INSOL International

Reforms in selected EU Member States in light of the Directive on preventive restructuring frameworks

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INSOL SPECIAL REPORT

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Contents

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Acknowledgement

INSOL International is delighted to publish this Special Report titled “Reforms in selected EU Member States in light of the Directive on preventive restructuring frameworks” by Sigrid Jansen (*Fellow, INSOL International*), Simon Aarts, Dave Hillen and Géza Orbán, Allen & Overy, The Netherlands, with contributions from colleagues in the various Allen & Overy offices in Europe.

In 2014, the European Commission (EC) adopted a Recommendation on a new approach to business failure and insolvency, encouraging EU Member States to introduce a framework that allows for the restructuring of viable companies in financial difficulty. The main aim of the Recommendation was to improve the functioning of the internal market. However, the Recommendation did not achieve its aim as only a handful of countries introduced new restructuring frameworks as recommended by the EC.

As a result, in 2016 the EC proposed to introduce a Directive laying down certain minimum rules that must be achieved in order to facilitate the rescue of viable businesses in financial difficulty. After two years of negotiations, the resultant Directive on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt came into force on 16 July 2019.

While the Directive has four parts, this report focuses on Titles II and IV of the Directive. Title II (preventive restructuring frameworks) describes the rules that a preventive restructuring framework should contain to provide debtors in financial difficulty with early and effective access to procedures that facilitate a restructuring plan. Title II further describes the rules of adoption of a preventive restructuring framework by creditors and possible confirmation by a judicial or administrative authority. Title IV (measures to increase the efficiency of restructuring, insolvency and discharge procedures) introduces supplementary measures to increase the efficiency of a restructuring plan.

This excellent report sets out the current and future restructuring options in selected EU Member States in light of the Directive. It therefore not only focuses on restructuring options currently available under existing legislation, but also includes proposals for reform. This report also provides insight into the available options in each jurisdiction in order to assess whether or not the various EU countries are compliant with the current Directive of the EC. The eight EU members states covered are Belgium, France, Germany, Italy, Poland, Spain, The Netherlands and the United Kingdom.

INSOL International sincerely thanks the Allen & Overy team, and Sigrid Jansen specifically, for leading this technical project and bringing it to a conclusion by providing this excellent Special Report.

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2.3 GERMANY

I. PREVENTIVE RESTRUCTURING FRAMEWORK (DESCRIPTION / AIM)

(1) Which preventive restructuring instruments are currently available in your jurisdiction?

Germany has advanced in-court insolvency and restructuring procedures set out in the German Insolvency Code (*Insolvenzordnung* – InsO). The law was influenced by a conceptual change from a simple liquidation approach to a rescue culture and was last revised in 2012 by the ESUG[50]-reform. Restructuring procedures are not only available for illiquid and overindebted debtors but also for debtors that are only under threat of becoming illiquid; they can to some extent be used to a similar effect as pre-insolvency proceedings in other jurisdictions. The InsO includes powerful restructuring tools such as insolvency plans, protection from enforcement, debt-to-equity-swaps, haircuts, cross-class cram-downs, or protection for new financing. They can be used in debtor-in-possession proceedings (called “self-administration”). The more pro-active debtors and creditors can use this to create a voluntary “pre-pack”.

Due to the current absence of a formal out-of-court restructuring framework, we set out below those restructuring instruments contained in the German Insolvency Code that are in line with the Preventive Restructuring Framework Directive which has been closely followed by the German Ministry of Justice.

With the adoption of self-administration and the insolvency plan, the restructuring of a debtor company to maintain and continue the business has become an equal ranking objective in addition to the liquidation of the company and the satisfaction of all creditors out of the liquidation proceeds. Whether the insolvency plan is set up for liquidation or restructuring purposes is the autonomous decision of the debtor’s creditors in the creditors’ assembly.

Since the ESUG-reforms of 2012, German in-court insolvency and restructuring procedures have been well received in the market, in particular by international investors. The objectives of the new law are to:

(a) strengthen the influence of creditors (for example, with the introduction of a preliminary creditors’ committee (*vorläufiger Gläubigerausschuss*) and in regard to the choice of an insolvency administrator or custodian); and

(b) to further improve the self-administration and plan procedure (for example, by amending the capital structure by allowing a debt-to-equity swap, limiting the appeal rights against the insolvency plan and introducing the “protective shield” procedure (*Schutzschirmverfahren*).

The “protective shield” procedure is designed as a (fast-track) insolvency plan procedure to be prepared within a maximum of three months by a debtor in (preliminary) self-administration and vested with the power to impose a moratorium-like effect on its creditors (following the US Chapter 11 model). Although the market had already called for a pre-insolvency framework, the

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[50] Act to Further Facilitate the Restructuring of Companies (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen)* of 7 December 2011.

legislator held on to the “protective shield” procedure as a formal insolvency procedure and as a compromise.

In 2018, the German legislator also introduced statutory rules facilitating the management of group insolvencies.[51] In line with the new group insolvency concept of the Recast European Insolvency Regulation (EIR), the aim of the reformed law is to provide a framework for restructuring a group on the basis of a co-ordination plan (*Koordinationsplan*) for the insolvent group of companies and to ringfence viable subsidiaries. The German law on group insolvencies even goes beyond the scope of the EIR as it allows (i) for a concentration of insolvency proceedings of members of a group before the same court (and even the same judge) and (ii) for the same insolvency practitioner to act as administrator (*Insolvenzverwalter*) in all of the insolvency proceedings over group companies (subject to a special administrator being appointed in cases where there are conflicts of interest). German group insolvency law is currently considered one of the most advanced group insolvency regimes worldwide.

The picture of German restructuring culture is completed by a well-developed market practice of using consensual, out-of-court and non-formal restructuring instruments with market actors who have the necessary experience in this field (being turnaround management firms, specialised law firms, specialised auditor firms and rescue-friendly insolvency practitioners and custodians). As part of out-of-court restructuring, the relevant parties would usually conclude a consensual restructuring agreement which, in case of failed consensus, can be used as a pre-pack for an insolvency plan and which can then be approved by a simple majority vote.

(2) Is your jurisdiction in the process of introducing new restructuring instruments in line with the purpose of the proposed directive?

The German legislator is currently preparing the implementation of the Preventive Restructuring Framework Directive, though no drafts have yet been made available to the public. The Preventive Restructuring Framework Directive will require changes to German law, but not necessarily as part of the Insolvency Code. It will then benefit from many years’ practical experience during which many instruments very similar to the ones contemplated in the Directive have been tested on all levels in the market (for example, insolvency / restructuring plan, debtor-in-possession, creditor groups, (cross-class) cram-down, debt-to-equity swap).

At present we are discussing the findings of a five year retrospective evaluation of the ESUG-reform which assesses the new restructuring tools (including self-administration, the insolvency plan, protective shield proceedings, (cross-class) cram-down voting, debt-to-equity swaps) on the continuing path to a modern restructuring culture.[52] We expect the outcome of the evaluation to be part of another milestone reform combined with and triggered by the Preventive Restructuring Framework Directive and its transformation into German restructuring and insolvency law. In the last two years the German restructuring experts and stakeholders took a very active but also diverse role in the

51 Act for the Facilitation of the Management of Group Insolvencies (*Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen*) of 13 April 2017.

52 The so-called *ESUG-Evaluation*. The international World Bank Ease of Doing Business Report 2019 ranks the German insolvency law on rank 4 (p 173).

discussions and genesis of the Directive and it was a hot topic at many restructuring symposia.

(3) Provide a short description of the restructuring instrument and explain the purpose of the instrument (including whether it is an insolvency process or out of court instrument).

The German Insolvency Code contains several rescue-orientated restructuring instruments. They are available to debtors who are facing pending illiquidity (*drohend zahlungsunfähig*),[53] or are over-indebted (*überschuldet*)[54]. Except for "protective shield" proceedings, they are also available to debtors who are already illiquid (*zahlungsunfähig*)[55]. These in-court rescue instruments may be summarised as follows:

(a) Self-administration (*Eigenverwaltung*)[56]

Self-administration allows the debtor's management to stay in control of the business, supervised by a court-appointed custodian (*Sachwalter*, also sometimes called trustee, monitor or supervisor in English texts). The court usually grants the request for self-administration if no circumstances are known that would lead to the expectation that the self-administration is detrimental to the debtor's creditors.

If the request for self-administration is not evidently without prospect of success, the court will refrain from installing a preliminary insolvency administrator, leaving the debtor in so-called preliminary self-administration (*vorläufige Eigenverwaltung*), that is, allowing its management to stay in control of the business during the preliminary proceeding (usually up to three months between filing and the opening of the insolvency proceedings).[57] The aim is to prevent disruptive effects to the debtor's business due to a displacement of management after filing.

In addition, self-administration facilitates the implementation of a "pre-pack". The existing management would draft an insolvency plan. They often draft the insolvency plan on the basis of a restructuring agreement which they negotiated with the stakeholders prior to filing and which is supported by not necessarily all, but at least the majority of the supporting stakeholders (for example, finance parties, large trade creditors, credit insurers, shareholders, potential fresh money providers and new investors). It is important to note that if there is still enough time, management will always try to implement a restructuring agreement with the debtor's main creditors and would only trigger insolvency and use self-administration (as a formal proceeding) if the consensual plan has failed, or has not received the full support of all required creditors. If important creditors are holding out, the debtor usually loses its "going-concern prognosis" and thereby usually become over-indebted (*überschuldet*), or, as the case may be, illiquid (*zahlungsunfähig*), which triggers the filing for insolvency in the form of (preliminary) self-administration.

53 InsO, s 18.
54 *Idem*, s 19.
55 *Idem*, s 17.
56 *Idem*, ss 270 *et seq*.
57 *Idem*, s 270a.

The debtor may also apply to the insolvency court for permission to raise additional financing or create liabilities which are liabilities of the estate and will therefore be satisfied prior to unsecured insolvency creditors as part of the main insolvency proceedings (*Masseverbindlichkeiten*).

(b) Insolvency plan proceedings (Insolvenzplanverfahren)[58]

The insolvency plan proceeding is a structured and sophisticated cram-down procedure based on US Chapter 11 proceedings. It allows the debtor and / or the insolvency administrator to set-up and agree an insolvency plan (*Insolvenzplan*). The purpose of this plan may be either to save the debtor company or its business, or to accommodate for a controlled liquidation and distribution of an (insolvent) debtor's assets to its creditors. The plan may also be used to deviate from parts of the insolvency procedure itself.

Voting on the plan takes place in different creditor classes with a simple majority (50% + x) *per capita* and by value within each class.[59] A cram-down of whole classes ("cross-class cram-down") is possible, in particular if the dissenting classes are "out of the money", that is, (i) they would not fare better without the insolvency plan, (ii) no other creditor with a lower ranking receives any value out of the plan and (iii) the majority of involved classes have voted in favour of the plan.[60]

The plan may include any type of arrangement generally admissible under corporate law.[61] The law explicitly permits the inclusion of the debtor's shareholders in the plan (as a separate class) and provides for a state-of-the art debt-to-equity swap procedure which has already been used in practice numerous times. If a debt-to-equity swap is part of a plan, the equity would usually be cut down as far as required to absorb the incurred losses (often down to zero) and would thereafter be increased by issuing new shares to existing creditors who are swapping their debt into equity.[62] Insolvency law overwrites the usually required 75% majority vote under corporate law, requiring only simple majorities for the plan as described above. The right of shareholders to subscribe in the new equity is often waived as part of the plan and in case the class consisting of shareholders dissents, it can be crammed down (essentially if the shareholders are "out of the money").[63]

The plan may include various other provisions regarding corporate and / or financial restructuring, for example haircuts, debt or asset push-downs and push-ups, extension of payment schedules and protected new financing.

After the debtor in self-administration (or the insolvency administrator) has presented the court with a plan proposal, the court has to review the plan within two weeks with respect to:

(i) the proper class formation;

58 *Idem*, ss 217 *et seq*.
59 *Idem*, s 244.
60 *Idem*, s 245.
61 *Idem*, s 225a.
62 *Idem*, s 225a, para 2, sentence 3.
63 *Idem*, s 245, para 3 (prohibition to obstruct).

(ii) whether the plan evidently has no prospect of success to obtain approval by the debtor's creditors; or

(iii) whether the claims of the creditors can evidently not be satisfied.[64]

If the court has not rejected the plan, it will ask, *inter alia*, the creditors' committee and the debtor or the insolvency administrator (depending on who presented the plan) to provide their opinion on the plan within two weeks.[65] Afterwards the court schedules a creditors' assembly to discuss the plan and to vote on the plan in the respective creditors' classes. The voting mechanism provides for cram-down and cross-class cram-down – see (15) and (18)-(20) below for further information.

Once the relevant majority of the voting parties has approved the plan, the court can only reject the requested confirmation of the plan if the provisions regarding the content and procedural steps to obtain the approval have not been satisfied.[66] Regarding appeal see (25). The confirmed plan is binding on all parties it affects, regardless of whether or how they voted on the plan.[67] If and to the extent the plan does not provide for a claim's satisfaction, that claim is discharged.[68] After confirmation of the plan the court will close the proceedings. Depending on the size of the proceeding, a well-organised debtor may generally be able to obtain a confirmed plan within as little time as three to six months.

(c) "Protective shield" proceedings (Schutzschirmverfahren)

"Protective shield" proceedings are a special form of preliminary self-administration which can provide for a moratorium of up to three months after the debtor has filed for insolvency, in order to allow the debtor's management to work on an insolvency plan (see (b) above).[69] Debtors can apply for a "protective shield" if they are over-indebted or under threat of becoming illiquid (but not yet illiquid). The main advantage of the protective shield proceeding is that the debtor can propose its own custodian (which facilitates the implementation of a "prepack") and the court has to grant the debtor upon its request the right to create liabilities that are liabilities of the estate and will therefore be satisfied prior to unsecured insolvency creditors as part of the main insolvency proceedings (*Masseverbindlichkeiten*).[70]

(d) Group co-ordination proceedings (Koordinationsverfahren)

Group co-ordination proceedings are aimed at facilitating the efficient coordination and rescue of a whole group of companies (*Konzern*).[71]

Corporate rescue usually becomes more complex and harder to achieve if more than one group member has filed for insolvency. