1 October 2020 from six to three years, transforming the commands of Art 21 EU Directive 2019/1023. Moreover, the introduction of the protective umbrella proceedings[48] grants the debtor the possibility of avoiding the total loss of participation rights.[49] Furthermore, the protection against attachment also favours the debtor in insolvency proceedings.[50] On the other hand, a debtor who is substantively insolvent cannot restructure outside of formal insolvency proceedings.

In contrast with instruments from other jurisdictions, the *Insolvenzordnung* would be considered to be (slightly) creditor-friendly overall.

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46 *Idem*, § 305(1) (No 1).
47 *Idem*, § 304(1) (sentence 1).
48 *Idem*, § 270d.
49 As is the case in standard proceedings – InsO, § 80.
50 InsO, § 36.

6.1.3 Role of the various stakeholders

Insolvency proceedings may only be opened upon a written request.[51] Such a request can be filed either by the debtor or by his creditors.[52] The insolvency court has jurisdiction to decide whether or not to open formal proceedings. To regulate the time elapsing between the request and the opening of proceedings, the court is empowered to designate a provisional insolvency administrator, whose role it is to secure the estate of the debtor or to take other provisional measures to protect the insolvency estate.[53] Within the opening proceedings, the insolvency court then appoints an insolvency administrator. With the appointment, the insolvency administrator becomes the central figure in the insolvency proceedings and the insolvency court takes on a purely supervisory function (see below for more detail).

In the order opening proceedings, the court also dockets a creditors' meeting deciding on the continuation of the insolvency proceedings (*Berichtstermin*). During this meeting, the insolvency administrator presents the economic state of the debtor[54] and, following this, the creditors vote on whether the debtor's enterprise should be closed down or temporarily continued.[55]

The creditors' meeting also decides on the establishment of a creditors' committee.[56] The members of the creditors' committee must support and monitor the insolvency administrator's execution of his office.[57] All decisions of particular importance require the approval of the creditors' committee.[58] However, such decisions do not become ineffective if this approval is lacking.[59] The creditors' committee should represent the creditors with a right to separate satisfaction, the insolvency creditors holding the maximum claims, the small sums creditors, and the debtor's employees.[60]

Insolvency proceedings are either terminated through a decision of the insolvency court after the final distribution has been carried out[61] or discontinued on the grounds of insufficiency of assets.[62]

The debtor has no substantive tasks in the course of the insolvency proceedings. Nevertheless, he or she is subject to duties of disclosure and co-operation. If he or she has applied for a discharge of remaining debt, the application can be rejected if the debtor did not fulfil its duties.

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51 *Idem*, § 13(1) (sentence 1).
52 *Idem*, § 13(1) (sentence 2).
53 *Idem*, § 21 *et seq*.
54 *Idem*, § 156.
55 *Idem*, § 157.
56 *Idem*, § 68(1) (sentence 1).
57 *Idem*, § 69 (sentence 1).
58 *Idem*, §§ 158 *et seq*.
59 *Idem*, § 164.
60 *Idem*, § 67(2).
61 *Idem*, § 200.
62 *Idem*, §§ 207 *et seq*.

6.2 Personal / consumer bankruptcy

6.2.1 Who qualifies as a "debtor"

An insolvency proceeding can be opened over the estate of every natural person. Proceedings over the estate of a natural person are fundamentally the same as those over the estate of a company. All debtors have access to the regular proceedings including the related insolvency strategies. There is only an exception for self-employed natural persons. They can continue their status of self-employment within the limits of § 35 (2) InsO. All other insolvency debtors are only allowed to continue their business with the help of the insolvency administrator. Furthermore, there are simplified consumer insolvency proceedings[63] for natural non self-employed persons and persons who have been self-employed but whose pecuniary circumstances are negligible.

6.2.2 Commencement of bankruptcy proceedings

Insolvency proceedings are only opened upon application. Both the debtor and each creditor have the right to apply for the opening of proceedings.[64] In the case of the latter, however, it has to be proven that they have a legal interest in the opening of insolvency proceedings, and their claim and the reason for opening of proceedings presented to the satisfaction of the court.[65]

Natural persons have no duty to request the opening of insolvency proceedings. However, should a debtor consciously delay the opening of insolvency proceedings, he or she could lose the right to a discharge of remaining debts under § 290(1)(No. 4) InsO.

Insolvency proceedings can only be opened if there is a reason to open insolvency proceedings.[66] The reasons to open insolvency proceedings are **inability to pay debts as they fall due / cash flow insolvency / illiquidity**,[67] **overindebtedness**,[68] and **imminent inability to pay debts**,[69] although the latter reason is only sufficient for an application from the debtor himself and overindebtedness is only a reason for legal persons or partnerships where no natural person is personally liable.

Inability to pay debts as they fall due / cash flow insolvency / illiquidity applies when the debtor is not able to meet his mature obligations to pay.[70] For a debtor to be deemed insolvent / illiquid, the requirements are that they are lacking the necessary means of payment and are resultantly, constantly and not just transiently, unable to meet a not inconsiderable number of the seriously requested monetary claims against them. Two methods are prescribed in to determine whether a debtor is illiquid. Under § 17(2) (sentence 2) InsO, a debtor is presumed

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63 *Idem*, §§ 304 *et seq*.
64 *Idem*, § 13(1) (sentence 2).
65 *Idem*, § 14(1) (sentence 1).
66 *Idem*, § 16.
67 Defined in InsO, § 17, as an inability to meet obligations when they fall due.
68 InsO, § 19.
69 *Idem*, § 18.
70 *Idem*, § 17 (2) (sentence 1).

to be illiquid if he has ceased payments. In this case, the determining factor is whether the inability to pay debts / illiquidity has become apparent to third parties. If the presumption proves unhelpful, then further consideration of the debtor's circumstances must be taken. A liquidities balance (*Liquiditätsbilanz*) is drawn up, listing the mature obligations against the financial means available to the debtor in the short term. The particular details of determining cash flow insolvency / illiquidity can be linked back to a detailed casuistry which includes extensive literature and case-law. One of the most important exceptions is a payment delay. Illiquidity cannot be presumed in a case of a mere payment delay, although this cannot continue beyond three weeks.

In order to determine **imminent inability to pay debts**, it is merely required that it is predominantly likely that a debtor will be unable to meet his existing obligations and pay them on the date of their maturity.[71] In contrast with cash flow insolvency / illiquidity, this consideration also includes payments or obligations whose maturity or emergence can be foreseen over the next two years. On the other hand, income that is reasonably likely to be added to the debtor's estate is also included in the considerations in a case of imminent insolvency.

Overindebtedness exists if the debtor's assets no longer cover its existing obligations to pay and the continuation of the enterprise is no longer highly likely.[72] A balance sheet shall be drawn up in which the assets and liabilities are compared. Objects that fall into the category of assets must be considered according to their liquidation value. The prognosis for the continuation of the enterprise covers the next twelve months and depends primarily on the desire for continuation of the debtor and the mid-term sustainability of the enterprise.

To open insolvency proceedings, it must be reasonably foreseeable that the insolvency estate will be able to cover the costs of those proceedings[73] according to § 26(1) (sentence 2) InsO. If the insolvency estate is not even able to cover the costs of the proceedings, and they are accordingly not opened, then the debtor is included in a register to warn potential future creditors of that a reason for insolvency exists.

6.2.3 Moratorium (stay)

The effects of an interim moratorium between the application for and the opening of insolvency proceedings require a court order on the basis of § 21 InsO. However, this is only true for the application stage. As soon as insolvency proceedings are opened an automatic stay comes into force, preventing creditors from enforcing their claims,[74] which is also true in self-administration.

According to § 166 InsO, the insolvency practitioner may dispose of a movable item to which a creditor has a right to separate satisfaction without restriction if it is in his possession. He is entitled to use and consummation as far as the financial interests of the secured creditor are not

[71] *Idem*, § 18(2).
[72] *Idem*, § 19 (2) (sentence 1).
[73] Especially court fees and the remuneration of the insolvency administrator – InsO, § 54.
[74] InsO, § 89.

infringed.[75] The infringement can be avoided by paying damages or offering a substitute security.

Pending lawsuits where the debtor is the defendant are interrupted.[76] The claimants must file their claims with the insolvency practitioner[77] and participate in the distribution of the proceeds. Where the debtor is the claimant, the lawsuit is interrupted until the insolvency practitioner decides to continue.[78] The enforcement of judgements by ordinary creditors is prohibited by § 89 InsO.

Within the so-called "protective umbrella proceedings", it is also possible for the court to order provisional protective measures.[79] If the debtor applies for such a proceeding, which is only possible if he is threatened with imminent inability to pay debts or overindebtedness but cash flow insolvency / illiquidity has not yet occurred, then the insolvency court shall set a deadline, not exceeding three months, in which the debtor can draw up an insolvency plan. The intention behind this period is to allow the debtor space and time in which to draw up this insolvency plan, without fear of individual enforcement proceedings being opened.

As regards executory contracts, if a mutual contract was not or not completely performed by the debtor and its other party at the date when the insolvency proceedings were opened, both claims to fulfilment lose their enforceability. The insolvency administrator then has the option to choose fulfilment, thereby making both claims enforceable again.

