This country-specific Q&A provides an overview to restructuring & insolvency laws and regulations that may occur in Germany.

For a full list of jurisdictional Q&As visit here
1. What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?

**Securities over immovable property**

There are two alternative instruments to charge real estate as collateral:

- Mortgage (*Hypothek*)
- Land charge (*Grundschuld*)

Differences: While the land charge simply determines a specific amount to be paid out of the real estate, the mortgage is accessory to a specific secured payment claim. The mortgage thus elapses with the satisfaction of the secured claim and transfers together with the secured claim in case of an assignment. Therefore, the land charge is more flexible and the most common security instrument regarding real estate.

Generally speaking, any type of collateral over immovable property requires registration with the land register (*Grundbuch*). The security is void if it is not registered. Such registration requires a notarized authorization by the owner. If the collateral is registered as certificated, the completion of the security also requires the owner to hand over the certificate. Usually the secured party also requests that the real estate owner submits to immediate enforcement of the encumbrance by way of a notarial deed; otherwise, the secured party requires a judgement or other enforcement title in order to enforce its security.

**Securities over movable property and receivables:**

The retention of title right (*Eigentumsvorbehalt*) allows a seller to retain title over the respective movable property as security for its claims until the agreed secured claims have been settled. The seller and purchaser must agree on the retention of title right in the purchase agreement. Depending on the specific structure, the retention of title right can provide a right for segregation of the relevant asset if the purchaser becomes insolvent.

Transfer of ownership by way of security of movable property (*Sicherungsübereignung*) is the most common type of security over movable property, because the debtor / buyer may retain the possession of the movable asset and keep using and producing with it. Such arrangement requires both a transfer agreement and a security purpose agreement. Moreover, the assets serving as security must be clearly identifiable.

The (chattel) pledge (*Faustpfandrecht*) regarding movable property is less common, as the possession of the asset must not remain with the debtor. This arrangement requires a pledge agreement and the transfer of possession of the movable property, and the security is accessory to a specific secured payment claim.
The assignment of receivables for security purposes (Sicherungsabtretung) is an arrangement whereby security is granted over receivables owed to the debtor.

Receivables may also be pledged for security purposes. Such arrangement is less common, because- in contrast to security assignments, – third parties must be notified of the pledge in order to complete this security. Moreover, this arrangement is not practicable for rolling receivable portfolios.

Other transferable rights may be pledged, and the specifics depend on the nature of the right. For example, pledges over shares in a German limited liability company (GmbH) are only valid if notarized.

2. What practical issues do secured creditors face in enforcing their security (e.g. timing issues, requirement for court involvement)?

**Immovable property with encumbrances**

Encumbrances of immovable property can be enforced by means of

- Sale of the real estate through a public auction (Zwangsversteigerung),
- The real estate being mandated under forced administration (Zwangsverwaltung) or,
- Freehand sales (if agreed upon by the collateral provider and collateral taker).

**Public auction**

In the case of a sale by public auction, several procedural prerequisites must be met. The first is the submission of a request of enforcement to the district court as the enforcement court (Vollstreckungsgericht). In most cases it takes at least two auction dates to sell the real estate because the minimum bid for the first auction date corresponds to 50% of the real estate’s market value. The cost incurred by the auction proceedings are to be paid from the proceeds.

**Mandating the real estate under forced administration**

Upon application of a secured creditor or the insolvency administrator, the enforcement court will appoint an administrator (Zwangsverwalter) to manage the real estate, in particular by collecting rental charges. The revenue gained in this manner, less administrative costs, serves to satisfy the secured creditor.

**Freehand sale**

The parties involved remain under no obligation to act according to the relatively strict
regulations applicable to public auctions and forced administration and can also agree on a freehand sale. Doing so is often in the best interest of all parties, because a freehand sale can result in a significantly higher purchase price.

**Movable property and receivables**

Prior to the opening of insolvency proceedings, collateral holders can enforce their collateral dependent on the respective Security Purpose Agreement (*Sicherungsvereinbarung*) by either selling the property or enforcing the receivable against the respective debtor.

When a debtor files for insolvency, the insolvency court can issue orders preventing secured creditors from realizing their security over movable property in the debtor’s possession. After the opening of insolvency proceedings, only the insolvency administrator is authorized (i) to sell encumbered movable property that is in his or her possession and (ii) to collect claims that have been assigned as collateral. The proceeds of such enforcement will be paid out to the secured creditor up to the secured claim and minus statutorily fixed costs of the estate corresponding 9% of the proceeds.

