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Global Restructuring & Insolvency Guide

Germany

Overview and Introduction

The main objective of any insolvency in Germany is to satisfy all creditors of the insolvent debtor jointly and equally to the greatest extent possible. This can be achieved either by way of liquidation or by corporate restructuring. In an insolvency of an individual the individual's assets that are not protected from legal enforcement are used to satisfy the creditors and the individual may eventually be granted discharge from his residual debt.

Applicable Legislation

Insolvencies are mainly governed by the Insolvency Code ("*Insolvenzordnung*"; the "**IC**"), which applies regardless of which industry a debtor is in. In addition, special rules apply to certain financial sector institutions: some aspects of insolvency proceedings regarding credit institutions and insurance companies are governed by special provisions of the Act on Credit Institutions ("*Kreditwesengesetz*") and of the Act on the Supervision of Insurance Companies ("*Versicherungsaufsichtsgesetz*") respectively, modifying the rules of the IC, in particular by providing that only the German Federal Financial Supervisory Authority ("**BaFin**") has the right to apply for the opening of insolvency proceedings for these banks and insurers (and similar institutions). Furthermore, following the recent financial crisis, the financial sector has been subject to new legislation aimed at avoiding insolvencies of system-relevant credit institutions.

The German government has started to implement a thorough reform of important aspects of German insolvency law. The reform is divided into three packages.

The first package, which has already been implemented, is aimed at improving the framework for corporate restructurings in general, and in particular for banks. In December 2010, the German parliament enacted a law on the Reorganization of distressed banks ("*Restrukturierungsgesetz*"). Amongst the core elements of the new law is the introduction of a pre-insolvency Reorganization regime for credit institutions intending to support voluntary Reorganization efforts. In addition, the BaFin may take over control of credit institutions (via a special commissioner) and impose, inter alia, Reorganization schemes. When the existence of a system-relevant credit institution is threatened, the BaFin is further entitled to order a carve-out of system-relevant parts of the credit institution and a subsequent transfer of these parts to a new entity. The idea behind this new "good bank" model is to focus the restructuring efforts on the system-relevant parts of the credit institution. Another important aspect of the new law is the introduction of a Reorganization fund to be financed through mandatory contributions by credit institutions and used for recapitalisation measures of system-relevant banks.

As a further part of the first reform package, the "Law to Further Facilitate the Restructuring of Companies" ("*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*"; the "**ESUG**") came into force on March 1, 2012. The ESUG has substantially amended the Insolvency Code by increasing predictability of insolvency proceedings and offering new restructuring tools:

- Creditors have greater influence on the selection of the insolvency administrator.
- Timely filings for insolvency by debtors are rewarded by:
  - the insolvency court ordering that the proceedings will be run as debtor-in-possession proceedings (*Eigenverwaltung*);
  - a debtor's right to select a custodian merely supervising its actions instead of an insolvency administrator being appointed to take control;

    - the provision of a "protective shield" (similar to a moratorium) under which the debtor may work out its insolvency plan.

- Insolvency plan proceedings are improved by:
    - limiting legal remedies so that individual creditors can no longer block the insolvency plan;
    - providing for the possibility of including the insolvent company's shareholders in the plan so that a company may be restructured over their objection, without dissolution;
    - making debt-equity swaps possible, even if the insolvent company's shareholders do not consent;
    - mitigating statutory capitalisation rules in the event of a debt-equity swap.

The second reform package deals in particular with the insolvency of individuals, a key element of which is to improve individuals' access to discharge from their residual debt on their request. It came into force on July 1, 2014.

The third package will address specific challenges related to group insolvencies. In January 2014, the German government issued a bill whose core elements are described below (*Debtors: Insolvency of Legal Entities*).

Debtors

The subject of insolvency proceedings (i.e., the debtor) can be either an individual or any type of private law entity, be it a corporation or a partnership. Generally, also legal entities organized under public law are subject to insolvency proceedings. However, insolvency proceedings may not be opened with respect to the assets of (i) the Federation ("*Bund*"), (ii) any federal state ("*Land*"), or (iii) any legal entity organized under public law which is under the supervision of a federal state if the law of that federal state exempts the entity from insolvency proceedings.

Personal Insolvencies

Individual insolvencies are in principle governed by the same set of rules as insolvencies of legal entities, but with some substantial modifications.

To individuals who are pursuing an independent business activity, in principle the same rules apply as to legal entities. The main difference is that an individual may apply for a discharge of residual debt after completion of insolvency proceedings, provided that the individual himself has applied for the opening of the proceedings. Furthermore, the debtor needs to be eligible for discharge of residual debt or his application may be rejected by court order upon petition of any creditor. For instance, a debtor who has been finally convicted of a bankruptcy crime pursuant to sections 283−283c of the Criminal Code ("*Strafgesetzbuch*"), or who has substantially breached his information or cooperation duties during the insolvency proceedings, is not eligible for discharge of residual debt.

If the insolvency court orders a discharge of residual debt, then the debtor enters a compliance period during which he is under a duty to pursue a gainful activity or, if unemployed, seek acceptable employment. Any income of the debtor during the compliance period exceeding a minimum amount (which may not be seized) is used to satisfy the creditors. The debtor risks that discharge from residual debt will not be granted if he conceals any income from his creditors. Principally, the compliance period lasts for six years from the opening of insolvency proceedings. Within the second reform package, the compliance period of individuals to achieve a discharge is shortened from six to three years if the debtor pays 35 % of his debts and covers the costs of insolvency proceedings or is shortened to five years by settling the costs of the insolvency proceedings. Provided that the debtor complies with his duties during the compliance period, the court will order discharge from residual debt, with the exception of certain liabilities, such as, e.g., fines, certain tax liabilities, unlawfully withheld alimony or debt created by intentional tort.

Individuals who have not pursued an independent business activity must try an out-of-court debt adjustment before their own insolvency petition will be considered by the insolvency court. If on the other hand a creditor files for insolvency an attempt to an out-of-court debt adjustment is not necessary. If insolvency proceedings are eventually opened, the proceedings are somewhat simplified compared to regular insolvency proceedings. The same applies to individuals who have previously pursued an independent business activity, provided their financial situation appears easily manageable.

Insolvency of Legal Entities

Legal entities organized under private law are in general subject to insolvency proceedings, regardless of their corporate form and regardless of whether these entities are privately owned or state-owned. Legal entities under public law may be exempted from insolvency proceedings if applicable public law so provides. This exemption applies in particular to municipalities.

