Restructuring across borders
Germany

CORPORATE RESTRUCTURING AND INSOLVENCY PROCEDURES | MARCH 2025

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Introduction

The German Insolvency Code (Insolvency Code) encompasses a standard procedure and several alternative procedural options. The default procedure is liquidation of the assets, with the estate being managed by a court-appointed administrator.

The main alternative options are: (i) an insolvency plan instead of liquidation; and (ii) self-administration by the debtor instead of an administrator. In the latter case, the debtor is supervised by a custodian.

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

It is also possible to implement a consensual out-of-court restructuring, unless there is a mandatory reason for the company to file for insolvency. Corporations and companies are obliged to file for insolvency if they are either (i) unable to pay their debts as they fall due, or (ii) overindebted (i.e. balance-sheet overindebted and unable to establish a positive going-concern prognosis for the next twelve months. They may also apply for insolvency if they are at risk of becoming unable to pay their debts as they fall due (in general, forecast period of 24 months)

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

The Insolvency Code is subject to constant improvement. A particularly significant amendment was implemented in 2012 by the “Act on the Simplification of the Restructuring of Enterprises” (Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (ESUG)), which strengthened creditors’ rights, in particular in the preliminary period between the filing for insolvency proceedings and the opening of main insolvency proceedings.

In June 2019, the EU legislator adopted the EU Directive on Preventive Restructuring Frameworks (Directive (EU) 2019/1023) (the Preventive Restructuring Framework Directive) relating to pre-insolvency frameworks, introducing a standalone moratorium outside of insolvency proceedings and providing for a safe harbour for new (interim) financing. Germany implemented the Preventive Restructuring Framework Directive with the “German Act on the Further Development of Restructuring and Insolvency Law” (Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts (SanInsFoG)), which contains in particular the long-awaited “German Act on the Stabilisation and Restructuring Framework for Companies” (Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen (StaRUG)).

The StaRUG, most of which came into force on 1 January 2021, closes the gap between a consensual out-of-court restructuring and in-court restructuring options. The adoption of the StaRUG was therefore an important step to further strengthen the restructuring culture in Germany.

Liquidation (Liquidation)

Liquidation results in a compulsory distribution of the company's assets. After the commencement of the main insolvency proceedings, the creditors' assembly (*Gläubigerversammlung*) or, if implemented, the creditors' committee (*Gläubigerausschuss*) resolves to either liquidate the company or to continue its business. A creditors' committee is introduced by the insolvency court and, in general, within its discretion (e.g. for sizeable insolvency estates) and needs to compromise at least a representative of the secured creditors, the creditors with the largest claim(s), the small/trade creditors and the employees. Liquidation proceedings involve selling either the assets of the company, the entire company, or part of its business (*übertragende Sanierung*) in order to satisfy creditors' claims as far as is possible on a *pari passu* basis. The competent insolvency court (*Insolvenzgericht*) appoints the (preliminary) insolvency administrator (*Insolvenzverwalter*) who supervises the company's management through the preliminary proceedings and, upon commencement of the main proceedings, takes control of the company and collects, realises and distributes its assets, including challenging any pre-insolvency transactions detrimental to the estate.

Insolvency plan (Insolvenzplan)

An alternative to liquidation proceedings is to establish an insolvency plan. The insolvency plan was modelled on the reorganisation plan under Chapter 11 of the U.S. Bankruptcy Code. This legal structure offers the debtor, its shareholders, and its creditors a legal framework for mutually agreeing how the insolvency estate (*Insolvenzmasse*) should be dealt with. Thus, the insolvency plan – which can involve a reorganisation, transfer, liquidation or other plan proposed by the debtor or the insolvency administrator (who may be instructed by the creditors' committee to prepare an insolvency plan) – offers comprehensive reorganisation proceedings. Within a regulatory framework (such as the preservation of minority rights and compliance with certain procedural steps), the creditors may decide to reorganise, rescue or liquidate the insolvent company or may choose a combination of these options.

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

A plan is adopted if at least 50% of creditors (by number and by value) in each voting group vote in favour of it.

The votes of voting groups that have not voted in favour of a plan are disregarded, provided that the insolvency plan (i) would *not* put them in a less favourable position than they would otherwise have been in or (ii) would not result in them receiving an adequate share of the economic value which would accrue under the insolvency plan. It is assumed that a shareholder receives an adequate share of the economic value if no creditor receives more than the full amount of its claims and no shareholder that would otherwise rank equally with the other shareholders is put in a better position as a result of the plan.