3. **What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency procedures upon the debtor becoming distressed or insolvent? Are there any consequences for failure to do so?**

There are three independent tests that determine whether a debtor can file for the opening of insolvency proceedings:

- **Illiquidity** (*Zahlungsunfähigkeit*): A debtor is illiquid if it is unable to honor its due payment obligations. According to exceptions set out by the Federal Court, a debtor shall not be regarded as illiquid (i) when it is unable to pay less than 10% of his aggregate liabilities unless it is foreseeable that the shortfall will exceed 10% in the near future, or (ii) if the debtor’s illiquidity can with some certainty be cured within a very short period of time (three weeks).
- **Over-indebtedness** (*Überschuldung* – only applicable to legal entities / partnerships which have no natural person as personally liable partner): A debtor is over-indebted if its assets (at liquidation value) no longer cover its existing payment obligations, unless it is predominantly likely, considering the circumstances, that the enterprise will continue to exist. Hence, even if the balance sheet test is negative, a debtor is not obligated to file for insolvency as long as the continuation of the company’s main business is predominantly likely (*positive going concern prognosis/positive Fortführungsprognose*). The prognosis is mainly based on (i) a sound liquidity plan for the current and following fiscal year and (ii) the existence of a conclusive business plan.
- **Impending illiquidity** (*drohende Zahlungsunfähigkeit*): A debtor is considered to be facing impending illiquidity if it is likely to be unable to meet its existing payment obligations on the date of their maturity.
Managing directors have a personal duty to file for insolvency within three weeks at the latest, if the entity/partnership (which has no natural person as personally liable partner) is illiquid or over-indebted, in accordance with the criteria set forth above. A breach of this obligation results in severe personal civil and criminal liability risks (see Question 14). In the event that a company with limited liability has no management, each shareholder, and in the event that a stock corporation or a cooperative has no management, each member of the supervisory board, is obliged to file an application for the opening of insolvency proceedings unless such person was unaware of the company’s illiquidity and over-indebtedness or lack of management.

Note: In case of impending illiquidity, management has the option, but not an obligation to file for the opening of insolvency proceedings.

4. **What insolvency procedures are available in the jurisdiction? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?**

The German Insolvency Code provides a single procedure for both liquidation and restructuring measures. Insolvency proceedings generally comprise two stages: (i) the preliminary insolvency proceedings between the insolvency filing and the actual opening of insolvency proceedings by respective court order, and (ii) the opened insolvency proceedings. These stages can be combined with several tools meant to facilitate restructurings: the debtor-in-possession (“DIP”) proceedings (Eigenverwaltung), the protective shield proceedings (Schutzschirmverfahren) and the insolvency plan proceedings (Insolvenzplanverfahren) (see Question 8). **Preliminary Insolvency Proceedings** The preliminary insolvency proceedings are initiated if a debtor or one of its creditors files for the opening of insolvency proceedings. After the insolvency court examined the petition for admissibility and substance, the court will order the commencement of preliminary insolvency proceedings and take measures to protect the creditors against harm to the estate, primarily by (i) appointing a preliminary insolvency administrator or monitor (in the case of debtor-in-possession or protective shield proceedings), and (ii) preventing the debtor from transferring assets without the preliminary insolvency administrator’s consent. The Federal Employment Agency (Bundesagentur für Arbeit) will cover employees’ wages for up to three months before the opening of insolvency proceedings – the so-called insolvency protection payments (Insolvenzgeld), and it is usually in the estate’s best interest to fully use these funds. Therefore, preliminary insolvency proceedings usually take up to three months (see Question 9). **Regular insolvency proceedings** After the preliminary insolvency administrator submits a report of the debtor’s state of affairs (inter alia confirming the insolvency and sufficient funds to cover the costs of the proceedings), the insolvency court will issue an order opening the regular insolvency proceeding. As of that point in time, the debtor is no longer entitled to manage and dispose of its assets. Instead, that power is vested in the (final) insolvency administrator, who is appointed uno actu and typically the preliminary administrator. The court also determines the date of the first creditors’ assembly (Gläubigerversammlung), which should take place within six to eight weeks after the opening of the insolvency proceedings. At the first creditors’ assembly, the insolvency administrator will report on the debtor’s economic situation and its causes. He or she will
assess the prospects (if any) of maintaining the debtor’s enterprise as a whole or in part, indicate the possibility of drawing up an insolvency plan, and describe how each solution will affect the creditors’ satisfaction. The first creditors’ assembly shall decide whether the debtor's enterprise should be closed down or temporarily continued. The assembly may commission the administrator to draw up an insolvency plan, and may determine the plan’s objective for the administrator. Unless insolvency plan proceedings are pursued, most proceedings result in the liquidation of the debtor’s assets, ideally by selling the debtor’s business as a going concern by way of an asset deal (Übertragende Sanierung). In regular insolvency proceedings, it usually takes several years for the process of asset liquidation and distribution of the insolvency quota among the (unsecured) creditors to be completed. Self-administration proceedings, protective shield proceedings and insolvency plan proceedings involve variations in the abovementioned processes. For more information, see Question 8.