German law does not recognise the concept of group insolvencies. Therefore, if several entities of a group of companies file for insolvency, separate insolvency proceedings will be initiated for each entity. While this principle may not change when the third reform package will be implemented, the current bill issued by the German government contemplates instruments to better coordinate group insolvencies, in particular by concentrating the proceedings of the various group entities at one single court (*Gruppengerichtsstand*) and under the administration of one group administrator (*einheitlicher Insolvenzverwalter*). In addition, the bill provides for cooperation duties between insolvency administrators, insolvency courts and creditors' committees (*Kooperationspflichten*) and additional proceedings coordinating the individual insolvency proceedings by a coordination administrator (*Koordinationsverfahren*) to improve the handling of several company insolvencies in a group.

Typical insolvency proceedings in Germany involving a commercial business entity are divided in two phases: the interim or preliminary proceedings and the main proceedings. After the management of the insolvent entity or a creditor has applied to the competent insolvency court for the opening of insolvency proceedings, the insolvency court appoints either (i) a preliminary custodian ("*Sachwalter*") supervising the ongoing management of the debtor-in-possession, or (ii) a preliminary insolvency administrator who secures the assets of the debtor. Under the new German insolvency law – as reformed by the ESUG – as a general rule, a (preliminary) custodian must be appointed, if so requested by the debtor's management. Normally, the preliminary custodian, or, as the case may be, the preliminary insolvency administrator, determines whether the main proceedings should be opened, in particular, whether there are sufficient assets to at least cover the cost of the proceedings. Depending on the custodian's/preliminary insolvency administrator's findings, the insolvency court may then open the main proceedings.

When insolvency proceedings are opened, the preliminary insolvency administrator is usually appointed to act as insolvency administrator; similarly, the preliminary custodian should usually become the custodian if the proceedings continue as debtor-in-possession proceedings.

The insolvency administrator will try to continue the business of the debtor or parts of it in the best way possible, e.g., by selling the business or parts of it to an investor. Any remaining business of the company is liquidated and the assets sold. Preferred creditors, e.g., creditors who hold title to assets in the possession of the debtor, who hold security rights, or whose claims came into existence after the opening of the main insolvency proceedings, may be able to reclaim their assets or satisfy their rights and claims in full. All other creditors, in particular creditors with payment claims that came into existence before the opening of the insolvency proceedings, are usually able to obtain only a small percentage of their claims: the "insolvency quota". The insolvency quota typically ranges between 0% and 10%, but can also be significantly higher. Full recovery of the debt is rare, but happens occasionally. It is often tried to restructure the debtor by an insolvency plan instead of selling/liquidating its business, particularly if a custodian is appointed.

The remainder of this Chapter focuses on insolvencies of entities under private law organized as corporations. Any peculiarities applying to other private law entities and public law entities are not discussed.

Creditors

While German insolvency law focuses on equal satisfaction of the creditors, it does recognise different classes of creditors:

- Creditors with rights of separation (described below) have a right to separate their assets from the debtor's estate. They do not belong to the insolvency creditors in the narrow sense of the word;

- Secured creditors have a right of separate satisfaction. Compared to creditors with rights of separation they face certain limitations of their legal entitlements;

- Estate creditors (i.e., with some exceptions, creditors whose claims arise upon or after the opening of formal insolvency proceedings) are satisfied before ordinary insolvency creditors;

- Insolvency creditors usually receive only a small fraction of their claims' nominal value. Their claims may also rank differently; for example, claims for repayment of shareholder debt are subordinated by operation of law.

- Any remaining proceeds from the insolvency proceedings after satisfaction of all other creditors are distributed among the debtor's equity holders. Such distribution is the rare exception.

Preferred Creditors

Preferred creditors are creditors who hold either a right of separation (typically if a creditor holds title to assets in the possession of the debtor – see "Right of Separation" below), or a right of separate satisfaction (if a creditor holds a security interest in an asset of the debtor – see "Right of Separate Satisfaction" below), or creditors who can claim preferred satisfaction as creditors of the insolvency estate (typically, if a claim has been established by the insolvency administrator – see "Estate Creditors" below).

A creditor claiming a right of separation or separate satisfaction needs to be able to demonstrate its valid security for any individual assets. For instance, if a creditor claims a right of separation for ten trucks and the debtor has 20 identical trucks stored in its warehouse, the creditor needs to be able to demonstrate and prove to which of these trucks it holds title. To be able to submit the required proof of title, any creditor should therefore keep track of its property and, e.g., request that its property be kept separate on the debtor's premises, mark its property as appropriate, and/or keep track of the serial numbers of any goods delivered to the debtor.

Right of Separation

A creditor has a right of separation in particular if it has legal title to any assets in the debtor's possession. This right benefits, for instance, suppliers who have retained title to the supplied products and leasing companies. Creditors with rights of separation can eventually request return of their goods and will generally suffer least from the debtor's insolvency.

Contractual rights generally (exceptions being, e.g., certain arrangements comparable to trusts) do not entitle a creditor to separation. If, for example, someone has purchased goods from the debtor and if title has not yet passed to the purchaser, the purchaser may not demand separation even if he has made partial or even full payment.

Right of Separate Satisfaction

A right of separate satisfaction exists if the creditor has a security interest in an asset of the debtor, e.g., a pledge, a security assignment of a movable item or of a claim, or, in certain cases, a withholding right. The creditor may claim priority satisfaction out of the proceeds from the sale of the specific asset.

Rights of separate satisfaction are often held by suppliers who delivered their products under all-monies clauses ("*erweiterter Eigentumsvorbehalt*"), which provide that the title of the delivered good be transferred under the condition that all deliveries or all receivables from the contractual relationship are fully settled, or under extended retention of title clauses ("*verlängerter Eigentumsvorbehalt*"), which provide that all receivables resulting from the resale of delivered goods are assigned in advance and that the supplier acquires joint ownership in new goods in the event that the delivered goods are processed, joined or mixed.

In insolvency cases involving suppliers, the suppliers often join a suppliers' pool ("*Lieferantenpool*") in order to coordinate their rights and assert their security interests.

To the extent that claims of secured creditors with rights of separate satisfaction are not satisfied by the realisation of their respective security interests, they can claim on their remaining claims the same quota as unsecured insolvency creditors.

Estate Creditors

If a creditor acquires claims against the debtor when the debtor has already entered insolvency proceedings, the claims may be privileged. Such claims are known as "estate claims". A creditor who has an estate claim is called an "estate creditor". Estate claims are, in particular, any claims created by the insolvency administrator after the opening of insolvency proceedings. Likewise, consideration for performance rendered after the opening of insolvency under pre-existing contracts for which the insolvency administrator has opted for performance can be claimed as estate claims (see below). Claims created by a preliminary insolvency administrator can be claimed as estate claims only if the preliminary administrator was appointed as a "strong" preliminary administrator or if the insolvency court had specifically vested in the preliminary insolvency administrator the power to create certain estate claims, which is only rarely the case.