6.2.4 Status of the debtor upon entering insolvency

The debtor is a subject of the insolvency proceedings which gives rise to an obligation of the court to hear him.[80] However, the debtor has no duties within the insolvency proceedings, except for supporting the court and the insolvency administrator.[81] While he or she can argue against a claim in the verification meeting, this has no impact on the insolvency proceedings themselves. With the opening of proceedings, the debtor loses the right to manage and dispose of the insolvency estate.[82] The same applies to the right of possession.[83]

The only exception to this applies when the debtor has requested debtor-in-possession proceedings and this has been approved by the insolvency court.[84] The court will order such debtor-in-possession proceedings if it is advantageous for the insolvency estate to continue to make use of the expertise of the debtor in the further running of the estate. The insolvency court has to give particular attention to any circumstances that may arise in which a debtor-in-possession procedure could be detrimental to the creditors. A debtor-in-possession takes on

75 *Idem*, § 172.
76 ZPO, § 240.
77 InsO, §§ 87 and 174.
78 ZPO, § 240; InsO, § 85.
79 InsO, § 270d(3).
80 *Idem*, § 14(2).
81 *Idem*, §§ 97 *et seq*.
82 *Idem*, § 80.
83 *Idem*, § 148 InsO
84 *Idem*, §§ 270 *et seq*.

many of the roles of the insolvency administrator – specifically in retaining the powers of management and disposition. The insolvency court appoints an insolvency monitor (*Sachwalter*) in place of an insolvency administrator, whose role is to oversee the activities of the debtor-in-possession. In many cases a debtor brings a restructuring expert into its management, who possesses the necessary experience in insolvency law. However, in the case of a consumer insolvency, debtor-in-possession management is not possible.[85]

6.2.5 Alternatives to formal bankruptcy

As an alternative to formal bankruptcy proceedings, a natural person who is an entrepreneur (that is, not a consumer) and is in the financial state of imminent inability to pay debts (yet not substantively insolvent) can make use of the instruments of the *Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen* (Act on the Framework for Stabilisation and Restructuring of Enterprises (StaRUG)). The StaRUG offers various instruments, in particular court proceedings for the voting on a restructuring plan, the preliminary examination by a court of questions relevant for the confirmation of a restructuring plan, a court-ordered moratorium, the confirmation of a restructuring plan by the court and the appointment of a restructuring mediator. These tools can be used separately or jointly, so that the debtor can ask for tailor-made court assistance to support the restructuring efforts.

Apart from this, the debtor can negotiate with the creditors and reach an agreement whereby they (partially) waive their right to satisfaction and the reason for insolvency is therefore averted. It is further sufficient for the creditors to declare themselves prepared to forego enforcement of their claims for a certain period of time, so that the debtor's illiquidity is averted (compare this to the definition of "illiquidity" provided above).

A consumer insolvency proceeding can only be opened if it is proven that the debtor's attempt to reach an out-of-court agreement with his creditors about the clearance of debts, has failed.

It is only possible for the debtor to request a protective umbrella procedure if he or she is not yet substantively cash flow insolvent / illiquid, to avoid the debtor making use of the prohibition of execution and attempt to restructure without formal proceedings (see above at paragraph 6.1 for more detail).

However, it should be mentioned that § 5 SchVG (*Schuldverschreibungsgesetz*, Debt Management / Bonds Act) permits the claims of lenders to be reduced on a majority vote among them, as long as such a reduction is provided for in the conditions of the loan.

The termination of an insolvency proceeding over a natural person leads to that debtor regaining the right to management and disposition of the insolvency estate. Furthermore, following the termination of insolvency proceedings, creditors regain the right to enforce the remainder of their claims against the debtor without restriction.[86] Insolvency creditors who have determined claims which have not been contested by the debtor during the verification meeting

[85] *Idem*, § 270(2).
[86] *Idem*, § 201(1).

may enforce such claims against the debtor by way of execution on the legal basis of their entry into the schedule as under an executable judgment.[87] Limitation periods that were stayed by the insolvency proceedings[88] continue after the termination of the proceedings.

This would frequently have the effect that a debtor would immediately have to apply for insolvency proceedings anew. Due to this, a debtor has the opportunity to apply for a discharge of any residual debts. If the debtor applies for a discharge of residual debts, then he is obliged to transfer any excess income throughout a three-year period to a trustee who will use it to cover his minimum expenses and pass the remaining monies on to creditors. After these three years, in which the debtor has a number of obligations to co-operate (most notably, that of finding adequate employment), the debtor's residual debts can be discharged. Following the discharge of residual debts, any claims that existed prior to the openings of insolvency proceedings can no longer be enforced.[89]

6.2.6 Appointment of insolvency officeholders

The appointment of the insolvency administrator follows § 56 InsO. According to this, the court is to appoint an independent natural person who is suited to the case at hand, who is particularly experienced in business affairs and who is independent of both the creditors and the debtor. The court compiles preliminary lists in which all natural persons (and only natural persons) can be included, who are willing to take on the appointment and is suited to the position. The court then chooses from these lists a candidate who is independent from the debtor and the creditors and is suited to the role. While the court can exercise a certain degree of discretion in the appointment of the insolvency administrator, they are bound by the occupational freedom protected by article 12 of the German constitution (*Grundgesetz*) and their decision can be appealed insofar as there is doubt as to whether their decision has been made with appropriate care and consideration. The person whose appointment is in question must be independent, suitable and, above all, possess the necessary technical, economic, and legal skills for the position as well as a certain degree of necessary practical experience in the field. Furthermore, the integrity and reliability of the applicant must be ensured. Finally, he or she must have access to sufficient resources for the fulfilment of the role.

These prerequisites also apply to the appointment of the provisional insolvency administrator and are of equal importance as, in the majority of cases, the provisional insolvency administrator goes on to be appointed as the final insolvency administrator.

The insolvency court must appoint a provisional creditors' committee if such is necessary, to prevent negative reductions in the value of the debtor's estate.[90] If an application is brought, the court should also appoint a provisional creditors' committee even when the prerequisite conditions are not present. The insolvency court can exercise discretion over the make-up and inclusion of creditors in the creditors' committee. However, it is necessary that the court ensures that members of the committee are sufficiently available to fulfil the obligations of the position

87 *Idem*, § 201(2) (sentence 1).
88 BGB, § 205(1) (No 10).
89 InsO, §§ 286 *et seq*.
90 *Idem*, § 21(1) (sentence 1) / (2) (No 1a).

and that they possess the necessary practical predisposition. Furthermore, members of the provisional creditors' committee must be independent.

According to § 67 InsO, the court may establish a creditors' committee prior to the first creditors' meeting and, according to § 68 InsO, the creditors' meeting must decide on the establishment of a creditors' committee, or alternatively, whether the creditors' committee established by the court should be maintained in office. The members of the final creditors' committee are appointed by the creditors' meeting.[91] It is unclear, whether the court can overrule the appointment decision of the creditors' meeting on the grounds that this decision is contrary to the general interests of all creditors.[92] In any case, it is clear that the insolvency court can dismiss individual members of the committee if the reasons are important. The concept of an important reason, however, is to be interpreted restrictively. A key reason deemed as sufficiently important occurs in the case of multiple breaches of obligations which would lead to an impossibility of future trusting co-operation. This is to be presumed when interests other than those of the creditors are represented.

6.2.7 Role of officeholders in bankruptcy proceedings

The *Insolvenzordnung* prescribes that in every regular insolvency proceeding an insolvency administrator must be appointed who embodies the central figure of the insolvency proceedings. The obligations of the insolvency administrator include the following:

- management and transfer of the insolvency estate;[93]
- possession of the insolvency estate;[94]
- creation of a record of the assets of the insolvency estate,[95] a record of creditors,[96] and a survey of property;[97]
- disposition of the insolvency estate;[98]
- satisfaction of the insolvency creditors.[99]

The insolvency administrator is appointed by the court and is the holder of a private office. He is entitled to remuneration in consideration of execution of his office as well as for adequate expenses.[100] The former is determined according to the value of the estate. The insolvency

[91] *Idem*, § 68.
[92] *Idem*, § 78.
[93] *Idem*, § 80(1).
[94] *Idem*, § 148(1).
[95] *Idem*, § 151.
[96] *Idem*, § 152.
[97] *Idem*, § 153.
[98] *Idem*, § 159.
[99] *Idem*, § 187(3) (sentence 1).
[100] *Idem*, § 63 *et seq*.

administrator is subject to supervision of the insolvency court[101] as well as being monitored in the execution of his activities by the creditors' committee[102] if such a committee has been appointed. The insolvency administrator is generally free in respect of the execution of the office concerning external relations. However, he is personally liable towards the participants in the insolvency proceedings not to breach the duty to act as a reasonably careful insolvency administrator. The insolvency administrator may be dismissed by the court for an important reason (for example, where he proves to be inept or is guilty of embezzlement).[103]