5. **How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities)? Could the claims of any class of creditor be subordinated (e.g. equitable subordination)?**

The German Insolvency Code provides the following ranks from senior to junior:

1. **Third party owners/creditors with segregation rights**, i.e. the owners of assets that do not belong to the estate. Such assets have to be surrendered to their owners.
2. **Costs of the proceedings**, i.e. the court costs and costs of the (preliminary) insolvency administrator.
3. **Other liabilities of the estate** (Masseverbindlichkeiten) created in the course of the insolvency administration, for example pursuant to contracts entered into by the insolvency administrator after the opening of insolvency proceedings.
4. **General and secured insolvency claims** in existence prior to the opening of the insolvency proceedings (Insolvenzforderungen). General insolvency claims are those existing prior to the opening of insolvency proceedings. These claims receive an insolvency quota of the proceeds generated by the liquidation of the debtor’s assets, and by realization of claw-back rights and other claims of the estate, after satisfaction of the senior ranking costs of the proceedings and the estate’s other liabilities. **Secured claims** are also general insolvency claims, but such creditors are entitled to a preferred satisfaction from the proceeds of the realization of their collateral. To the extent they remain unsatisfied after the preferred satisfaction, they are treated the same as other creditors with general insolvency claims.
5. **Subordinated creditors**: Pursuant to Sec. 39 Insolvency Code, certain claims, in particular, certain claims for the repayment of shareholder loans and claims corresponding in economic terms to such loans as well as claims that the creditor and debtor agreed to be subordinated, are subordinated by operation of law and shall be satisfied after the claims of other insolvency creditors.
6. **Shareholders**: Any remaining surplus after satisfaction of all creditors shall remain with the debtor or be distributed to the shareholders of a debtor that is a legal entity automatically dissolved by the insolvency and not continued by an insolvency plan.

6. **Can a debtor’s pre-insolvency transactions be challenged? If so, by whom, when and**
on what grounds? What is the effect of a successful challenge and how are the rights of third parties impacted?

1. General requirements
   According to German law, any transaction or action that harms the creditors as a whole, and which has been executed within certain hardening periods of up to 10 years prior to or after the filing of the petition for the opening of insolvency proceedings, could potentially be subject to contestation/claw-back rights which are executed by the insolvency administrator (or the insolvency monitor in the case of self administration/DIP proceedings). Voidable “action” is understood in the broadest sense, including, e.g., the granting of collateral or satisfaction, as well as the omission to sue, claim or defend in court. An action is detrimental to the creditors if it leads to a direct or indirect reduction of the value of the debtor’s estate, or to a complication regarding the enforcement of the estate’s rights.

2. Specific grounds of contestation materialized
   In addition to these general requirements, a specific ground of contestation must be realized. Such specific grounds are: Congruent coverage, Sec. 130 Insolvency Code (Kongruente Deckung)
   Pursuant to Sec. 130 Insolvency Code, fulfilling a debt, granting collateral or enabling the other party to seize such fulfillment or collateral can be challenged if the action in question was committed up to three months prior to the filing of the opening petition, the company had been illiquid at that time, and the counterparty was aware of that state of illiquidity.

   Incongruent coverage, Sec. 131 Insolvency Code (Inkongruente Deckung)

   In contrast, a coverage is deemed incongruent, when a creditor receives something other than agreed upon, according to the (initial) contractual agreement, for example, a granting of collateral or premature satisfaction of a claim, or the creation of a set-up situation that has not been owed. Such actions can be challenged, if they were undertaken (i) during the month prior to the date of the application for commencement of insolvency proceedings or following such application, (ii) within the second or third month prior to the date on which the application for commencement of insolvency proceedings is filed and the debtor was illiquid when the act took place or, (iii) within the second or third month prior to the date on which the application for commencement of insolvency proceedings is filed and the creditor was aware when the act took place that it would prejudice the insolvency creditors.