Estate claims are usually paid in full when due, unless the assets of the insolvent debtor prove insufficient to cover all estate claims. If the estate claims are not fully covered, the estate creditors may under certain circumstances hold the insolvency administrator liable for the losses they incur due to insufficient assets.

Insolvency Creditors

Insolvency creditors are creditors with unsecured claims that came into existence prior to the opening of insolvency proceedings. However, this class does not include exceptional creditors that can claim preferred treatment as insolvency estate creditors (see above). Insolvency creditors are rarely paid in full but receive only a quota on their claims. This insolvency quota amounts to approximately 5% on average. It is often lower, particularly in small insolvencies, but can also be significantly higher.

Within the group of unsecured insolvency creditors, claims have different ranks. Lower ranked claims are only paid after all higher ranked claims have been fully satisfied. For instance, monies due under a shareholder loan (with some exceptions) have a lower rank compared to third-party claims of the debtor's business partners. Further, interest on the filed claims of the insolvency creditors accruing after the opening of insolvency proceedings ranks behind principal amounts. Unlike in several other jurisdictions, insolvency claims of employees or tax or other public authorities generally do not rank above insolvency claims of other creditors, e.g., suppliers or customers. However, certain tax claims stemming from the preliminary insolvency proceedings (i.e., the period after the filing of the insolvency petition and prior to the opening of formal proceedings) have the quality of estate claims.

Insolvency creditors must file their claims with the insolvency administrator. While insolvency creditors are called to do so within the deadline ordered by the insolvency court in its opening order, they can file their claims after this deadline has expired until right before the final distribution of proceeds takes place. Any filing of insolvency claims needs to properly identify the relevant claims, indicate the basis of the claims, and be backed by appropriate documentation (such as contracts and invoices, etc.). Insolvency administrators usually provide creditors with standard forms which can be used for the filing. However, depending on the complexity of the matter, creditors often seek professional advice to handle such filings.

Creditors' Bodies

Creditors have the opportunity to influence the insolvency proceedings through three creditors' bodies: the creditors' assembly, the preliminary creditors' committee and the creditors' committee.

Creditors' Assembly

The creditors' assembly consists of all insolvency creditors and creditors with rights of separate satisfaction. Creditors with rights of separation do not belong to the creditors' assembly. The debtor and, respectively, its representatives and the insolvency administrator are entitled to attend meetings of the creditors' assembly. These meetings are chaired by the insolvency court. At certain important stages of the insolvency proceedings such meetings must be summoned. Further, they have to be summoned on the request of the insolvency administrator, the creditors' committee or a specified number of creditors holding a certain percentage of all insolvency claims. In creditors' assembly meetings, the creditors vote by the amount of their respective claims and in some cases also per capita. Among others, the following creditors' assembly meetings are mandatory:

- A meeting no later than three months after the opening of the insolvency proceedings to decide on the basis of a report of the insolvency administrator as to how the insolvency proceedings will be conducted ("report hearing");

- A meeting no later than two months after the deadline to submit insolvency claims has ended to decide on the validity of the claims submitted ("examination hearing"). Both the examination hearing and the report hearing are scheduled by the insolvency court when the insolvency proceedings are opened and may coincide;

- A meeting at the end of the insolvency proceedings when the insolvency administrator presents to the creditors a final financial report on the result of the insolvency proceedings.

The creditors' assembly has the authority to make important decisions in the insolvency proceedings, e.g., to:

- Establish or abolish a creditors' committee or replace its members (see below);

- Replace the insolvency administrator;

- Decide on the temporary continuation of the debtor's business;

- Decide on whether an insolvency plan is to be prepared (see below).

Although the creditors' assembly has numerous means to influence the insolvency proceedings, typically attendance at creditors' assembly meetings is rather low. Further, the creditors' assembly usually follows the recommendations and suggestions of the insolvency administrator. Creditors should always consider attending creditors' assembly meetings because these meetings offer the opportunity to gain additional information on the insolvency proceedings and the prospects of recovery of outstanding claims. The creditors may also send a representative with a proper power of attorney.

Preliminary Creditors' Committee

The preliminary creditors' committee generally has to be appointed by the insolvency court during the preliminary insolvency proceedings if a mid-sized or large company is involved. But also in respect of small companies, the in-solvency court is supposed to appoint a preliminary creditors' committee if the debtor, the preliminary insolvency administrator or a creditor request its appointment and if persons are nominated as members who may participate in the committee and are willing to do so. Ideally, the members of the committee shall include creditors with a right of separate satisfaction, insolvency creditors with the highest claims, small creditors and a representative of the employees. Often, also a representative of the pension security fund is a member of the committee. There is no fixed number of members of the preliminary creditors' committee and, in contrast to the creditors' assembly, the creditors vote only per capita.

One important right of the preliminary creditors' committee is to participate in the appointment of the (preliminary) insolvency administrator/custodian: The preliminary creditors' committee is to be heard by the insolvency court before the appointment. In case the committee unanimously agrees upon a certain (preliminary) insolvency administrator/custodian, the insolvency court may deviate from this nomination only if the person proposed is not suitable to hold the office. The preliminary creditors' committee may also agree on a profile that the administrator/custodian must meet and which the insolvency court has to take into account when appointing.

Besides its participation in the appointment of the administrator/custodian, the preliminary creditors' committee is also involved in the decision whether the (preliminary) proceedings are run as debtor-in-possession proceedings (*Eigenverwaltung*) (see "Debtor-in-Possession Proceedings" below). The preliminary creditors' committee is to be heard unless such hearing would obviously lead to a deterioration of the debtor's financial position. If the preliminary creditors' committee unanimously supports the debtor's application for debtor-in-possession proceedings, it shall be granted.

Creditors' Committee

A creditors' committee need not necessarily be appointed – not even in mid-size or large insolvencies. Prior to the first creditors' assembly the insolvency court may establish a creditors' committee; afterwards the creditors' assembly itself is charged with the establishment. As with the preliminary committee, there is no fixed number of members and voting is per capita.

The creditors' committee supports and supervises the insolvency administrator (or, in the event of debtor-in-possession proceedings, the debtor) in his management activities, but does not have the right to instruct the insolvency administrator (the debtor). Because it is a smaller body, the committee can be summoned more often and more easily than the creditors' assembly. Thus, if a creditors' committee is constituted, it replaces the creditors' assembly for certain decisions, e.g., certain actions of the insolvency administrator (the debtor) are subject to the committee's approval and not the assembly's approval. Examples of such actions are the sale of the business or significant assets of the debtor. However, once the creditors' assembly meets for the first time, it may abolish the creditors' committee or replace its members.