Two types of provisional insolvency administrator can be distinguished from one another. In principle, a provisional insolvency administrator only has the individual competences with which they have been specifically empowered by the court.[104] Specifically, it is possible for the court to enforce that all dispositions on the part of the debtor necessitate approval from the provisional insolvency administrator.[105] This kind of insolvency administrator is also called a "weak" provisional insolvency administrator (this will be explained below). The court can apply a general prohibition on dispositions by the debtor which has a result that the power to dispose is passed on to the provisional insolvency administrator.[106] This kind of provisional insolvency administrator is described as a "strong" provisional insolvency administrator. An important restriction applies to the provisional insolvency administrator, irrespective of whether his appointment is "weak" or "strong": the estate of the debtor is to be secured and maintained.[107] Because the fate of the debtor and if a reason for opening insolvency proceedings is in actual fact present has not yet been finally decided, the leading principle is that the provisional insolvency administrator should not make dispositions of the debtor's assets. The insolvency court can assign the provisional insolvency administrator with the role of determining whether grounds for opening insolvency proceedings are present.[108]

The function of the creditors' committee is primarily to oversee the working of the insolvency administrator (see above at paragraph 6.1). This duty does not merely apply to the committee as a whole, but is also the individual responsibility of each member of the committee. Under § 71 InsO, each individual member is obliged to pay compensation if it culpably breaches this obligation. The obligations and functions of the provisional creditors' committee reflect those of the final creditors' committee. However, the preliminary creditors' committee has certain rights to participate in the appointment of the insolvency administrator.[109]

6.2.8 Proof of claims by creditors

Every creditor who wishes to participate in the insolvency proceedings must file their claim in writing with the insolvency administrator.[110] The reason for and amount of the claim must be

[101] *Idem*, § 58.
[102] *Idem*, § 69.
[103] *Idem*, § 59.
[104] *Idem*, § 22(2) (sentence 1).
[105] *Idem*, § 22(1) (sentence 2) (No 2) (alternative 2).
[106] *Idem*, § 22(1) (sentence 1).
[107] *Idem*, § 22(1) (sentence 2) (No 1).
[108] *Idem*, § 22(1) (sentence 2) (No. 3) and, in relevant cases, also in combination with § 22(2).
[109] *Idem*, § 56a.
[110] *Idem*, § 174(1) (sentence 1).

included in this notice[111] as well as copies of any documents evidencing the claim.[112] The insolvency administrator then enters these claims into the schedule to which the participants in the proceedings have access.[113] During the verification meeting, all filed claims are then verified in accordance with their amount and rank.[114] If no participant objects to a claim, then it is formally included in the schedule. This also applies when a claim doesn't have a title. The substance of the claim is then not contested. If the insolvency administrator or a creditor opposes a claim, then its substance is subsequently assessed in a court trial and, if the creditor succeeds in this assessment, the claim is included in the schedule. If the debtor opposes a claim, the insolvency proceedings are not impacted and the determination of the claim remains the same. However, in this case, the insolvency schedule does not entitle creditors to open enforcement proceedings against the debtor.[115]

6.2.9 Treatment of executory contracts upon insolvency

Contracts are, in principle, also wound up in insolvency proceedings. That means that the partner to the contract also has to fulfil their obligations under the contract, even after the opening of insolvency proceedings. A claim against the debtor, however, is only satisfied by the insolvency administrator on a *pro rata* basis.[116] Reciprocal contracts which are not yet fulfilled by either party are regulated differently. Under § 103 InsO, the following applies: after the opening of proceedings, no winding up occurs. Both parties only fulfil if the insolvency administrator so chooses. If this is the case then the creditor's claim must be satisfied in full from the insolvency estate.[117] If the insolvency administrator rejects fulfilment of the claim, then the contracting partner can register a claim for equalisation to the schedule which will then be satisfied on a *pro rata* basis.[118]

§§ 104 *et seq* InsO contain specialised provisions intended to apply to specific types of contract. These especially encompass alternative provisions for tenancies and leases over immovable objects,[119] contracts of employment[120] and for the expiration of mandates.[121]

No specific provisions based in insolvency law apply. Nevertheless, consideration must be taken for the fact that these contracts are continuing obligations which remain unsatisfied by either party, hence the existence of the right to choose fulfilment on the part of the insolvency administrator. Even when the insolvency administrator chooses to fulfil the obligations under the contract, the back-dated debts of the debtor need only to be fulfilled on a *pro rata* basis.

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[111] *Idem*, § 174(2).
[112] *Idem*, § 174(1) (sentence 2).
[113] *Idem*, § 175.
[114] *Idem*, § 176.
[115] *Idem*, § 201(2) (sentence 1).
[116] *Idem*, § 38.
[117] *Idem*, § 55(1) (No 2) (alternative 1).
[118] *Idem*, § 103(2) (sentence 1).
[119] *Idem*, §§ 108(1) and 109.
[120] *Idem*, §§ 108(1) (sentence 1) (alternative 2) and 113.
[121] *Idem*, §§ 115 *et seq*.

The obligations need only be fulfilled in full as far as assets were added to the estate by the counter-party after the opening of the insolvency proceedings.[122]

6.2.10 Set-off and netting in financial contracts

§ 104 InsO regulates fixed-date transactions and contracts over financial services. Under § 104(1) InsO, performance may not be claimed for such fixed date contracts after the opening of insolvency proceedings. Instead, the disadvantaged party can claim for non-performance to cover the difference between the agreed price and the market or stock exchange price prevailing at the point in time agreed by the parties. § 104(3) InsO prescribes that a contractually agreed liquidations-netting is protected in insolvency: when a number of contracts are combined within a framework contract and it has been agreed that they can only be wound up in unanimity, then the entirety of the performances are considered as one under the definition of § 104(1) InsO.

6.2.11 Vulnerable transactions (claw-back provisions)

Transactions made before the opening of insolvency proceedings can be contested if they were made to the disadvantage of the creditors and a reason to contest (avoidance ground) has been shown.[123]

A transaction disadvantages the general body of creditors if it reduces the amount of proceeds that can be paid to the ordinary creditors. Typical examples are payments, creation of security rights, waiver of claims, but also transactions of creditors, for example satisfaction by individual enforcement or set-off. A disadvantage cannot be established where the debtor transfers assets that do not belong to the estate or are worthless, further where security rights, which are not challengeable themselves, are realised, where collateral is exchanged against other objects, or where already existing security rights exceed the value of the collateral.

The avoidance grounds are listed in §§ 130 *et seq* InsO. In summary, assets must be returned to the insolvency estate if they left it in close timing to the opening of the insolvency proceedings or under circumstances which justify their return, even if the third party has already relied on their disposition. The following are reasons to contest:

(1) A transaction granting or facilitating an insolvency creditor a security or satisfaction to which the opponent had a claim (so-called congruent coverage) is contestable if it occurred in the last three months before the application to open insolvency proceedings, the debtor was already cash flow insolvent / illiquid and the creditor was aware of this. If there has already been an application to open insolvency proceedings, then the knowledge of such an application is sufficient grounds to contest.[124] Whether a transaction has been performed within the suspect period of three months prior to the application for insolvency

[122] *Idem*, § 105 (sentence 1).
[123] *Idem*, § 129(1).
[124] *Idem*, § 130.

proceedings must be decided by applying §140 InsO, which refers to the point in time where the transaction was perfected.

(2) A transaction granting an insolvency creditor a security or satisfaction without his entitlement to such a security or satisfaction (so-called incongruent coverage) can be contested. The suspect period is also three months (as in § 130 InsO), but there are no subjective requirements (mental elements). The only additional prerequisite is the cash flow insolvency (inability to pay debts) of the debtor and, if the payment has been made during the last month before (or after) the application for insolvency proceedings, even this is not necessary.[125]

(3) Transactions that immediately disadvantage insolvency creditors may be contested if the debtor was already illiquid and the creditor was aware of the illiquidity or of an application to open insolvency proceedings.[126] Note, however, that § 132 InsO is not applicable in cases where §§ 130,131 InsO apply.

(4) A transaction made by the debtor in the last 10 years before the request to open insolvency proceedings may be contested if it was made with the intention to disadvantage creditors and if the other party was aware of the intentions of the debtor.[127]

(5) A transaction at an undervalue performed by the debtor may be contested if it was made within four years of the request to open insolvency proceedings.[128]

(6) Payments and securities granted to shareholders can be clawed back under alleviated conditions. All payments which have been made during the last year – and all charges granted during the last 10 years – prior to (or after) the application for insolvency proceedings are voidable. There are no further prerequisites, especially no mental elements.[129]

Someone who has received property from the debtor which has been successfully contested, must restitute it to the insolvency estate. The Insolvency estate should be returned to the state in which it would have been, had the challengeable transaction never occurred. The claim for restitution already arises after the opening of proceedings by force of law and not upon a declaration by the insolvency administrator.[130]

To argue against the claim for restitution, the party opposing the avoidance must dispute that the requirements were not present – in the case of most avoidance grounds this especially means that he or she did not possess the necessary knowledge. It is then for the insolvency practitioner to prove the prerequisites. However, the burden of prove shifts to the defendant where he is a party closely connected to the debtor.

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[125] *Idem*, § 131.
[126] *Idem*, § 132.
[127] *Idem*, § 133.
[128] *Idem*, § 134.
[129] *Idem*, § 135.
[130] *Idem*, § 143(1) (sentence 1).