   Detrimental actions, Sec. 132 Insolvency Code

   Any action on the part of the debtor constituting a direct disadvantage to the creditors may be contested if it was taken (i) during the last three months prior to the insolvency filing, if the debtor was illiquid at the date of such transaction, and if the other party was aware of the insolvency on that date, or (ii) subsequent to the insolvency filing if at the time the legal transaction was made the other party was aware of either the insolvency or of the request for the opening of insolvency proceedings.
Legal acts of willful detriment to the insolvency creditors, Sec. 133 Insolvency Code (Vorsatzanfechtung)

Pursuant to Sec. 133 Insolvency Code, a prerequisite for contestation is that the debtor acted with the intent of impairing its creditors, and that the counterparty was aware of such intent. Sec. 133 Insolvency Code allows for the challenge of a transaction made by the debtor not more than 10 years prior to the filing of the insolvency petition. In the case of actions granting security or satisfaction to the counterparty, this hardening period is shortened to four years.

Granting of gratuitous services, Sec. 134 Insolvency Code

The granting of performances free of charge, falls under the scope of Sec. 134 Insolvency Code, and can be clawed-back up to four years before the filing for insolvency proceedings.

Shareholder loans, Sec. 135 Insolvency Code

Payments the debtor made in order to repay a shareholder loan (or equivalent claim) within one year prior to the filing for the opening of insolvency proceedings can be challenged. The same applies vis-à-vis the shareholder, if a third party loan secured by a shareholder was repaid by the debtor within the one year period.

3. Exemption from voidance in cases of cash-transaction (Bargeschäft, Sec. 142 Insolvency Code) If an action constitutes a so-called privileged cash transaction as defined by Sec. 142 Insolvency Code, it can be challenged only in accordance with Sec. 133 Insolvency Code provided that the other party recognized that the debtor acted unfairly. A privileged cash transaction requires (i) that performance and consideration be equivalent in value (Gleichwertigkeit) and (ii) a close time connection (Unmittelbarkeit) between performance and consideration, such that they are deemed linked.

4. Consequence in law, Sec. 143 Insolvency Code In the case of a successful contestation, everything received from the debtor’s estate pursuant to the challenged transaction(s) must be restituted to the insolvency estate. The insolvency estate only has to return the consideration/values received if such are still identifiable and available in the estate (which is rarely the case).

7. What form of stay or moratorium applies in insolvency proceedings against the continuation of legal proceedings or the enforcement of creditors’ claims? Does that stay or moratorium have extraterritorial effect? In what circumstances may creditors benefit from any exceptions to such stay or moratorium?

After the opening of insolvency proceedings, general claims in regard to the estate cannot be pursued by suing. Instead, a creditor must register its claims with the insolvency
As of the opening of insolvency proceedings, legal proceedings regarding the debtor’s estate are suspended until (i) the administrator resumes such proceedings or (ii) the insolvency proceedings are terminated.

The same is true for enforcement of claims regarding the estate which are also suspended for the duration of the insolvency proceedings (Sec. 89, 90 Insolvency Code). Only creditors that can show that the respective asset does not belong to the estate on grounds of a right of segregation (Aussonderungsrecht, Sec. 47 Insolvency Code) may enforce their claim during insolvency proceedings.

The enforcement of title in immovable property that is encumbered with a mortgage or land charge is not blocked during insolvency proceedings, unless the insolvency administrator successfully files for a stay of enforcement according to Sec. 30d, 153b ZVG.

Creditors may benefit from such stay as individual creditors are not permitted to access the insolvency estate to the detriment of other creditors.

Pursuant to the rules of the European Insolvency Regulation 2015/848 and Sec. 335 Insolvency Code, German insolvency law, including, without limitation, the aforementioned stay does have extraterritorial effect.

8. **What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play?**

**Debtor-in-possession (“DIP”) proceedings (Eigenverwaltung)**

The debtor may apply for insolvency proceedings in the form of DIP proceedings (Eigenverwaltung), particularly, if it wants to implement a restructuring plan. The insolvency court will adopt such motion (after consultation with an existing (preliminary) creditors’ committee) if there is no reason to expect that such DIP management would place the creditors at a disadvantage. In light of this requirement, the debtor’s management is regularly supplemented or supported by experienced restructuring experts. The DIP i.e., the management of a debtor, which is a legal entity must assume the position of an otherwise appointed (preliminary) insolvency administrator. The DIP must comply with insolvency laws. In particular, it must honor the creditors’ interests. The court always appoints an insolvency monitor (Sachwalter), rather than an insolvency administrator, to verify the debtor’s economic situation and monitor the management of its business, among other things.

The debtor normally applies for DIP proceedings when it files for the opening of insolvency...
proceedings (so-called preliminary DIP proceedings) as the debtor thus is able to prepare the restructuring in line with its plans from the very beginning.

**Protective shield proceedings (Schutzschirmverfahren, Sec. 270b Insolvency Code)**

A variation on application for DIP management during the preliminary insolvency proceedings is the application for so-called protective shield proceedings (Schutzschirmverfahren). Such application must be accompanied by an expert’s certification, with grounds, that offers evidence (i) that the debtor faces imminent insolvency or over-indebtedness but is not already illiquid, and (ii) that the intended restructuring does not manifestly lack the prospect of success. In practice, the main advantage of protective shield proceedings is that the debtor can propose a preliminary insolvency monitor (vorläufiger Sachwalter) and the court may only deviate from the proposal, if the debtor’s selection is manifestly unsuited to the office. A debtor may also benefit from the opportunity to call the proceedings protective shield proceedings, by hiding the fact that it filed for insolvency and reassuring stakeholders.

**Insolvency plan proceedings**

An insolvency plan can be a very flexible tool that allows deviation from the standard liquidation rules of the insolvency code. For example, an insolvency plan can provide for (i) the restructuring of the debtor itself, rather than its liquidation; (ii) a debt-for-equity swap, share transfer and other corporate transactions; and (iii) an alternative satisfaction of the creditors, such as through future profits rather than liquidation proceeds. An insolvency plan can be used in order to achieve higher and faster pro rata satisfaction of creditors and a much quicker termination of the insolvency proceedings often within months.

Both the debtor and the insolvency administrator (if there are no DIP proceedings) are entitled to submit an insolvency plan to the insolvency court, which will check the plan for completeness, economic conclusiveness/comprehensiveness and several formalities.

The insolvency plan must reasonably define groups of creditors of similar interests/rights, and these groups in turn must approve the insolvency plan in a creditors’ meeting. A group of creditors is deemed to have approved the insolvency plan if its majority – according to both headcount and debt amount – consents to the plan.

If the majority of the creditor groups consent to an insolvency plan, a dissenting creditor group can be overruled if (i) its creditors are not likely to be worse off under the provisions of the insolvency plan, and (ii) they are adequately participating in the economic value devolving on the parties under the insolvency plan.

The insolvency court must confirm the final insolvency plan once it has been approved by the creditors. The court may refuse such approval, if a creditor that is likely to be worse off under
the plan objects to the plan. As soon as the final insolvency plan is confirmed, and unless the insolvency plan provides otherwise, the insolvency court shall decide on the termination of the insolvency proceedings.

**Bond restructuring**

The German Bond Act (*Schuldverschreibungsgesetz*) provides rules for an out-of-court restructuring of German bonds. Apart from that, there exists not yet a formal out of insolvency restructuring process in Germany.

9. **Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?**

An insolvency plan may provide a lower ranking status for existing insolvency creditors compared to creditors with entitlements deriving from loans or other credits entered into by the debtor or the takeover company during the period of a monitored insolvency plan. The German Insolvency Code does not provide for any other special priority rights for new financing. In particular, German law does not allow for subordination of secured creditors vis-à-vis fresh money providers regarding existing collaterals.

During the preliminary insolvency proceedings, the operations of the debtor are typically financed out of the available funds. This is further facilitated by the fact that the debtor can avoid paying salaries for up to three months preceding the opening of insolvency proceedings as those salaries are funded (up to a certain ceiling) by the Federal Employment Agency (*Bundesagentur für Arbeit*).

After the insolvency proceedings have been opened, repayment claims pursuant to loan agreements entered into by the DIP or the insolvency administrator constitute debts of the estate (*Masseverbindlichkeiten*), which rank higher than regular insolvency claims (see Question 5) during the insolvency proceedings.

10. **Can a restructuring proceeding release claims against non-debtor parties (e.g. guarantees granted by parent entities, claims against directors of the debtor), and, if so, in what circumstances?**

German insolvency law does not provide for a release of non-debtor parties without the beneficiary’s consent. Sec. 254 para. 2 Insolvency Code expressly states that an insolvency plan must leave unaffected the rights entitling the insolvency creditors against the debtor’s co-obligors and guarantors, as well as the rights of such creditors to objects not forming part of the insolvency estate. The plan shall, however, discharge the debtor of its co-obligor’s, guarantor’s and any other redressing party’s claims against it in the same way as it is discharged of the insolvency creditors’ claims. Against this background, non-debtor parties who assumed the position as co-obligor/guarantor may have to file for insolvency in order to
deal with this issue in corresponding insolvency plans.

11. **How are existing contracts treated in restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any ability for either party to disclaim the contract?**

**Executory contracts**

If the debtor and another party did not perform, or perform completely, a mutual contract at the date the insolvency proceedings were opened, the insolvency administrator may perform such contract, replacing the debtor and claiming the other party’s consideration. If the administrator refuses to perform such contract, the other party shall be entitled to its claims for non-performance only as an insolvency creditor. Contractual clauses excluding or limiting this election right of the debtor shall be void. If the other party requires the administrator to opt for performance or non-performance, the administrator shall state his or her intention to claim performance without undue delay. If the administrator does not give a statement, he or she may no longer demand performance.

The election right of the debtor set forth above is excluded or restricted by more specific rules for (i) certain fixed-date financial market transactions (ii) real estate transactions protected by priority notices (Vormerkung), (iii) real estate leases and (iv) service and employment agreements.

**Retention of title rights**

If before the insolvency proceedings were opened, the debtor sold a movable asset while retaining title and transferring its possession to the purchaser, the purchaser may claim performance of the sales contract.

If before the insolvency proceedings were opened, the debtor purchased a movable asset in which the seller retained title, and the seller transferred possession of such asset to the debtor, the seller has a right to withdraw such asset from the estate without paying fees, if the insolvency administrator opts for the non-performance of the underlying purchase agreement. However, the insolvency administrator is entitled to execute its election right only after the first creditors’ assembly (Berichtstermin), unless a considerable reduction in the value of the movable asset is to be expected and the creditor has notified the administrator of this circumstance.

**Set-off rights**

If a creditor had a right to set off a claim on the date the insolvency proceedings were opened, such right shall remain unaffected by the proceedings unless, among other things,
an insolvency creditor has become an obligor to the insolvency estate only after the opening of the insolvency proceedings; (ii) an insolvency creditor acquired its claim from another creditor only after the opening of the insolvency proceedings; (iii) an insolvency creditor acquired the opportunity to set off its claim by a transaction that is subject to contestation; and/or (iv) a creditor with a claim to be satisfied from the debtor’s free property is an obligor to the credit of the insolvency estate.

12. What conditions apply to the sale of assets / the entire business in a restructuring or insolvency process? Does the purchaser acquire the assets “free and clear” of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted? Are pre-packaged sales possible?

The fate of the debtor shall not be determined prior to the opening of insolvency proceedings. Therefore, the disposal of assets beyond the debtor’s regular business/trade normally does not take place during the preliminary insolvency proceedings. However, the preliminary insolvency proceedings are often used to start a sales process. Thus, while German law does not provide for pre-packaged deals, pre-arranged deals that can be quickly implemented after the opening of insolvency proceedings are typical.

In regular insolvency proceedings, only the insolvency administrator is entitled to sell the debtor’s assets. In DIP proceedings such power vests in the debtor, but the insolvency court may order the debtor to obtain the consent of the insolvency monitor.

Internally, the insolvency administrator or the debtor-in-possession, respectively, shall obtain the consent of the creditors’ committee if he or she intends to engage in transactions of particular importance to the insolvency proceedings. If no creditors’ committee has been appointed, the administrator shall obtain the consent of the creditors’ assembly. In case of a sale to a person with a specific interest (e.g. a secured creditor or a person close to the debtor), the transaction shall require the approval of the creditors’ assembly.

The purchaser acquires the assets, including encumbered assets that the administrator is allowed to dispose of in accordance with Sec. 166 Insolvency Code (see Question 2) free and clear of third-party claims and liabilities. If the insolvency administrator erroneously sells assets that are subject to a right of segregation (Aussonderungsrecht, Sec. 47 Insolvency Code) and/or are not up for his or her disposal/collection, the purchaser only acquires the assets free and clear of claims and liabilities if the acquisition took place in good faith, according to Sec. 932 et seq. Civil Code. In such a case, the administrator may be held liable by the owner/beneficiary of the sold asset.

Under German law, any party may bid on pledged assets, including lenders or pledgees, in a public or private (freehand) sale process. However, German law does not provide for rules on non-cash credit bidding but requires (partially) debt payments in public auctions.
What duties and liabilities should directors and officers be mindful of when
managing a distressed debtor? What are the consequences of breach of duty? Is there any scope for other parties (e.g. director, partner, shareholder, lender) to incur liability for the debts of an insolvent debtor?

**Liability of managing directors**

The management of (i) a company limited by shares (Kapitalgesellschaft) and/or (ii) a partnership (Personengesellschaft) without a partner who is a fully liable natural person must be very mindful in entity crisis situations. In particular, they should try to solve the crisis as soon as possible, and must monitor the entity’s financial situation and potential insolvency very carefully. Management has general fiduciary duties vis-à-vis the entity and its shareholders until it must file for insolvency due to illiquidity or over-indebtedness.

Among other responsibilities, the management is required to inform the entity’s shareholders in due course. If an annual or any interim balance sheet of a company limited by shares shows that 50% or more of the registered share capital has been lost, the managing directors must call an extraordinary shareholders’ meeting without undue delay. A violation of this duty can constitute a criminal offence and trigger a personal liability for management. In case of an impending illiquidity, a shareholder resolution is required on whether the managers should file for the opening of insolvency proceedings.

Once a company limited by shares or a partnership without a partner who is fully liable natural person becomes illiquid or over-indebted (see Question 3), management must not make any payments (or certain similar reductions of the estate) unless such payments are compatible at that point in time with the due care of a prudent businessperson. A breach of this obligation triggers a severe personal liability for managers, as they must compensate the entity for such payments.

When a company limited by shares or a partnership without a partner who is a fully liable natural person becomes illiquid or over-indebted, each manager must file for the opening of insolvency proceedings without undue delay, and at the latest within three weeks. Managing directors who negligently or intentionally breach this filing obligation commit a criminal offense and are personally liable for damages that can be asserted by (i) the insolvency administrator regarding the damages incurred by creditors of the entity whose claim originated prior to the obligation to file for insolvency, and (ii) by each creditor whose claim originated thereafter.

With regard to liability to social security authorities, the German Criminal Code imposes sanctions on directors who intentionally refuse to pay social security contributions. The same applies to tax debts. The tax code provides for a personal liability of the managing director with regard to tax debts. Additionally, a criminal liability might be applicable. Not paying the employee portion of social security contributions is punishable pursuant to Sec. 266a Criminal Code, as is any action by the debtor that diminishes the debtor’s main assets or
obscures the actual development of the business in ways that clearly present a breach of business standards (no bookkeeping, dissipating money or squandering goods, falsifying balance sheets, etc.). If an entity is in a state of insolvency, or if such acts lead to bankruptcy, they are punishable by imprisonment up to five years.

Liability for fraud, especially crimes pertaining to insolvency, is allocated to directors who actually committed the crime or who were fully aware of the crime.

Liability of third parties

Other parties are not liable for the company's debts—provided there are no guarantees, contractual assumptions of liability or domination agreements. Third parties may, however, be held liable for the company's debts on grounds of tort. This applies, for example, to the shareholders of the debtor if they acted towards the company in a way that the German Federal Court calls exterminating interventions (Existenzvernichtender Eingriff), i.e., actions that eventually lead to the company failing the test for insolvency. The right of contestation also can lead to civil liabilities for third parties (see Question 6).

14. **Do restructuring or insolvency proceedings have the effect of releasing directors and other stakeholders from liability for previous actions and decisions?**

There is no such effect that directors or other stakeholders are generally released from liability for previous actions or decisions. On the contrary, during the course of the insolvency proceedings the insolvency administrators gather information specifically on the actions taken prior to their appointment, in order to examine what party or stakeholder may have induced or catalyzed the debtor's distress for their own benefit and/or to the detriment of the estate or other parties. Furthermore, an insolvency plan may not stipulate waivers in regard to the personal liability of directors towards the company for breaching their duties.

15. **Will a local court recognise concurrent foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition? Has the UNCITRAL Model Law on Cross Border Insolvency or the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments been adopted or is it under consideration in your country?**

The opening of insolvency proceedings by a competent court in an EU member state shall be recognized in all other EU member states (Article 19 European Insolvency Regulation 2015/848) to the extent the effects of such recognition violate German public policy (ordre public) (Article 33 EU Regulation 2015/848).

The opening of insolvency proceedings in other states is automatically recognized in Germany without formal proceedings, unless (i) the court of the state opening the proceedings is not competent pursuant to German law or (ii) the recognition leads to results that are obviously
incompatible with major principles of German law, particularly basic rights.

The UNCITRAL Model Law on Cross Border Insolvency has not been adopted in Germany and such adoption is currently not under consideration. The standards of German international insolvency law are similar to the standards of European Insolvency Regulation 2015/848 and thus are more liberal than the UNCITRAL rules.

16. **Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction?**

Pursuant to Article 3 of the European Insolvency Regulation 2015/848, the courts of the EU member state in the territory where the center of the debtor's main interests (COMI) is situated shall have jurisdiction to open insolvency proceedings. Thus, a debtor incorporated in another EU member state can file for the opening of insolvency proceedings in Germany. The COMI is the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. In the case of a company or legal person, the place of the registered office shall be presumed to be the COMI in the absence of proof to the contrary, unless the registered office was moved to another EU member state during the preceding three months.

Pursuant to Sec. 3 Insolvency Code (analogue application), German jurisdiction also applies to a foreign debtor that is not incorporated in another EU member state but has its COMI in Germany.

Please note that most German courts tend to be critical regarding forum shopping and assuming their own jurisdiction. Thus, an insolvency filing of a foreign debtor in Germany must be well prepared and should provide detailed information/reasoning regarding the German COMI / jurisdiction.

17. **How are groups of companies treated on the restructuring or insolvency of one of more members of that group? Is there scope for cooperation between office holders?**

“One debtor, one estate, one procedure“ – this characterizes one of the main principles of German insolvency law. Affiliated companies that are in distress and/or insolvent are generally liquidated or restructured in separate proceedings.

However, the Insolvency Proceedings of Corporate Groups Improvement Act (Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen) came into force in 2018 and allows for concentration of group insolvencies (at least for group companies with their COMI in Germany) in the same competent court, with the same judge and the same (preliminary) insolvency administrator.
In addition, so-called coordination proceedings (Koordinationsverfahren) have been enacted as an additional option for group insolvencies. In case different insolvency administrators or monitors have been appointed, these proceedings allow appointing a coordinator of proceedings (Verfahrenskoordinator) who can draw up a coordination plan for the group as a whole in order to ensure concerted restructuring or liquidation measures. In cross-border group insolvencies, the involved insolvency administrators often enter into so-called protocols which can serve a similar purpose.

These new German rules confirm and further facilitate what had been common practice in many insolvency proceedings regarding group companies anyway. They do not change the basic principle that the insolvency proceedings regarding one debtor have to achieve the best results for this debtor’s creditors.

18. Is it a debtor or creditor friendly jurisdiction?

On the one hand, German insolvency law is creditor friendly. As examples:

- Pursuant to Sec. 1 Insolvency Code, the main purpose of the German Insolvency Code is the joint satisfaction of the creditors.
- German law honors creditors’ security rights
- Creditors have a decisive role via the creditors’ assembly and the creditors’ committee (see Question 11) and can influence the outcome of the proceedings.

However, on the other hand, the German jurisdiction provides for rules which certainly allow debtors to restructure their business. In response to cases of forum shopping and political discussions at the EU level, German law has become more debtor friendly and this tendency will continue. In March 2019, the European Parliament adopted a directive on the preventive restructuring framework. The aim of this directive is to simplify corporate restructurings prior to an insolvency. After approval by the Council and publication in the Official Journal, the national legislators have two years to transpose the Directive into national law. The German transposition of this directive will most likely lead to a more debtor friendly pre-insolvency restructuring. However, any such pre-insolvency restructuring will finally also require the majority vote of the involved creditor classes.

19. Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the state play in relation to a distressed business (e.g. availability of state support)?

Generally the state does not influence the affairs of a private company in distress in the course of a liquidation or restructuring and remains in a neutral position in the vast majority of cases. However, as recent events and cases of companies in distress have shown (e.g. AirBerlin), the sociopolitical and economic significance of a company can cause the state to take action, by means such as granting new financing on short notice in order to avoid major
Distressed businesses can apply for state subsidies (subject to EU state aid control) or special situation loans backed by state-owned banks provided they can present a sound restructuring plan.

20. **What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?**

The German insolvency law has been consistently improved (most recently by new rules regarding group insolvencies (see Question 18) and been most recently officially reviewed by the federal government and legislator. The team of experts consulted by the Federal Government have come to the result that the improvements introduced have largely been perceived as positive in practice and that a return to the old law is not necessary. In particular, the insolvency plan procedure is essentially working well. The practical scope of application for plan solutions has expanded considerably. The experts’ report proposes amendments only in some minor respects. In particular, without limitation, the report suggests a higher concentration of insolvency courts particularly for restructuring proceedings and a higher specialisation as well as better education/preparation of insolvency judges regarding restructurings. Restructuring proceedings prior to insolvency or in the form of an insolvency plan proceedings frequently require the (partial) waiver of creditor claims that are not or not fully recoverable. Under the former German tax laws, such waivers triggered taxable profits. The German legislator reacted to this and – after carrying out the notification procedure of the European Commission – passed a law on the tax exemption of restructuring profits (§ 3a EStG). Thus, this barrier has also been removed in Germany recently.

Another barrier can constitute the fact that restructuring measures outside of insolvency proceedings sometimes fail due to the lack of approval by individual creditors. So far, interventions in creditors’ rights against their will are only permitted in insolvency proceedings which themselves trigger some disadvantages like the costs of the proceedings, the negative impact on the debtor’s reputation and its business. In this regard, however, an EU directive coming into force soon will lead to an improvement: The European Parliament adopted a “Directive on preventive restructuring frameworks, second chance and measures to improve the efficiency of restructuring, insolvency and asset relief procedures” in March 2019. The transposition of these rules into German law will allow for setting up a privy restructuring plan affecting only certain classes of creditors and taking restructuring measures based on a majority vote of the affected creditors at an early stage.