The implementation of the SanInsFoG also now allows the inclusion of intra-group third-party security (*gruppeninterne Drittsicherheiten*) (e.g. guarantees) granted by a subsidiary or parent in the insolvency plan proceedings in exchange for an appropriate compensation for such secured creditors.

If an insolvency plan is not successfully voted on and the relevant legal period for appeal has expired, the insolvency proceedings will continue in its normal course. The debtor is generally allowed to hand in a new insolvency plan, although due to the failure by the debtor to achieve the necessary majorities for the first insolvency plan, the insolvency court may reject such new insolvency and is not required to put such new plan to vote if the insolvency administrator and, if established, the creditors' assembly request the court to reject such new insolvency plan.

Self-administration (Eigenverwaltung)

In regular insolvency proceedings, the insolvency administrator takes possession of the insolvency assets and is entitled to dispose of them. The management of the insolvent company is prohibited from possessing and disposing of the insolvency assets. However, on application by the debtor, the court may approve the "self administration" procedure (*Eigenverwaltung*) set out in the Insolvency Code. This procedure was influenced by the U.S. model of a "debtor in possession".

One of the aims of ESUG was to promote self-administration as a standard procedure for insolvency proceedings. It appears that ESUG has had some success in promoting self-administration and making it popular as a restructuring tool. If the court approves self-administration, the management of the insolvent company will continue to possess and dispose of the insolvency assets under the supervision of an insolvency monitor (*Sachwalter*).

Typically, in self-administration proceedings the debtor will prepare, with the help of insolvency experts, an insolvency plan to be voted on by the creditors and (if applicable) shareholders (see above). The debtor may also use the protective shield procedure (*Schutzschirmverfahren*) during the preliminary stage of self-administration proceedings and benefit from the prevention of any enforcement measures during such protective shield procedure to allow itself to prepare properly for insolvency proceedings and develop an insolvency plan. Upon the insolvency plan's approval (see above regarding the relevant approval thresholds) by the creditors, shareholders (if applicable) and the court, the debtor's management will implement the restructuring set out in the plan with the help of insolvency experts. The combination of protective shield proceedings (*Schutzschirmverfahren*) and self-administration proceedings leading to an insolvency plan has been used in a wide-range of prominent cases in the German market in the last years (e.g. Air Berlin, Condor, Peek + Cloppenburg), presenting an alternative to StaRUG proceedings for German debtors requiring not only a financial restructuring, but also an operative restructuring of their respective businesses (e.g. termination of executory contracts, amendment to employees' rights etc.) which is not within the scope of StaRUG proceedings.

The StaRUG

In January 2021 the long-awaited StaRUG came into force.

With the implementation of the StaRUG, a framework for restructurings outside formal insolvency proceedings was created which enables companies to take restructuring measures on the basis of a restructuring plan accepted by a qualified majority (at least 75% of votes by value) of the creditors. With this, the StaRUG closed the gap between (i) a consensual out-of-court restructuring and (ii) an in-court restructuring within insolvency by way of self-administration and/or insolvency plan or transfer of assets. A StaRUG restructuring can be implemented ahead of insolvency filings.

The StaRUG procedure is available to debtor companies that are expected to not be in a position to meet their future payment obligations when due. In this context, a prognosis period of 24 months will generally apply. Even before such state of potential future illiquidity, the StaRUG now offers a new option for a debtor to seek the support of a restructuring mediator (*Sanierungsmoderator*) who is non-publicly appointed by the insolvency court.

The StaRUG offers a toolbox from which a debtor can pick and choose the tools that suit its situation best in order to successfully implement the restructuring concept. The proceedings are not opened by the court; the court is merely notified of a restructuring project and is involved to appoint a restructuring officer (if necessary) and at specific milestones during the procedure.

The restructuring plan can amend unsecured claims, most types of security (including intra-group third-party security, similarly to the insolvency plan, see above) as well as individual and ancillary provisions in multilateral legal relationships of the debtor with several creditors or in contracts that the debtor has entered into with a large number of creditors on identical terms. In particular, intercreditor agreements, syndicated financing and bond conditions can be affected. Voting takes place in classes. Minorities blocking the vote can be outvoted both within a class by a majority of at least 75% (by value) and by a cross-class cram down mechanism. On application by the debtor, the restructuring court can also issue a stabilisation order (ie a moratorium) protecting the company's business while a restructuring plan is prepared and voted on. Under the moratorium, enforcement measures against the debtor are prohibited for three or four months and security created over movable assets may not be realised. Moreover, a creditor cannot refuse to fulfil its contractual obligations simply due to the fact that obligations of the debtor are outstanding on the date the order is issued.

For moderation during the restructuring project, but also to protect the interests of all creditors jointly and to keep the court informed, a restructuring nominee (*Restrukturierungsbeauftragter*) may be appointed by the court on application by the debtor and must be appointed by the court in certain cases. The restructuring nominee mediates between the debtor and its creditors in finding a solution to overcome the economic or financial difficulties. The restructuring nominee reports to the court in writing on a monthly basis on the progress of the restructuring moderation.

The provisions and the implementation measures of a final and non-appealable restructuring plan cannot be avoided or set aside in a subsequent insolvency (safe harbour). In this way, new financing, interim financing and other restructuring-related transactions are protected to some extent against insolvency avoidance.

The debtor decides whether or not the proceedings are deemed to be insolvency proceedings within the meaning of the Recast European Insolvency Regulation. (see further detail in the section titled "European Insolvency Regulation" below).

Out-of-court restructuring (*Außergerichtliche Sanierung*)

Out-of-court restructurings by consensual agreement are the common solution for (German) companies which are facing financial difficulties or other form of distress. As there is no formal procedure, the company, its shareholders, and its creditors are free to agree upon financial restructuring measures, reorganisation, liquidation, or anything in between, although out-of-court restructurings are, generally, driven by generally applicable expectations of stakeholders with regard to such restructuring efforts (e.g. shareholder contribution as requirement for lenders participate, equal treatment between stakeholders with similar rights and participation of all relevant stakeholders to only name a few). Also, as such voluntary measures may only be established if no mandatory reason to file for insolvency occurs prior to the implementation of the out-of-court restructuring to avoid managements' and lenders' liability, avoiding such mandatory reasons to file for insolvency (and, especially, overindebtedness due to its relatively extensive forecast period of 12 months for the going concern) is another key driver for any out-of-court restructuring in the German market.

To (further) avoid lenders' liability risks it has become market standard to validate the restructuring concept for any consensual out-of-court restructuring through a restructuring opinion (in general, based on the IDW S 6 standard established by the German Institute of Auditors) issued by an independent third party expert. In typical A&E refinancing situations in the German market, the need and scope of such restructuring opinion will be a key topic to discuss between the different stakeholders due to the strict regime in Germany on financing of distressed companies.

Group Insolvency Law (Konzerninsolvenzrecht)

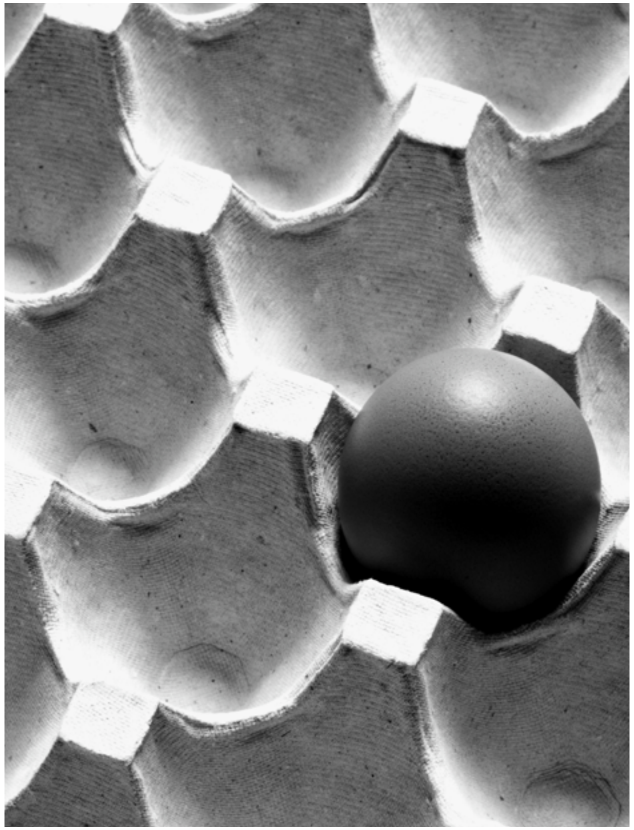
In 2018 the German legislator also introduced statutory rules facilitating the management of group insolvencies. In accordance with the European approach, the reformed law provides a framework of sophisticated concentration, cooperation, and coordination provisions with the aim of safeguarding the intrinsic surplus value of the group.

Important elements of the group insolvency law include:

- provisions allowing for the concentration of all-group proceedings at the same court (and even the same judge) as well as the same insolvency practitioner (subject to a special administrator being appointed in cases where there are conflicts of interest). However, concentration of proceedings does not mean that proceedings are substantially consolidated in a way that the assets of the individual debtorwould become assets of the group. Accordingly, although the new group insolvency law provides for the concentration of all group proceedings in the same court, proceedings are still dealt with on an entity-by-entity basis;
- provisions facilitating effective cooperation between the main bodies in the insolvency proceedings (administrator, courts, and creditors' committees). In particular, creditors' interests can be pooled through the establishment of a group creditors' committee, allowing for more efficient communication between the creditors and the other constituents; and
- the option to install a coordinator who is personally independent from the individual debtors and their creditors and, whose task is to set up a coordination plan in order to harmonise certain elements throughout all proceedings concerning members of the group. The group coordination plan is non-binding; however, the creditors' assemblies in the individual proceedings can vote to make it binding on the insolvency administrator. A coordination plan can be used as a "blueprint" for insolvency plans in each individual proceeding which is particularly useful if the individual proceedings have different officeholders.

With its advanced group insolvency regime, Germany provides an attractive forum for group insolvency cases. One of the major benefits of the law is that it interlinks with the very similar provisions in the EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the Recast Regulation).

European Insolvency Regulation



The Recast Regulation applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the Original Regulation) continues to apply to all proceedings opened before 26 June 2017. Two of the key changes in the Recast Regulation are: (i) it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation (incl. StaRUG as from July 2022, see below); and (ii) it introduces a coordination and cooperation regime for insolvency proceedings of several entities within the same group.

The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding-up proceedings – secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to winding-up proceedings) in Annex B.

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

Of the above restructuring and insolvency regimes, liquidation (Liquidation), insolvency plan (Insolvenzplan), and self-administration (Eigenverwaltung) were already available as main and secondary proceedings under the Original Regulation on Insolvency Proceedings. Under the Recast Regulation these same procedures are listed under Annex A.

While at first, despite the Recast Regulation allowing for the inclusion of pre-insolvency rescue proceedings, no such proceedings existed in Germany. Now (as discussed further in the section titled, "European Directive on Preventive Restructuring Frameworks" and the section titled "Adoption of the Directive: the StaRUG" below) Germany introduced pre-insolvency rescue proceedings on 1 January 2021.

A debtor can decide for such StaRUG proceedings to be "public" by requesting the restructuring court to make announcements in public. Then those public StaRUG proceedings qualify as "public proceedings" and thereby as insolvency proceedings within the meaning of the Recast Regulation, because the public StaRUG proceedings are listed in Annex A of the European Insolvency Regulation. Whether private StaRUG proceedings and decisions during such proceedings (e.g. plan sanctioning) may be recognised within the European Union based on the European Judgment Regulation (Regulation (EU) 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters) is debated within German literature with no case law available yet.

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If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at A&O Shearman, or email **rab@aoshearman.com**.

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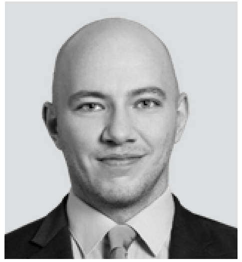

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Further information

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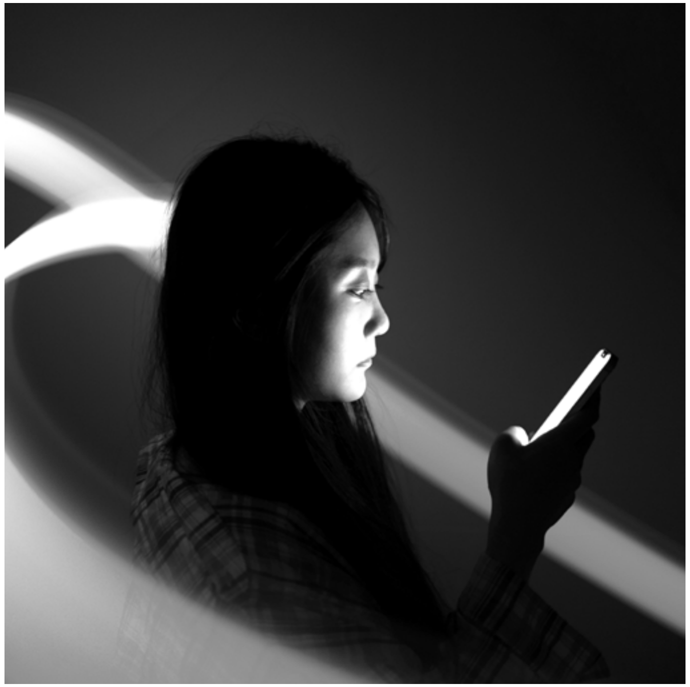

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