6.2.12 Exempt property

Only assets that are subject to attachment are included in the insolvency estate, those that are not subject to attachment are not included.[131] This is particularly relevant for income up to a threshold of EUR 930 generated by the debtor's employment.[132] Under § 36 InsO read with § 811 ZPO, the following assets are not attachable and thus are not included in the insolvency estate:

- objects forming a part of the debtor's household or personal use, insofar as the debtor requires these for a modest life and continuation of a modest household;

- clothing and specialised equipment needed for working.

The insolvency administrator my "release" certain parts of the insolvency estate which has as a consequence that those assets no longer fall within the insolvency estate.[133] The insolvency administrator will only release an asset from the insolvency estate if its disposition would not be beneficial to the insolvency estate or its retention could give rise to further expenses (for example, in the form of legal fees[134]) which would negatively impact the estate.

German insolvency law contains no homestead exemption.

6.2.13 Statutory preferential or priority claims

In contrast to the *Konkursordnung*, (which contained a § 61 protecting *inter alia* public treasuries, churches, schools, midwives and doctors) the *Insolvenzordnung* does not privilege certain groups of creditors. These privileges were abolished as they often resulted in the insolvency estate being reduced to such an extent that in most cases little to nothing remained to satisfy the claims of the remaining creditors. While it must be considered that this also resulted in the abolition of the privilege for workers' claims, state support in the form of *Insolvenzgeld* (insolvency money) is provided for the last three months prior to insolvency.[135]

Under § 53 InsO, the debts and costs incumbent on the estate are fully satisfied by the insolvency estate. This includes the costs of the insolvency proceedings[136] and the other debts incumbent on the estate[137] – this includes, in particular, debts created by the activities of the insolvency administrator, debts arising from executory contracts claimed to be performed by the insolvency administrator and obligations due to an unjust enrichment of the insolvency estate.

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[131] *Idem*, §§ 35 *et seq*.
[132] *Idem*, § 36(1) (sentence 2) read with ZPO, § 850c.
[133] *Cf*, InsO, § 32(3) (sentence 1).
[134] *Idem*, § 85(2).
[135] *Sozialgesetzbuch III* (SGB III) (Social Act, Vol 3), § 165 *et seq*.
[136] InsO, § 54.
[137] *Idem*, § 55.

6.2.14 Discharge (or rehabilitation)

If the debtor is a natural person, he or she can apply, under §§ 287 *et seq* InsO for a discharge of residual debt.[138] This requires an application from the debtor which must be combined with the application to open insolvency proceedings.[139] If the debtor is granted a discharge of residual debt, then the claims that were claims in the insolvency proceedings (or which could have been claims in the insolvency proceedings – the discharge also covers claims that weren't registered in the schedule) become imperfect obligations, which means that the debtor could still satisfy them, but can no longer be forced to do so.[140] The debtor has to pledge all seizable claims to emoluments within the compliance period of the next three years to a trustee.[141] The trustee then distributes them to the creditors on an annual basis. During the compliance period, the debtor has to endeavour to find gainful employment,[142] otherwise the discharge of residual debt will be refused upon application by a creditor.[143] A discharge of residual debt is also refused under § 290 InsO if, for example, the debtor has committed an insolvency-related offence[144] or negligently breached duties of co-operation and disclosure. A discharge of debt does not require that the creditors are satisfied with a minimum percentage of their claims. A small number of claims are excepted from being discharged under § 302 InsO; these include, *inter alia*, claims for compensation in tort, claims for unpaid legally prescribed maintenance (insofar as these were registered as such), or claims from interest free loans granted to the debtor to cover the costs of insolvency proceedings.

A discharge of residual debt can also be achieved within an insolvency plan.

6.2.15 Simplified procedure for small or assetless estates

A simplified insolvency proceeding is included for consumers.[145] This type of proceeding finds application for natural persons who do not or have not pursued self-employed business activity or who, despite having pursued self-employed business activity, have comprehensible assets and no standing claims exist against them from employment (specifically from employees).

Prior to the opening of insolvency proceedings, multiple attempts to reach an agreement are made. The debtor must submit at the application to open proceedings a statement – certified by a suitable person or agency – that out-of-court attempts at an agreement were made and that these were unsuccessful. The debtor must also include a plan for the settlement of debts with the application to open insolvency proceedings to which the creditors have access and to which they can also object. The court only reaches its final decision about the application to open insolvency proceedings – and opens them once this final attempt to reach an agreement with the creditors has also failed.

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[138] *Idem*, § 286.
[139] *Idem*, § 287(1) (sentence 1).
[140] *Idem*, § 301(1) and (3).
[141] *Idem*, § 287(2).
[142] *Idem*, § 287b.
[143] *Idem*, § 290(1) (No 7).
[144] *Idem*, § 290(1)
[145] *Idem*, §§ 304 *et seq*.

Such proceedings are markedly simplified. This follows, firstly, from the fact that the creditor must supply the court with certification documenting income and the estate, information about creditors, and obligations. The court should waive the report meeting under § 29 (2) (sentence 2) InsO and the proceedings are generally conducted as written proceedings.[146] The possibility of a debtor-in-possession management is excluded.

Self-Assessment Exercise 3

Question 1
Present the statements from the last chapter that have positive impacts on the insolvency estate. Give a short justification for your answer.

Question 2

Name and define the different reasons to open insolvency proceedings.

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Corporate liquidation

6.3.1 Introduction

It must be stressed at the very beginning of this section that no special regime for corporate insolvency exists. There is only one kind of insolvency proceeding, regulated by the *Insolvenzordnung* and applicable to all kinds of debtors, natural as well as legal persons. Hence, for the most part reference can be made to the material covered under paragraph 6.2. Under this section only aspects relating to corporate liquidation that were not covered above, will be dealt with.

6.3.2 Who qualifies as debtor

Insolvency proceedings can be opened over the estate of every legal person. Under German law, this particularly includes:

(a) Public Limited Company (*Aktiengesellschaft* (AG));

(b) Partnership Limited by Shares (*Kommanditgesellschaft auf Aktien* (KGaA));

(c) Limited Liability Company (*Gesellschaft mit beschränkter Haftung* (GmbH));

[146] *Idem*, § 5(2).

(d) Registered Co-operative (*Eingetragene Genossenschaft* (eG));

(e) European Company (*Europäische Gesellschaft*);

(f) Foundation (*Stiftung*);

(g) Registered Association *(rechtsfähiger Verein*).

Besides this, § 11 InsO permits insolvency proceedings to be opened over the assets of alternatively structured companies. This includes particularly the following:

(a) Unincorporated Association (*Nicht rechtsfähiger Verein*);

(b) General Partnership (*Offene Handelsgesellschaft* (OHG));

(c) Limited Partnership (*Kommanditgesellschaft* (KG));

(d) Partnership Company (*Partnerschaftsgesellschaft*);

(e) Private Company (*Gesellschaft des bürgerlichen Rechts* (GbR));

(f) Ship-owning Partnership (*Partenreederei)*;

(g) European Economic Interest Grouping (*Europäische wirtschaftliche Interessenvereinigung*).

Although not a company, it is nevertheless important to consider that, under § 11(2) (No. 2) InsO, an inheritance estate,[147] as well as an undivided estate or an estate that was administered by partners or spouses can be subject to insolvency proceedings.

6.3.3 Commencement of proceedings

Once the debtor is substantively insolvent (illiquid or overindebted), Germany provides only one avenue for both liquidation and restructuring – in the form of the insolvency proceedings. The answer to this question can therefore be found in the preceding paragraphs. The opening of insolvency proceedings requires an application from either the debtor or a creditor.

There are two approaches to liquidation. If a company is insolvent, then the insolvency administrator can either dispose of the enterprise or sections thereof in their entirety (asset deal, restructuring by transfer – *übertragende Sanierung* – as the company can be liquidated while the enterprise survives) or dispose of individual assets separately. The approach that is eventually taken by the insolvency administrator is at his discretion. However, the insolvency administrator is bound to take the most profitable option while also being bound by the decisions of the creditors (closure or continuation of the business) which were made at the report meeting.

[147] See InsO, §§ 315 *et seq*.

The directors (members of the representative entity) of a legal person are obligated to request the opening of insolvency proceedings no longer than three weeks after the occurrence of inability to pay debts (cash flow insolvency / illiquidity) or six weeks after the occurrence of balance-sheet insolvency (overindebtedness). The same applies for all representatives of companies without legal personality, insofar as no natural person is personally liable. If such a representative fails to meet this obligation, either wilfully or negligently, then they have to pay damages and face a period of imprisonment or a fine.[148] If payments are made by a Public Limited Company or a Limited Liability Company after the reason for insolvency has become apparent, then the members of the representative entity are obliged to replace the assets to the estate, on the condition that the payments were not made with the care of a reasonable businessman.[149] Every member of the representative entity is also obligated to replace damage that occurs through the breach of the obligation to request the opening of insolvency proceedings.[150]

As under German law rescue attempts are only possible under insolvency proceedings, it is for the insolvency administrator to decide whether liquidation or restructuring is the best option. Hence, conversion from liquidation to corporate rescue is possible within the same proceedings. This is also true if self-administration has been ordered.