Insolvency Administrator

The insolvency administrator manages the affairs of the insolvent company and ensures that the creditors are satisfied to the maximum extent possible. After the submission of an application to open formal insolvency proceedings, a preliminary insolvency administrator is appointed by the insolvency court (for the participation of the preliminary creditors' committee, if applicable, see above), unless the proceedings are run as debtor-in-possession proceedings, in which case instead of an administrator a custodian is appointed (see below). Each local court holds a list of insolvency practitioners − in most cases qualified lawyers − and usually appoints a person from this list as preliminary insolvency administrator, though this is not mandatory and may be overruled by a unanimous decision of the preliminary creditors' committee (see above). If formal insolvency proceedings are opened, the court appoints an insolvency administrator. In most cases the preliminary insolvency administrator is also appointed as insolvency administrator.

Preliminary Insolvency Administrator

The court may vest the preliminary insolvency administrator with different degrees of authority. The "strong" administrator takes over the debtor's right to manage and transfer the debtor's property. In cases where a "weak" administrator is appointed, the debtor formally remains entitled to manage its property, but usually the insolvency court will order that any act of disposal (e.g., any payments, transfer of rights or assets, etc.) by the debtor requires the consent of the administrator. This means that even a weak preliminary insolvency administrator will practically take over management functions and may be the main contact for the creditors during preliminary insolvency proceedings.

Obligations created by a strong administrator are privileged and are paid from the insolvency estate before other creditors are satisfied (see above). On the other hand, obligations created by the debtor with the consent of a weak preliminary administrator are not privileged, unless upon specific order of the insolvency court. Any creditor would be well advised to exercise due care when continuing business with a debtor in the state of preliminary insolvency proceedings, because it may end up only with additional insolvency claims, typically with a very low recovery rate.

The task of the preliminary insolvency administrator is to evaluate the current financial situation of the debtor, to monitor the actions of the debtor and protect the debtor's assets for the benefit of the community of creditors, and to develop a strategy of how to conduct the insolvency proceedings. The preliminary insolvency administrator is entitled to access all the debtor's books and records and to conduct inquiries among the debtor's management as well as among third parties. The debtor's management must actively support the preliminary insolvency administrator's efforts. The insolvency court may at its discretion vest additional powers in the preliminary insolvency administrator. The preliminary insolvency administrator will summarise his conclusions in a report to be submitted to the insolvency court.

Insolvency Administrator

The insolvency administrator must decide how best to use the assets of the debtor to ensure that the creditors are satisfied and must take all necessary measures to this effect. Typically, he follows the strategy already decided upon during the preliminary insolvency proceedings. His main options are to either liquidate the business altogether or try to sell all or parts of it (for further options, see below).

As opposed to a weak preliminary insolvency administrator, the insolvency administrator is authorised to represent the debtor and enter into agreements on its behalf. Any claims from such agreements are treated as preferred claims which have to be fulfilled completely by the insolvency administrator from the insolvent estate when due. If the assets of the debtor are not sufficient to satisfy these claims, the insolvency administrator may be liable to the creditor. Thus, generally speaking, a creditor has the prospect that claims created after the opening of the insolvency proceedings, as opposed to claims created before the opening of the insolvency proceedings, will be fully satisfied.

Reasons for Insolvency

Insolvency proceedings can only be initiated if a formal reason for insolvency exists.

If filed by the debtor or by a creditor, the insolvency petition can be based on illiquidity ("*Zahlungsunfähigkeit*");

And, if the debtor is a legal entity, also on over-indebtedness ("*Überschuldung*");

In addition, petitions filed by a debtor itself may also be based on the reason of imminent illiquidity ("*drohende Zahlungsunfähigkeit*").

Illiquidity

A debtor is considered illiquid, if it is – other than only temporarily – unable to meet its due payment liabilities (section 17, para 2, sentence 1 of the IC). Under current German case law, an inability is considered only "temporary" if it can be overcome (e.g., by borrowings from banks) within three weeks. Furthermore, if the debtor can meet at least 90% of its due payment obligations, it will also generally not be considered illiquid. In other words, if a liquidity gap can be rectified within three weeks or amounts to less than 10% of all due payment liabilities, the debtor can generally still be regarded as solvent unless it is foreseeable that the liquidity gap will exceed the 10% threshold in the future. If the debtor has ceased making any payments, it is generally considered illiquid.

Over-Indebtedness

A debtor is considered over-indebted (section 19, para 2 of the IC) if:

- It has a net deficit, i.e., the total amount of its liabilities (including reserves for contingent liabilities) exceeds the total amount of its assets (including undisclosed reserves); and, in addition,

- The likelihood of a debtor's avoiding an illiquidity over a medium term (i.e., in general − though different terms may apply depending on the debtor's business − at least until the end of its following fiscal year) is 50% or less, i.e., the prospects of the debtor surviving as a going concern are insufficient (the "going concern test"; "*Fortführungsprognose*").

The prospects must be determined on the basis of a well-prepared profit-and-loss financial plan ("*Ertrags- und Finanzplan*"). It is prudent to have this plan prepared by an independent auditor. Whether the debtor has a net deficit is not determined on the basis of its financial statements under applicable GAAP, but using a special balance sheet for insolvency test purposes ("insolvency test balance sheet"; "*Überschuldungsstatus*"), in which any marketable assets (including the debtor's self-created intellectual property and, if marketable, its goodwill) may be shown at their fair market value.

Imminent Illiquidity

Imminent illiquidity allows the debtor – but not its creditors – to initiate insolvency proceedings if the debtor is likely to become unable to meet its future payment obligations when they fall due. The test to apply for determining whether illiquidity is imminent is similar to the going concern test to be applied when assessing whether the debtor is over-indebted.

Filing Rights and Obligations

In the event of illiquidity and/or over-indebtedness, the managers of any legal entity providing for limited liability (e.g., the directors of a stock corporation (*Aktiengesellschaft*) or the managing directors of a limited liability company (*Gesellschaft mit beschränkter Haftung*)) need to file for insolvency without undue delay, but not later than three weeks after the illiquidity and/or over-indebtedness occurs. If they do not file in time the managers are subject to personal liability – both under civil and under criminal law. Imminent illiquidity does not obligate the management to make a filing but gives rise to only a right to file.

A creditor may file an insolvency petition against the debtor if the debtor is illiquid and/or over-indebted. A creditor filing must substantiate such illiquidity and/or over-indebtedness. If the debtor objects to the filing, the burden of proof is with the filing creditor.

Insolvency Proceedings

After filing of an insolvency petition with the competent insolvency court, the court opens formal insolvency proceedings if the debtor is (imminently) illiquid or over-indebted, as the case may be, and if the debtor has sufficient assets to cover the costs of the proceedings. The court also appoints an insolvency administrator; however, if the debtor applies for, and the court grants, a procedure under which the debtor's management (and not the in-solvency administrator) remains in charge of the business decisions (see "Debtor-in-Possession Proceedings" below), then the court appoints instead a custodian to review the actions of the debtors. During formal insolvency proceedings the creditors' assembly can decide to authorise the insolvency administrator to deviate from certain mandatory provisions applying to ordinary insolvency proceedings on the basis of an insolvency plan and, thereby, make the proceedings more flexible and tailor them to the needs of the particular debtor.

Opening Proceedings

The interim period between the filing of an insolvency petition until the opening of formal insolvency proceedings, called "opening proceedings", "preliminary proceedings" or "interim proceedings", is often crucial for the debtor as it is during the opening proceedings that the course for the insolvency proceedings is set.

The preliminary insolvency proceedings start immediately upon receipt of the insolvency petition and end with the court order adjudicating on the opening of formal insolvency proceedings; during this period the employees may receive payment of their wages from social security ("insolvency money"; "*Insolvenzgeld*"). A preliminary insolvency administrator will often use the insolvency money to keep the business operational and improve the debtor's short-term liquidity situation.

Shortly following receipt of the insolvency petition, the insolvency court usually issues a court order determining the rules to be followed during the preliminary insolvency proceedings, including safeguarding measures to protect the debtor's assets (e.g., restrictions on transfer of property by the debtor and suspension of measures of enforcement (unless relating to immovable assets)). German insolvency law, however, does not grant an automatic stay to prevent creditors from exercising rights against the debtor's assets. The court order is published on the Internet (www.insolvenzbekanntmachungen.de), except when the court allows debtor-in-possession proceedings.

As mentioned above, unless the proceedings are run as debtor-in-possession proceedings, in all major insolvencies the insolvency court appoints in its court order a preliminary insolvency administrator who will control the debtor's business. Creditors should no longer rely on the debtor's staff and management, but should always involve the preliminary insolvency administrator or his team when taking decisions regarding their business relationship with the debtor.

Often, the preliminary insolvency administrator will take important actions which more or less predetermine the course of later formal insolvency proceedings. For instance, if the preliminary insolvency administrator finds that the debtor's business is not profitable on a standalone basis, he will look for potential investors. The preliminary insolvency administrator may also develop a contract selling the debtor's business (or parts of it) to an investor, subject to confirmation by the creditors and the (final) insolvency administrator after opening of formal insolvency proceedings. Especially in larger insolvency cases, when the preliminary insolvency administrator needs the creditors' support to implement important actions (and to limit his liability risks when doing so), he may need a preliminary creditor's committee to support his Reorganization efforts (see above).

Based on the preliminary insolvency administrator's report, the insolvency court will decide whether there exists a valid reason for the commencement of insolvency proceedings and whether the debtor's assets are likely to cover the costs of the proceedings, i.e., the administrator's fees and court costs. If both of these criteria are met, the court will open formal insolvency proceedings.

Formal Insolvency

The court order opening the insolvency proceedings will usually be published immediately on the Internet (www.insolvenzbekanntmachungen.de) and served on the insolvent debtor, its creditors and debtors. Generally, unless the proceedings are run as debtor-in-possession proceedings (see "Debtor-in-Possession Proceedings" below), the court order will:

- Appoint an insolvency administrator (in most cases, the insolvency administrator is the same person as the preliminary insolvency administrator);
- Order the debtors of the insolvent debtor to make payments to the insolvency administrator's trust account only and prohibit the debtors of the insolvent debtor from paying the debtor directly;
- Request the creditors of the insolvent debtor to file their claims against the insolvent debtor with the insolvency administrator and to inform the administrator about any security rights in the insolvent debtor's assets;
- Set a deadline for the registration of the creditors' claims;
- Docket meetings for the creditors' assembly to decide on the further course of the proceedings (report hearing) and verify the filed claims (verification hearing).

The main consequences of the court order are:

- The debtor loses its right to manage and transfer its assets; this right is vested with the insolvency administrator;
- Any individual enforcement measures (unless relating to immovable assets) are prohibited;
- Any transfers of property by the debtor are invalid;
- Pending civil actions are interrupted;
- Pending agreements are subject to special provisions (e.g., under section 103 of the IC, the administrator's option to choose performance or non-performance of mutual contracts which are not yet fully performed by both parties – see below).

During the report hearing, the creditors' assembly will decide on the basis of a report of the insolvency administrator whether the debtor is to be immediately liquidated or continued for Reorganization. In most cases, the debtor is liquidated and its business or profitable parts of it may be sold to an investor. As already mentioned, such sale to an investor is often already pre-arranged during preliminary insolvency proceedings and the creditors' assembly's vote is simply required to close the transaction.

The insolvency administrator and the debtor have the option to set up an insolvency plan. The insolvency plan regime was introduced in Germany in 1999 and is inspired by US Chapter 11 proceedings. The insolvency plan, which is prepared either by the debtor or the insolvency administrator, may deviate from the rules set forth in the IC. Thus, it can be tailored to the needs of each case. For instance, the insolvency plan can propose that certain groups of creditors receive better treatment than others. An insolvency plan can also provide for a sale to an external investor. Insolvency plans used to be applied in rare cases only, but have substantially increased in popularity. For details, see "Restructuring by Insolvency Plan" below.

Debtor-in-Possession Proceedings

Instead of appointing an insolvency administrator who takes over the management of the debtor, upon the request of the debtor, the insolvency court may leave the debtor, i.e., its management, in control of the business throughout the insolvency proceedings (debtor-in-possession proceedings, "*Eigenverwaltung*"). This option is inspired by the similar concept under Chapter 11 of the US Bankruptcy Code. When the court orders debtor-in-possession proceedings, the company is both advised and supervised by a (preliminary) custodian (*Sachwalter*), who is empowered with certain rights and duties generally attributed to an insolvency administrator, such as challenging avoidable transactions, but who has no direct control over the debtor's operations.

Prior to the ESUG, debtor-in-possession proceedings had been granted under exceptional circumstances (to be shown by the debtor) only. The vast majority of the proceedings were run as "normal" insolvency proceedings with a (preliminary) insolvency administrator selected and appointed by the court. When filing for insolvency, debtors could expect to lose control over their businesses without even knowing who the (preliminary) administrator in charge would be; as a consequence, management tried to avoid a filing if at all possible and many filings were late.

The ESUG tries to establish debtor-in-possession proceedings as a general rule: The insolvency court shall now order debtor-in-possession proceedings if so applied by the debtor, provided that the court is not aware of any circumstances based on which it may be expected that such an order will disadvantage the creditors. If the preliminary creditors' committee unanimously supports the debtor's application, the law presumes that ordering debtor-in-possession proceedings will not disadvantage the creditors. If the debtor files for insolvency due to imminent illiquidity and applies for debtor-in-possession proceedings, but in the court's view the prerequisites for such proceedings are not given, the court shall notify the debtor so that the debtor may withdraw the filing prior to the court's decision. Once debtor-in-possession proceedings have been granted, the court may repeal its decision only if requested by (i) the creditors' assembly by a majority in number and amount, (ii) a creditor with a right of separate satisfaction or an insolvency creditor, provided that the creditor credibly shows circumstances based on which it may be expected that the debtor-in-possession proceedings will disadvantage the creditors at large and substantially disadvantage the requesting creditor, or (iii) the debtor.

Following the introduction of the ESUG the insolvency courts have allowed debtor-in-possession proceedings significantly more often. In particular, large restructurings are increasingly conducted as debtor-in-possession proceedings by using the newly introduced "protective shield".

Protective Shield

Since the ESUG has come into effect, debtors who intend to restructure their business without being dissolved may substantially benefit from earlier filing. If a filing is made in the event of imminent illiquidity and/or over-indebtedness but before the debtor is illiquid, the debtor may, as a debtor-in-possession, slip under a "protective shield" (*Schutzschirm*) which will unfold for a period of up to three months and enable the debtor to work out its insolvency plan (see "Restructuring by Insolvency Plan" below):

- The insolvency court may take a set of protective measures to secure the debtor's assets. In particular, the court may – and, if applied for by the debtor, must – order a restriction on enforcement measures against the debtor.

- The debtor will stay in possession (see "Debtor-in-Possession Proceedings" above), unless it is obvious that the intended restructuring will fail. Moreover, the insolvency court will have to appoint the (preliminary) custodian proposed by the debtor, unless such custodian is obviously ineligible (e.g., because of a prior involvement).

- The debtor may apply for a preliminary creditors' committee to be constituted and make proposals as to the members of such committee. Smart debtors will do so and make sure that creditors who support the restructuring dominate the committee: To terminate the "protective shield" a resolution of the creditor's committee passed by a majority in number is required, unless the intended restructuring has failed – in which case the shield is removed anyway.

- Upon its request, the debtor will be able to create liabilities binding on the insolvency estate, i.e., estate claims (*Masseverbindlichkeiten*) ranking prior to any unsecured (pre-insolvency) claims of creditors (see "Creditors" above).

In other words: A timely filing of a debtor having ensured that the majority of its creditors support the intended restructuring will be honoured; it will allow the debtor to keep control and, at the same time, finalize its insolvency plan.

A major challenge and potential stumbling block when applying for a protective shield is the restructuring opinion that is required to support the application. The restructuring opinion needs to be issued by an independent and qualified restructuring professional based on an analysis of the business to be restructured. Preparing the opinion usually takes at least a few weeks and courts tend to set a high standard as to its content. Therefore, work on the restructuring opinion should be started as early as possible in the restructuring process.

Selected Instruments of the Insolvency Administrator

When taking over the management of the debtor, the insolvency administrator (or, in case the proceedings are run as debtor-in-possession proceedings, the custodian or the debtor's management under supervision of the custodian) has various tools to ensure that the insolvency creditors are satisfied to the maximum extent possible. One important tool is to choose whether to perform certain mutual contracts. This option enables the insolvency administrator to prevent the consummation of certain transactions that may be to the disadvantage of the debtor. Another important tool of the insolvency administrator is the right to contest past transactions between the debtor and third parties or its shareholders or other group companies which may have put the other insolvency creditors at a disadvantage. If the insolvency administrator is successful, the other party to the transaction has to return to the debtor anything it obtained under the contested transaction. This increases the value of the assets which the insolvency administrator may distribute to the creditors.

Mutual Contracts

The insolvency administrator is entitled to opt for performance or non-performance of such mutual contracts (e.g., sales contracts or supply agreements) to which the debtor is a party and which upon opening of insolvency proceedings have not yet been fully performed by at least one party (sections 103 and 105 of the IC). If the insolvency administrator opts for non-performance, the contract remains suspended for the duration of the insolvency proceedings. The insolvency administrator can therefore refuse to perform under the contract and the creditor can terminate the contract and claim damages, but, typically, only as an insolvency creditor (see above). If the insolvency administrator opts for performance, he can claim outstanding performance under the contract. In return he has to pay the outstanding consideration as an estate claim (see above), but only to the extent that it relates to the creditor's performance after the opening of insolvency proceedings. For example, if the creditor has supplied 50 of 100 cars owed under a sales contract before the opening of insolvency proceedings and has received 30% of the purchase price, the insolvency administrator when opting for performance can request delivery of 50 cars and in return has to pay not the outstanding 70% of the purchase price, but only 50%. The difference of 20% can be claimed by the supplying creditor as an insolvency claim, only.

The insolvency administrator's right does not apply to every mutual contract. Certain types of contracts are governed by special provisions. This is the case, for instance, for certain purchase agreements where the seller has retained title to a good sold, for certain rental agreements (which continue to be effective, but with termination rights modified for the benefit of the debtor), certain leasing agreements, loans granted by the debtor, service agreements and agency agreements.

Avoidance Rights

The insolvency administrator is entitled to void certain contracts and transfers of assets made by the debtor prior to the opening of insolvency proceedings. Generally, transactions are voidable only if they set the other insolvency creditors at a disadvantage. This is especially the case if the transaction reduced the insolvency estate because the debtor transferred an asset without receiving adequate consideration. However, even where the debtor has received adequate consideration, a transaction can nevertheless be qualified as detrimental to the creditors if upon opening of insolvency proceedings the consideration is no longer available for the benefit of the creditors (e.g., because it has been spent on wages, electricity, etc.).

If a transaction is determined to have set other creditors not involved in the transaction at a disadvantage, the insolvency administrator has a right to void the transaction and reclaim ("claw back") transferred assets if additional requirements as set forth in the IC are met. In general, transactions made during a period of three months prior to the filing of an insolvency petition or thereafter are at a particular risk of being voided. During this general preference period the risk of any creditor dealing with the debtor is usually significant if the creditor enters into transactions which are not at arm's length, if the creditor accepts performance or security to which the creditor is not entitled or if the transaction is made at a time where the debtor's liquidity issues were already apparent to the creditor. Outside the general preference period, transactions can nevertheless be voided if certain circumstances apply. For gratuitous benefits granted by the debtor to a creditor, for instance, the preference period is four years. Further, where the debtor intended to place its creditors at a disadvantage and where the other party to the transaction was aware of such intent (intentional creditor disadvantaging), transactions made up to ten years before the filing of the insolvency petition can be voided.

In March 2015, the German Federal Ministry of Justice issued a draft bill to improve legal certainty of avoidance actions. The draft especially proposes to limit the administrator's right to claim for intentional creditor disadvantaging by (i) shortening the maximum claw-back period in many cases from 10 years to 4 years, (ii) requiring an inappropriate (*unangemessen*) dealing of the debtor, and (iii) increasing the requirements for proving the creditor's knowledge of the debtor's intent. The proposed changes to the avoidance rules are currently under discussion.

Pre-Insolvency Restructuring

Typically, long before a company files for insolvency, the shareholders and creditors, including lenders, have undertaken various efforts to prevent an insolvency of the company.

Shareholders often inject additional capital which, if provided as equity, will usually be lost in the event of in-solvency if the pre-insolvency restructuring fails. Also, if funds are provided under shareholder loans and the debtor has to file for insolvency, the shareholders are unlikely to be able to recover any such funds because their claims rank behind those of other insolvency creditors. Further, any repayment on shareholder loans and/or the transfer of any assets as security for the loans can be voided by the insolvency administrator, if the payment/transfer took place within one/ten year(s) before the submission of the application to open insolvency proceedings. Lenders that gave additional funds to the debtor in a crisis before the debtor became insolvent may under certain circumstances be liable towards other creditors under tort, if before granting the additional funds the lender did not form its own opinion on whether the debtor was able to overcome its financial crisis on the basis of a commercially sound business plan,. This liability also arises if the lender is able to withdraw funds in the crisis of the debtor but does not do so. Typically, banks request from the company in a financial crisis an audited Reorganization report ("*Sanierungsgutachten*") to mitigate this risk.

Another restructuring instrument is a debt-to-equity swap. This is an effective means of preventing the company from becoming over-indebted and at the same time reduces the on-going financial burden of the company (interest payments, etc.). A lender contributes its claims against the company into its equity and obtains shares in the company in return. From a lender's perspective, a debt-to-equity swap may be especially attractive when a company faces short-term difficulties while having long-term potential. A debt-to-equity swap poses numerous technical challenges and any debtor or creditor contemplating a debt-to-equity swap should obtain qualified advice. Usually, a debt-to-equity swap is implemented by decreasing the company's capital followed by a capital increase. The shareholders waive their rights to acquire new shares originating from the capital increase and the lenders contribute their payment claims in return for new shares. This transaction requires a valuation of the lenders' claims since they may not be contributed at face value, but at their real value only. Correctly valuing the creditors' claims is one of the main challenges in a debt-to-equity swap and requires specialist advice.

Another challenge is the tax implications that a debt-to-equity swap poses. By virtue of the contribution below face value the company realises a gain which is in principle taxable. If the lenders do not swap all their loans into equity, another issue to consider is potential subordination of the lenders' continuing claims as shareholder loans. Under certain conditions, claims are exempted from such subordination if a lender acquires shares in a company's crisis. Lenders contemplating a debt-to-equity swap should seek specialist advice to ensure that they will be able to rely on this exemption. The capital decrease and increase which is typically part of a debt-to-equity swap requires the participation of the current shareholders, who will be diluted in the process. A debt-to-equity-swap may also be used in formal insolvency proceedings (see below).

A distressed company or group of companies may contemplate selling part of its operations to generate liquidity. In such cases, the purchaser needs to consider the possibility of the seller subsequently filing for insolvency. Any purchase from a distressed seller needs to be carefully structured to minimise typical insolvency-related risks, in particular the insolvency administrator's right to opt for non-performance of a pending purchase contract or to claw back assets transferred. Typically less critical from a legal viewpoint are situations where not the seller, but the target, is in distress. In a distressed target scenario, the purchaser's primary challenge is to realistically evaluate the target's potential and to determine a reasonable purchase price or negative purchase price, as the case may be. However, the risk of a potential target's insolvency also needs to be considered, in particular when the sale is combined with a carve-out.

Many other tools exist which are often used in pre-insolvency restructurings to prevent an insolvency. Creditors are sometimes willing to agree to a temporary standstill or a (conditional) waiver of some of their claims, possibly with a view to participating in future profits of the debtor after a successful restructuring. Shareholders may agree on a subordination of their claims or issue payment or liquidity guarantees to the debtor or to certain creditors. The debtor may seek to improve its operational business and consider reducing its workforce.

Post-Insolvency Restructuring

Debtor's management and shareholders may also aim for a post-insolvency restructuring, which is increasingly becoming an option as the ESUG has made debtor-in-possession proceedings easier to be granted. Likewise, the (preliminary) insolvency administrator also can begin preparing a restructuring of the debtor which may be achieved by an asset deal or, alternatively, by an insolvency plan prepared by the (preliminary) administrator or the debtor for a restructuring without liquidation.

As compared to an acquisition in a distressed situation, post-insolvency restructurings have many advantages. The insolvency administrator (or, in debtor-in-possession proceedings, the debtor) has special termination rights which allow him to terminate or renegotiate the terms of disadvantageous contracts and reduce the debtor's workforce. In addition, the purchaser faces fewer liability risks. In an asset deal outside the insolvency, the purchaser may be liable: for the seller's unpaid taxes relating to the acquired business; towards the seller's creditors, if the purchaser continues to operate the business under the same firm; and for unpaid salaries and other benefits owed by the seller to transferring employees. These risks either do not apply in insolvency, or are at least reduced.

Restructuring by Asset Deal

If the insolvency administrator comes to the conclusion that the debtor's business or parts of it can be continued by a third party investor, he will seek the investor's agreement to acquire the business (or parts of it) by way of an asset deal. Any remaining assets are liquidated.

The insolvency administrator faces several challenges. First of all, he has to identify those parts of the business that can be continued, then find a suitable buyer and finally obtain the creditors' consent. There is also only a small window for closing the deal before the financial situation of the debtor further deteriorates and the business has to be liquidated altogether. Since the creditors' assembly usually does not meet sooner than two or three months after the opening of the insolvency proceedings, the insolvency administrator often needs to request from the insolvency court permission to appoint a preliminary creditors' committee to rule on the sale of the debtor's business (or parts thereof). In addition to the approval of the creditors' committee, each creditor holding title to an asset that would be transferred to the buyer has to agree to such transfer, as must the other party to any contract that would need to be transferred.

The employees belonging to the transferred business automatically migrate to the purchaser by operation of German Civil Law. Thus, an overstaffed business may deter potential investors. There are several options to deal with this issue. German insolvency law facilitates a termination of employment amongst the workforce, and the insolvency administrator may use this option to decrease the labour force before closing the asset deal. Another model often used is transferring the employees to a separate entity for professional reorientation. This is possible only with the consent of both the employees and the works council (if applicable). In practice, the employees will often grant their consent if a potential investor makes its acquisition of the debtor's business conditional upon the employees transferring to the reorientation entity. If the business is sold to the investor after all employees have transferred to the reorientation entity, the employees will not transfer automatically, but instead the investor can extend job offers to selected employees. While decreasing the workforce prior to an asset sale is thus possible and often works in practice, it needs to be done correctly to avoid unwanted transfers of employees.

Normally, it is already the preliminary insolvency administrator who starts looking for, or is approached by, potential investors, and sometimes the preliminary insolvency administrator agrees with an investor on the terms of a sale of the business prior to the opening of formal insolvency proceedings. In such cases, the purchase contract is often made conditional upon the opening of formal proceedings and the consent of the creditors to the transaction to minimise the risks for the preliminary insolvency administrator and the investor.

Restructuring by Insolvency Plan

The insolvency plan regime is a flexible tool which allows the stakeholders to deviate from certain provisions and principles of the IC. One major difference between insolvency plan proceedings and regular insolvency proceedings is the option, with the creditors' consent, to grant the debtor full or partial discharge from its residual debt. A restructuring by insolvency plan may enable the debtor to continue the operation of its business without dissolution and to transfer the (entire) business to a new entity. This is particularly attractive – also from a creditor's perspective – when the debtor is a listed company and/or its business depends on non-transferable licenses, permits or other entitlements, or on contractual rights the transfer of which would require the consent of a third party.

Discharge of the debtor's residual debt can be tailored to the debtor's individual situation and it can, e.g., be combined with standstill arrangements. Another option is to make the discharge conditional upon the fulfilment of certain requirements by the debtor so that the creditors would participate in a liquidation of the debtor with their original claims amounts if the restructuring eventually fails. The insolvency plan does not need to be approved by all creditors. Instead, the creditors are divided into several groups. All of these groups need to approve the insolvency plan with a majority vote (in number and amount) within each group being sufficient. Dissenting groups may under certain conditions be disregarded, in particular if their dissenting is economically unreasonable (cram-down).

In insolvency plan proceedings preferred lending may be made available to certain lenders who finance the debtor's restructuring. In the case of an eventual failure of the restructuring and a subsequent liquidation of the debtor, the claims of such preferred lenders will rank not only prior to the insolvency creditors but also prior to creditors with new claims stemming from the time after the insolvency plan became effective.

Nevertheless, prior to the ESUG, though applied in some landmark restructurings (e.g., Herlitz, Senator Entertainment, Ihr Platz, Garant Schuh+Mode, Märklin, Karstadt), the insolvency plan had not been widely used. One obstacle in applying this restructuring tool was the blocking potential of dissenting individual creditors: "Free riders" could try to prevent the insolvency court from approving the plan by arguing that without it (i.e., in the event of a liquidation and dissolution of the debtor) they would receive a higher dividend on their claims. Once the insolvency court had approved a plan, creditors could appeal the approval and even further appeal a decision of the appellate court. The ESUG has now diminished such blocking potential by restricting legal means:

- Creditors may no longer seek to prevent the court from approving the insolvency plan if funds are set aside to compensate creditors for any disadvantage they suffer due to the plan being approved.

- Appeals from the court's approval of the plan may be dismissed (subject to the creditor's right to claim damages outside the insolvency proceedings) if the interest in the plan becoming effective immediately prevails over the creditor's potential damage; a further appeal is permissible in exceptional cases only.

Another reason for the minor role the insolvency plan played in German restructurings was the inability to bind the debtor's shareholders to any such plan. Any debt-to-equity swap required the shareholders' consent; even a decision to continue the operations of the debtor required a corresponding shareholders' resolution. As a consequence, restructurings could be blocked not only by dissenting creditors but also by shareholders. Even if the shareholders agreed to a debt-to-equity swap, swapping creditors ran the risk that statutory capitalisation rules potentially required them to make additional cash contributions to the company's capital if it later turned out that the swapped claims had been misvalued.

Now, after the ESUG has come into effect, shareholders may be included in an insolvency plan. If so, they will be entitled to vote on the plan as a group, and can be crammed down like any other creditors' group. The plan may include a shareholders' resolution to continue with the company's business and also provide for a debt-to-equity swap, even if the shareholders do not consent. Moreover, statutory capitalisation rules applying to swaps by insolvency plans will be mitigated: If the plan has been approved by the court any subsequent claims against the swapping creditor to make cash contributions are excluded. Hence, swapping creditors no longer bear the risk of becoming obligated to make future cash contributions because the swapped claims had been misvalued.

Insolvency plans may be prepared by the debtor itself – prior to the filing, during the preliminary proceedings or after the opening of the proceedings – or by the (preliminary) insolvency administrator/custodian. Individual creditors are not entitled to prepare an insolvency plan; however, the creditor's assembly may instruct the administrator to do so.

Conclusions and Additional Observation

German insolvency law is highly complex and a lot of experience and knowledge is required to navigate through it. Very popular misconceptions are, for instance, that the insolvency administrator is, like a notary public, required to look out for the interests of all participants in an insolvency, including a potential investor, or that all claims established with the consent of a preliminary insolvency administrator have to be fully satisfied by a debtor. Thus, when dealing with an insolvent company, it is very important to understand the (preliminary) insolvency administrator's role and the scope of his authority.

In addition, German insolvency law is in a constant state of flux, which adds to its complexity. By the ESUG having come into effect on March 1, 2012, the first package of the reform of German insolvency law has been enacted. A second package, amending the rules applicable to the insolvency of individuals, has come into effect on July 1, 2014. The third package, dealing with group insolvencies, is still to come. Also, the introduction of special rules for protection of licences, as well as avoidance rules, continue to be discussed. Thus, in a few years or even only months, the IC may be subject to further substantial changes, giving the debtors and creditors more options to re-strengthen the business of the debtor.

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