Liquidation is only possible within the parameters of an insolvency proceeding. The thresholds are the same for all insolvency proceedings. When the debtor is a legal person or a private company, in which no natural person is personally liable, then "overindebtedness" is also a reason to open proceedings. See – also to the other reasons for insolvency – above at paragraph 6.2.

6.3.4 Moratorium (stay)

What is said above at paragraph 6.2 is equally applicable here.

6.3.5 Alternatives to formal liquidation

The debtor can use the tool-box of the StaRUG; see above at 6.2.5.

6.3.6 Appointment of officeholders

What is said above at paragraph 6.2 is equally applicable here.

6.3.7 Role of officeholders in the liquidation process

What is said above at paragraph 6.2 is equally applicable here.

[148] InsO, § 15a.
[149] InsO, § 15b.
[150] BGB, § 823(2) read with InsO, §15a.

6.3.8 Proof of claims by creditors

What is said above at paragraph 6.2 is equally applicable here.

6.3.9 Treatment of executory contracts upon liquidation

What is said above at paragraph 6.2 is equally applicable here.

6.3.10 Treatment of specific contracts upon liquidation

What is said above at paragraph 6.2 is equally applicable here.

6.3.11 Treatment of specific contracts upon insolvency

What is said above at paragraph 6.2 is equally applicable here.

6.3.12 Set-off and netting in financial contracts

What is said above at paragraph 6.2 is equally applicable here.

6.3.13 Vulnerable transactions (claw-back provisions)

What is said above at paragraph 6.2 is equally applicable here.

6.3.14 Director liability

What is said above at paragraph 6.2 is equally applicable here.

All fraudulent behaviour towards a contracting party leads to a liability towards that party.[151] For example, when representatives of a company mislead a contracting party over the cash flow insolvency / illiquidity of the company to secure a credit, this can lead to personal liability of the acting person.

If the representative organ of a company wastes or otherwise causes loss to that company's assets, he or she is liable for such loss caused through his wilful or negligent actions. Such persons are under an obligation to exercise the care of a reasonable businessperson.[152]

6.3.15 Statutory preferential or priority claims

What is said above at paragraph 6.2 is equally applicable here.

[151] BGB, §§ 826 and 823(2) read with StGB, § 263.
[152] See, as a substitute, GmbHG, § 43 and AktG, § 93.

6.3.16 Dealing with groups of companies in a domestic context

A legislative framework regulating group insolvencies was only created with the passing of the Act to Facilitate the Insolvency of Groups of Companies (*Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen*) which came into force on 24 April 2018. In particular, it is now possible for a court that has opened insolvency proceedings over one member of the group to claim and enforce its jurisdiction over other branches of the group.[153] Furthermore, § 56b InsO is intended to contribute to the same insolvency administrator being appointed for proceedings over all parts of the group. However, conflicts of interests will often arise between different branches of the group. In such a scenario, a special insolvency administrator is appointed; however, this revives the co-ordination problem. When multiple insolvency courts or insolvency administrators are responsible for companies within the same group, then §§ 269a *et seq* InsO prescribe that a co-ordination hearing will be implemented and the two insolvency administrators will work together (as far as possible).

6.3.17 Dissolution

The opening of insolvency proceedings over the estate of a legal person or a company without legal personality leads to its dissolution.[154] The insolvency administrator has to completely dispose of the estate and then the debtor is removed from the commercial-, associations-, or co-operatives register, provided that the debtor is registered in one of these.[155]

6.3.18 Simplified procedures for small or assetless estates

No simplified proceedings are provided for small or assetless estates. Consumer insolvency proceedings[156] are explicitly limited to natural persons.

Self-Assessment Exercise 4

Question 1

What main differences arise between corporate insolvency and bankruptcy proceedings over a natural person?

Question 2

In which article is the duty mentioned to request insolvency proceedings in companies?

[153] InsO, §§ 3a *et seq*.
[154] BGB, §§ 42(2) (sentence 1), 728(1) (sentence 1); HGB § 131(1) (No 3); AktG, § 262(1) (No 3); GmbHG, § 60(1) (No 4).
[155] *Gesetz über das Verfahren in Familiensachen und in den Angelegenheiten der freiwilligen Gerichtsbarkeit* (FamFG) (Act on Proceedings in Family Matters and in Matters of Voluntary Jurisdiction), § 394(1) (sentence 2).
[156] InsO, §§ 304 *et seq*.

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

German law has no applicable provisions relating to receivership.

6.5 Corporate rescue

6.5.1 Introduction

Most of what has been described above (in paragraphs 6.2.and 6.3) regarding consumer bankruptcy and company liquidation, also applies here. Under this heading, only aspects that directly relate to corporate rescue and which have not been covered in the previous paragraphs will be discussed here. In this respect, corporate rescue in insolvency proceedings under the InsO must be distinguished from pre-insolvency rescue under the StaRUG.

6.5.2 Informal creditor workouts

There are no rules or regulations relating to informal creditor workouts in Germany.

However, it should be mentioned that § 5 SchVG (*Schuldverschreibungsgesetz* - Debt Management / Bonds Act) permits the claims of lenders to be reduced on a majority vote among them, as long as such a reduction is provided for in the conditions of the loan.

6.5.3 Debtors to whom the corporate rescue provisions apply

German insolvency law contains no specialised procedures for corporate rescue. Instead, corporate rescue is achieved through the standard insolvency proceedings and the debtors who qualify have already been described in paragraph 6.3.

The pre-insolvency tool-box of the StaRUG is available for entrepreneurs of all kinds, no matter whether they are natural persons or legal entities.

6.5.4 Commencement of corporate rescue proceedings

The available avenues for entering insolvency proceedings have already been explained above under paragraph 6.2. The threshold for entering proceedings and whether or not there is an obligation to file for insolvency proceedings in specific circumstances, has already been covered under paragraph 6.3.

Under the StaRUG, the debtor may commence out-of-court negotiations with the creditors needed for restructuring. Only where the debtor applies for court assistance, the court will provide the debtor with the necessary instruments.

6.5.5 Mechanisms for conversion from corporate rescue to liquidation

As far as rescue attempts are conducted under insolvency proceedings, it is for the insolvency practitioner to decide whether liquidation or restructuring is the best available option. Conversion from corporate rescue to liquidation is therefore possible within the same proceedings. This is also true if self-administration has been ordered.

Where pre-insolvency rescue has been commenced, those proceedings must be stopped as soon as the debtor becomes substantively insolvent (unable to pay debts or overindebted). They are not automatically converted to insolvency proceedings. Hence, debtor and creditors can apply for ordinary insolvency proceedings.

6.5.6 Using corporate rescue to wind down (liquidate) a company if rescue attempts fail

Both corporate rescues as well as liquidation can be achieved through standard insolvency proceedings. If the rescue is not successful, then the company is liquidated within the same proceeding.

In the case of per-insolvency restructuring proceedings, these must be terminated and regular insolvency proceedings ensue.

6.5.7 Moratorium (stay)

As far as insolvency proceedings are concerned, this has already been covered under paragraph 6.2 and 6.3. However, where the debtor is (only) imminent illiquid, he or she can apply for a moratorium under § 49 StaRUG and ask for a court order which stays all individual enforcement and (if applied for) hinders secured creditors to realise the collateral (so-called stabilisation order).

6.5.8 Appointment and role of officeholder

These topics have already been covered under paragraph 6.2 and apply equally here. In StaRUG-proceedings, a restructuring practitioner (monitor) can be appointed only where consumers or small, medium-sized or micro-enterprises are involved as creditors, or where the moratorium or the restructuring plan covers (nearly) all creditors.

6.5.9 Sale of assets outside the ordinary course of business

Under § 160(1) (sentence 1) InsO, the insolvency administrator has to seek the approval of the creditors' committee if he wishes to make a disposition of a particularly important nature. This includes, in particular, the disposition of the enterprise, an operation thereof, a warehouse in its entirety, etc.[157] The creditors' meeting has to approve when the disposition of the enterprise of

[157] *Idem*, § 160(2) (No 1).

an operation is to be made to someone who has particular interests (for example, relatives of the debtor, creditors entitled to separate satisfaction, etc.).[158]

In pre-insolvency restructuring proceedings, all these measures are up to the debtor whose power of disposal is not restricted.

6.5.10 Post-commencement financing (also known as DIP financing)

During the course of insolvency proceedings the insolvency practitioner[159] can apply for credit on the capital markets. The obligations arising from the credit agreement are considered expenses of the proceedings (debts of the insolvency estate) and therefore are satisfied from the insolvency estate directly after the costs of the insolvency proceedings. If the insolvency estate is insufficient to cover the costs of the debts that have arisen through the proceedings, then the insolvency administrator is personally liable towards the other contracting party under § 61 InsO, unless it was not foreseeable (the same applies for the manager in debtor-in-possession insolvency proceedings).

In pre-insolvency proceedings under the StaRUG, fresh money must be acquired by the debtor. Such restructuring loans can be part of the restructuring plan. If the restructuring attempt fails and insolvency proceedings ensue, the loan does not enjoy a privilege in ranking. However, according to § 90 StaRUG, granting and collateralisation of the loan is not challengeable in subsequent insolvency proceedings if it is regulated in a court-confirmed restructuring plan.

6.5.11 Proof of claims

This has already been covered under paragraph 6.2 above.

For pre-insolvency restructuring, the StaRUG does not provide for special rules on this subject.

6.5.12 Rescue plan

It is relevant, firstly, to note that an insolvency plan is also available in proceedings over the estate of a natural person. While the plan can aid in a corporate rescue, it can also be used with the intention to dispose of or liquidate an enterprise.

The entitlement to submit an insolvency plan is granted only to either the debtor or the insolvency administrator.[160] The creditors' meeting can, however, also charge the insolvency administrator with the establishment of an insolvency plan.[161] The plan is to be submitted to the insolvency court; this determines whether the submitting party is authorised and whether the provisions over the contents of the plan have been followed. The plan must have two parts.[162] The first part surmises the information which is necessary for the parties entitled to vote to form

[158] *Idem*, § 162.
[159] Or, in the case of a debtor-in-possession insolvency proceeding, the debtor under InsO, § 270a.
[160] InsO, § 218(1) (sentence 1).
[161] *Idem*, §157 (sentence 2).
[162] *Idem*, § 219.

informed decisions.[163] The second part of the plan must determine how the insolvency plan will transform the legal position of the parties involved.[164] For this, the parties must be formed into groups with differing legal statuses. Under §§ 222 (1) (sentence 2) InsO, a distinction must be made, at least, between:

(a) the creditors entitled to separate satisfaction if their rights are encroached upon by the plan;

(b) the ordinary creditors, according to § 38 InsO;

(c) each class of subordinated creditors;

(d) persons with a participating interest in the debtor where their share rights or membership are included in the plan.

However, further groups can be formed if this is justified under the circumstances. Within a group, all parties involved must be offered equal rights.[165] When these requirements are complied with and the debtor-submitted plan has the prospect of success[166] the insolvency court will forward it to the creditors' committee, the insolvency administrator and the debtor for their comments[167] and lay it out for their inspection.[168]

The plan then has to be accepted by the creditors. For these purposes, the court determines a discussion and voting meeting.[169] Voting commences in groups determined by the second part of the plan (see above). The creditors entitled to vote are all those whose claims are impacted by the plan.[170] The same is true for shareholders of the debtor under § 238a InsO. All groups must vote to accept the plan for it to be finally approved, although in every group both a simple majority in value and a majority in number must be achieved.[171] A majority in number means that the majority of the members of the group accept the plan and a majority in value means that the accepting group members represent more than 50% of the sum of the claims held by the creditors present and voting. § 245 InsO contains an "cross-class cram-down" exception to this. Insofar as the necessary majorities are not reached, acceptance is presumed when the following three prerequisites are present:

(1) the members of such a group are likely not to be placed at a disadvantage by the plan compared with their situation without a plan;

(2) the members of such a group participate to a reasonable extent in the economic value devolving on the parties under the plan (which includes the "absolute priority rule", That is,

[163] *Idem*, § 220(2). This includes, in particular, the state of the assets, finances and income, the means of disposition, suggestions for a possible rescue or operational changes),
[164] *Idem*, § 221 (sentence 1).
[165] *Idem*, § 226(1), with a possible exception in § 226(2) if all parties consent.
[166] Otherwise it will be refused – InsO, § 231.
[167] InsO, § 232.
[168] *Idem*, § 234.
[169] *Idem*, § 235.
[170] *Idem*, §§ 237 *et seq*.
[171] *Idem*, § 244.

that no lower ranking creditors participate in the proceeds unless all higher ranking claims are fully satisfied);

(3) the majority of the voting groups have backed the plan with the necessary majorities.

The debtor must also consent to the plan.[172] However, the debtor's opposition is not relevant if he is not placed at a disadvantage by the plan compared with a situation without a plan.[173] Finally, the court must approve the plan. For this, the court tests whether the necessary procedure was followed and, importantly, that no votes had been "bought.[174] In addition, a minority protection has to be granted if 1) the person filing the request opposed the plan in writing or for the records at the latest in the voting meeting, and 2) the person filing the request is likely to be placed at a disadvantage by the plan compared with his situation without a plan.[175]

As soon as the order approving the plan becomes final, its effects under the constructive part become binding.

As discussed in the previous section, the creditors' groups vote. It is, however, necessary that all groups approve the plan. If this fails, there are no means available for individual groups to approve a plan whose effects are restricted to only that group.

Within one group, only the majority in number and the majority in value need to be achieved for the entire group to have approved the plan. Even when these majorities are not achieved, the plan can still be approved as long as the requirements of § 245 InsO are met (see above).

When the order approving the plan becomes final, its effects become binding on all participants and therefore also on all those who objected to the plan and those who are not participating in the insolvency proceedings.[176]

§ 251 InsO protects minorities from being disadvantaged. Such a minority can request that the court refuses the insolvency plan if:

(1) the person filing the request opposed the plan in writing or for the record at the latest voting meeting;

(2) the person filing the request shows that he or she is likely to be placed at a disadvantage by the plan compared to the situation without a plan.

To avoid jeopardising the implementation of the plan, its second part can provide for funds to compensate a disadvantage. In such a case, the impacted party is banned from opposing the

[172] *Idem*, § 247.
[173] *Idem*, § 237(2).
[174] *Idem*, § 250.
[175] *Idem*, § 251.
[176] *Idem*, §§ 254(1) and 254b.

plan and instead has to claim for equalisation from these funds[177] without this impacting on the approval of the plan.

No particular provisions exist in regard to the role of equity in corporate rescue proceedings. The equity remains part of the insolvency estate. The satisfaction of shareholder loans occurs only after the satisfaction of all other insolvency creditors.[178]

As part of an insolvency plan[179] it can be agreed that the claims of the creditors can be transferred into equity in the company.[180] By doing this, the liabilities are reduced.

All creditors are entitled to vote if their claims are likely to be impacted through the plan.[181]

In pre-insolvency proceedings, similar rules apply. The debtor (only) can present a restructuring plan in which affected creditors can be divided in several groups.[182] Unless all affected creditors agree, the plan needs the approval of a creditors' meeting which requires a majority of 75% of all affected claims (that is, not only of creditors present and voting)[183] in each group and the confirmation of the court.[184] Cross-class cram-down is possible with minor exceptions to the absolute priority rule.[185] Apart from this, the StaRUG mirrors the rules on insolvency plans as available under the InsO.

6.5.13 Executory contracts under corporate rescue proceedings

As in every insolvency proceeding, this is regulated by §§ 103 *et seq* InsO (see above). In an insolvency plan, these prescriptions can be circumvented. § 119 InsO does not preclude this as this agreement was not made before the opening of insolvency proceedings.

The StaRUG does not contain any rules on executory contracts but provides for norms which deprive *ipso facto* clauses of their effect and hinder creditors during a moratorium to terminate contracts.

6.5.14 Treatment of specific and essential contracts under corporate rescue

This has already been covered under paragraph 6.2 and 6.5.13 above.

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177 *Idem*, § 251(3).
178 *Idem*, § 39(1) (No 5) - subordinated claims.
179 Since the introduction of the ESUG – see above under the history of insolvency law.
180 InsO, § 225a – a so-called debt for equity swap.
181 *Idem*, §§ 237 *et seq*.
182 StaRUG, § 9.
183 *Idem*, § 25.
184 *Idem*, §§ 60 *et seq*.
185 *Idem*, §§ 26 *et seq*.

6.5.15 Treatment of the continued provision of supplies essential to the continuation of the business

Supply agreements also fall within the parameters of §§ 103 *et seq* InsO; this applies irrespective of whether essential goods are impacted or not. In such a case the insolvency administrator has the option to choose performance or not. If the administrator chooses performance, then the other party to the contract must fulfil the obligations and continue to deliver the goods. The insolvency administrator must then fully satisfy the resulting claims of the contracting parts – as debts of the insolvency estate.[186] The return obligation must only be satisfied in full for services performed after the opening of insolvency proceedings; those performed before the opening of insolvency proceedings are only satisfied as an insolvency claim on a *pro rata* basis by way of a dividend.[187] These circumstances do not give rise to a right to claim restitution for the contracting parties.[188]

For pre-insolvency restructuring, the StaRUG does not provide for special rules on this subject.

6.5.16 Set-off and netting in regard to financial contracts

The rules as set out above under paragraph 6.2 also apply here.

For pre-insolvency restructuring, the StaRUG does not provide for special rules on this subject.

6.5.17 Disclaiming onerous contracts

The insolvency administrator has the option to choose performance if the contract has not been fulfilled on both sides.[189] If he or she does not choose to fulfil then the contract is not further wound up and the contracting party can only register for compensation (the benefit from the contract) in the insolvency schedule. This claim is then only satisfied on a *pro rata* basis.

For pre-insolvency restructuring, the StaRUG does not provide for special rules on this subject.

6.5.18 Vulnerable transactions (claw-back provisions)

The norms as already explained above are applicable without exceptions.

For pre-insolvency restructuring, the StaRUG does not provide for transactions avoidance but protects transactions contained in, or executing, a restructuring plan in subsequent insolvency proceedings.

6.5.19 Director liability

The norms as already explained above are applicable without exceptions.

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[186] InsO, §§ 103 and 55(1) (No 2) (alternative 1).
[187] *Idem*, §§ 105(1) and 38.
[188] *Idem*, § 105(2).
[189] *Idem*, § 103.

In pre-insolvency proceedings, directors are obligated to take the interests of the general body of creditors into account and to conduct the restructuring with the care of a diligent and conscientious manager. Otherwise they face personal liability under § 43 StaRUG.

6.5.20 Statutory preferential (priority) claims

See above at paragraph 6.2.

For pre-insolvency restructuring, the StaRUG does not provide for special rules on this subject.

6.5.21 Groups of companies in the context of corporate rescue

See above at paragraph 6.3.

For pre-insolvency restructuring, intra-group third-party security may be included in the restructuring plan.[190] Apart from this, the StaRUG does not provide for special rules on this subject.

6.5.22 Specialised corporate rescue proceedings for MSMEs

No special proceedings are provided for under German law.

Self-Assessment Exercise 5

What are the advantages of an insolvency plan?

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

7.1 General background

International insolvency law is regulated by §§ 335 *et seq* InsO. Those norms are binding as long as no bi- / multilateral agreements apply. The EU Regulation 2015/848 (hereinafter EIR) applies between EU Member States (with the exception of Denmark).

For insolvency proceedings that were opened in Germany, German law follows the principle of universality (*Universalitätsprinzip*) which prescribes that the effects of an insolvency proceeding are also binding in all other countries. The inverse constellation – whether a foreign proceeding is recognised in Germany – was historically treated differently. The jurisprudence instead

[190] StaRUG, § 2(4).

applied a principle of territoriality (*Territorialitätsprinzip*) and did not recognise the effects of foreign insolvency proceedings. The *Bundesgerichtshof* overruled this in 1985 and has since followed the principle of universality. Currently, this jurisprudence is also legally represented by § 343 (1) InsO, under which a foreign proceeding will only not be recognised if:

(1) the courts of the state of the opening of proceedings do not have jurisdiction in accordance with German law;

(2) where recognition would lead to a result which is manifestly incompatible with major principles of German law, particularly in cases of incompatibility with fundamental rights (*ordre public*).

If no one presents these grounds for exclusion, then the proceedings must be recognised.

The EIR also assumes the principle of universality. However, it also stipulates that proceedings are only to be recognised where their opening is binding, especially in that the court has jurisdiction under Article 3 EIR[191] and that the recognition of such proceedings would not violate the *ordre public*.[192]

Both § 343 InsO and Article 19 EIR have become formally binding.

7.2 UNCITRAL Model Law on Cross-Border Insolvency

Germany has not adopted the UNCITRAL Model Law on Cross Border Insolvency. Questions of international insolvency are regulated in §§ 335 *et seq* InsO. § 335 InsO establishes the principle that the *lex fori concursus,* the law of the state in which proceedings were opened, is applicable.

International jurisdiction is not explicitly regulated. However, the principle is applied that the international jurisdiction is to be accepted if the regional jurisdiction within a country is accepted. Further, §§ 3 and 4 InsO, read with §§ 12 *et seq* ZPO, are to be applied. If, through this, the jurisdiction of, for example, a German court is confirmed, then it follows that the German courts also have international jurisdiction. Under § 3 InsO, the regional court in which the debtor has his centre of economic activities, or his registered office, has jurisdiction.

§§ 336 *et seq* InsO provide differing exceptions to the *lex fori concursus*. Thus, § 336 InsO provides that the effects of an insolvency proceeding over a contract concerning a right *in rem* to an immovable object, or a right to use an immovable object, are subject to the laws of the state in which the object is situated. For contracts of employment, according to §337 InsO, Regulation 593/2008 (Rome I) applies and set off and transactions avoidance are specificities of §§ 338 *et seq* InsO.

[191] EIR, Art 19.
[192] *Idem*, Art 33.

The requirements for the recognition of the effects of insolvency proceedings opened in another state have already been considered.[193] No formal proceedings are necessary in which the decision to open proceedings is recognised in Germany through a formal ruling or suchlike. Instead, the recognition occurs automatically and is examined incidentally if the need arises. The decision to open proceedings has, as a rule, the same effect as in the country in which it was made.

Foreign creditors and insolvency administrators can also request the opening of insolvency proceedings in Germany, although the latter can only apply for the opening of secondary proceedings.

7.3 Treaties and conventions

Most cases of international insolvency in Germany occur in relation to other EU Member States. Such cases are (with the exception of Denmark) regulated by the EIR. In this area, the EIR replaces §§ 335 *et seq* InsO. The scope of application is opened for every insolvency proceeding when the debtor does not fall into the categories in Article 1(2) EIR (*inter alia*, banks and insurance companies) and have their seat in an EU Member State.

Article 3 of the European Insolvency Regulation determines international jurisdiction. Under this, the courts of the state in which the debtor has his Centre of Main Interests (COMI) have jurisdiction. The determination of this place often gives rise to issues in practice. Article 3(1) (sentence 2) of the European Insolvency Regulation therefore defines this place as follows: it is the place in which the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. Article 3(1) (subs 2) gives rise to a presumption that this is the place of the registered office.

Under Article 7 of the European Insolvency Regulation the principle of the *lex fori concursus* also applies – however, Article 8 *et seq* of the EIR provide exceptions to this. Article 8 of the European Insolvency Regulation provides that third parties' rights *in rem* (credit securities) are under the jurisdiction of the state in which they are situated (*lex situs / lex rei sitae*).

7.4 Important cross-border insolvency cases

The most attention in conjunction with cross-border insolvency was enjoyed by the NIKI insolvency. Within a short period of time, many academic voices were raised and even the general public gained a great interest in the issues. An application to open insolvency proceedings over the NIKI Luftfahrt GmbH was made in Germany. The *Amtsgericht Berlin-Charlottenburg*[194] tested the international jurisdiction under Article 3 of the European Insolvency Regulation and came to the conclusion that it had jurisdiction. While the appeal of this opening decision was still being heard, the application to open insolvency proceedings was

[193] InsO, §343.

[194] AG Charlottenburg, 13.12.2017 and 4.1.2018 – 36n IN 6433/17, ZInsO 2018, 62 and 111; appeal was granted by LG Berlin, 8.1.2018 – 84 T 2/18, NZI 2018, 85; further appeal to the *Bundesgerichtshof* was withdrawn after the decision of Austrian *Landesgericht Korneuburg*.

also filed in Austria. Thus, the *Landesgericht Korneuburg*[195] in Austria also tested jurisdiction under Article 3 of the European Insolvency Regulation, concluded that it had international jurisdiction and opened main proceedings. This state of affairs gave rise to significant uncertainty and was accompanied by a significant loss of assets, as a timely disposition was prevented and the company lost the trust of its (potential) contracting partners on a daily basis. For these reasons, an appeal to higher courts did not occur; instead, both insolvency administrators reached an agreement that the main proceedings opened in Germany would be changed into secondary proceedings.

The differing decisions arose because COMI is an indeterminate legal term and its determination must follow based on a consideration of all the relevant factors. This offers the advantage that the proceedings can be opened in the state with which the debtor has the closest connection, which will have a positive impact on the financial outcome of any dispositions. There are multiple factors which have been accepted to indicate the place of the head office functions, yet it remains unclear how these are interrelated and interact with each other. Although a presumption exists in favour of the registered office, this cannot be taken to mean that the rebuttal of the presumption is only possible when no further criteria point to a COMI in the country.

The discussion around this question remains in full swing.

Self-Assessment Exercise 6

Question 1

Which question is central, when problems of international insolvency law need to be solved?

Question 2

Why did the German insolvency administrator approve the opening of the Austrian proceedings in the NIKI case?

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

Foreign judgments can be recognised. Their recognition is regulated in §§ 343 and 352 InsO. Articles 19 and 32 *et seq* of the EIR apply in relation to other EU Member States.

The recognition of the decision to open proceedings of a foreign court has already been considered and explained. Under § 343(2) InsO the same applies to security measures that were

[195] *Landesgericht Korneuburg*, 2.1.2018 – 36 S 5/18d-3, ZIP 2018, 393.

reached after the application to open proceedings, as well as for decisions that were met for the continuation or termination of the proceedings. If a decision is not covered by § 343 InsO, §353 InsO and § 722 *et seq* ZPO apply: a legal action has to be made to determine the foreign decision as executable. Recognition requires that the decision to be recognised has become binding. The recognition will especially not be made when, according to §§ 723(2), 328(1) (No 1), (No 4) ZPO, the court that passed the decision did not, from the German perspective, have jurisdiction, or when the recognition would violate the German *ordre public*.

Cases where insolvency proceedings are opened in another EU Member State have also already been considered. The decision to open proceedings are to be recognised automatically.[196] All further decisions within such proceedings are also to be recognised automatically.[197] The only exception to this applies in cases where this would violate the *ordre public* in Germany.[198]

The effects of the opening of proceedings of a foreign court are fundamentally recognised following the judgment IX ZR 178/84 of the *Bundesgerichtshof* dated 11 July 1985. This decision was also codified by § 343 InsO, which came into force on 20 March 2003. For comparisons, please see above.

Self-Assessment Exercise 7

Question 1

Why is the principle of universality advantageous?

Question 2

Which requirements have to be fulfilled so that a foreign opening order will be accepted?

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

9. INSOLVENCY LAW REFORM

Currently, there are no reform proposals in the pipeline.

[196] EIR, Art 19.
[197] *Idem*, Art 32.
[198] *Idem*, Art 33.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

How many insolvency statues currently exist in Germany and what are their scope?

Question 2

Do the jurisdiction requirements encourage "good" decisions on the part of the courts within and outside of insolvency? Explain your decision.

Feedback and Commentary on Self-Assessment Exercise 1

Question 1

There is only one statute (the *Insolvenzordnung*) which applies to all kinds of debtors and is applicable to liquidation as well as the restructuring of insolvent entities.

The StaRUG (the *Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen* - Act on the Framework for Stabilisation and Restructuring of Enterprises) is not an insolvency statute, since it deals with pre-insolvency restructuring (although its application requires imminent inability to pay mature debts).

Question 2

Yes. Outside of insolvency proceedings, easier cases are heard in "smaller" courts and complex cases are heard by courts which are staffed with multiple judges. Furthermore, county courts (*Landgerichte*) are staffed with specialised chambers in which specialised knowledge is pooled.

Within insolvency proceedings, structures are also in place through which such specialised expertise with regards to insolvency matters is pooled. Each region of a *Landgericht* generally only contains one *Amtsgericht* which has jurisdiction for the entire region of the Landgericht so that one judge is primarily responsible for all insolvency matters within the region and is thereby able to acquire a high level of experience.

Self-Assessment Exercise 2

Question 1

How would you secure your claim if you had the free choice from the position of the creditor? Choose one personal and one real security and explain your reasoning.

Question 2

Why was the concept of ownership by way of security developed, when pledges already provide a real security for movable objects?

Feedback and Commentary on Self-Assessment Exercise 2

Question 1

With regards to personal securities, the type of security chosen is less decisive. The crucial element is rather the liquidity of the guarantor of the security. As security rights are primarily intended to protect in the case of insolvency, it must be ensured that the debtor and the guarantor are not directly dependent on one another. If a subsidiary company acts as a securities guarantor for a parent company, it does not protect in case of insolvency if the subsidiary company is also pulled into insolvency along with it because in that case the claim against the subsidiary would also only be satisfied on a pro rata basis. If a free choice is possible, the guarantee is probably the best personal security as the claim against the guarantor is completely separated from the secured right.

Retention of title is the most profitable real security for the creditor. With respect to the right to recover, the creditor is not an insolvency creditor, § 47 InsO. From this follows that the realisation of the asset is incumbent upon the creditor although the asset itself is in the possession of the debtor (or the insolvency administrator). Moreover, this has the advantage that the proceeds of realisation are available for the full satisfaction of the claim for the disposition (in contrast to separate satisfaction, c.f. § 171 InsO). However, retention of title is only available for suppliers. All other creditors, particularly banks, must be content with other securities. Here, transfer of title by way of security is preferable regarding movables and the *Grundschuld* is preferable regarding immovables. Although they grant a right to separate satisfaction only, both are not of an accessory nature and therefore relatively stable.

Question 2

The granting of a pledge requires the transfer of possession and the consequent retention thereof, §§ 1205, 1253 BGB. Often, the borrower requires the collateral object to allow him to make profits, out of which the credit can be repaid. This would not be possible without possession of the collateral object. Furthermore, the pledge is connected with high costs on the part of the creditor (bank) as all collateral objects must be stored (see § 1215 BGB). Ownership by way of security overcomes all of these negative aspects.

Self-Assessment Exercise 3

Question 1
Present the statements from the last chapter that have positive impacts on the insolvency estate. Give a short justification for your answer.

Question 2

Name and define the different reasons to open insolvency proceedings.

Commentary and Feedback on Self-Assessment Exercise 3

Question 1

Insolvency proceedings can be opened with a mere imminent insolvency. If proceedings are opened early, there is regularly more available insolvency estate.

In the case of bilateral contracts which have not been entirely fulfilled by either party, the insolvency administrator has an option to choose fulfilment of the obligations. This allows for only advantageous contracts to be wound up which has positive impacts on the insolvency estate.

Through the introduction of debtor-in-possession proceedings (§§270 et seq. InsO), it has become possible to utilise the expertise of the insolvency debtor for the continued benefit of the insolvency estate.

The insolvency court can, per §21 InsO, allow a number of measures to avoid the creation of disadvantages for the insolvency estate during the opening proceedings.

§§129 et seq. InsO allow disadvantageous actions made close to the opening of proceedings to be reversed.

Question 2

§17 InsO (inability to pay debts as they fall due / cash flow insolvency / illiquidity): "The debtor shall be deemed illiquid if he is unable to meet his mature obligations to pay. Insolvency shall be presumed as a rule if the debtor has stopped payments." (§17(2)(2) InsO).

§18 InsO (imminent inability to pay debts): "The debtor shall be deemed to be faced with imminent insolvency if he is likely to be unable to meet his existing obligations to pay on the date of their maturity." (§18(2)(1) InsO).

§19 InsO (overindebtedness): "Overindebtedness shall exist if the debtor's assets no longer cover his existing obligations to pay, unless it is highly likely, considering the circumstances, that the enterprise will continue to exist over the next twelve months." (§19(2)(1) InsO).

Self-Assessment Exercise 4

Question 1

What main differences arise between corporate insolvency and bankruptcy proceedings over a natural person?

Question 2

In which article is the duty mentioned to request insolvency proceedings in companies?

Commentary and Feedback on Self-Assessment Exercise 4

Question 1

Overindebtedness is a further reason to open insolvency proceedings, applicable for legal persons only (§19 InsO).

The directors of a legal person have an obligation to file for liquidation (§15a InsO).

After a proceeding over the estate of a legal person or a company without legal personality it will be dissolved (according to the relevant company law).

Neither consumer insolvency proceedings nor discharge of residual debts are available for companies.

Question 2

§ 15a InsO.

Self-Assessment Exercise 5

What are the advantages of an insolvency plan?

Commentary and Feedback on Self-Assessment Exercise 5

In an insolvency plan, the participants can use all private law mechanisms to facilitate relief for the insolvency debtor, thereby especially a business rescue becomes possible. Debts can be written off or replaced through a debt-equity swap, in both cases the liabilities are reduced. The choices are made through majority decisions which are binding upon all, if especially the provisions for the protection of minorities being followed.

In practice, it is not uncommon for individual creditors to "block" a plan through refusing their approval in the hopes of their claims being fully satisfied (in most cases, these have been cheaply bought shortly beforehand). German law tries to fight this phenomenon by an "obstruction ban". In the abstract, in every group of the plan both majority in value and a majority in number must be achieved, §244 InsO. However, if the necessary majorities are not reached, acceptance is presumed (§245 InsO) when the following three prerequisites are present:

the members of such a group are likely not to be placed at a disadvantage by the plan compared with their situation without a plan;
the members of such a group participate to a reasonable extent in the economic value devolving on the parties under the plan (which includes the "absolute priority rule", that is, that no lower ranking creditors participate in the proceeds unless all higher ranking claims are fully satisfied);
the majority of the voting groups have backed the plan with the necessary majorities.

Self-Assessment Exercise 6

Question 1

Which question is central, when problems of international insolvency law need to be solved?

Question 2

Why did the German insolvency administrator approve the opening of the Austrian proceedings in the NIKI case?

Commentary and Feedback on Self-Assessment Exercise 6

Question 1

The most important question is where the debtor has their centre of main interests. The answer determines in which jurisdiction the insolvency proceedings are opened and, consequently, the applicable law (*lex fori concursus*).

Question 2

Even when the German insolvency administrator is of the opinion that the COMI is in Germany, every day of continued legal uncertainty costs enormous amounts of money. While it remains unclear in which country the proceedings are to be opened, it also remains unclear under which law the sale of the company can be made. Every day of company deadlock comes hand in hand with major losses of profit leading to the reduction of the sale price of the company. In such a case, it would therefore be advantageous for all parties to gain legal certainty as quickly as possible, as otherwise, there may be little left of the assets which could have been distributed through German insolvency proceedings.

Self-Assessment Exercise 7

Question 1

Why is the principle of universality advantageous?

Question 2

Which requirements have to be fulfilled so that a foreign opening order will be accepted?

Commentary and Feedback on Self-Assessment Exercise 7

Question 1

The alternative to the principle of universality is the principle of territoriality. If the principle of territoriality were applicable, then the effects of the insolvency proceedings would only apply to the assets which are situated within the country which has opened the proceedings. To gain the full advantages of an insolvency proceeding over the entirety of the debtor's estate, insolvency proceedings would have to be opened in every state in which assets are situated. This would give rise to high procedural costs and a number of insolvency administrators are appointed which all have differing competences and represent differing interests (the largest possible insolvency estate for their own proceedings). This would give rise to conflicts which would impact negatively on the entirety of the insolvent estate. Specifically the rescue of the business and its continuation would be considerably hindered through the application of the principle of territoriality.

Question 2

On the one hand, it is required that the foreign court has jurisdiction (§§ 343(1)(No. 1) InsO/Art. 19, 3 EIR) and on the other hand, that the *ordre public* is not breached (§ 343(1)(No.2) InsO/Art. 33 EIR).

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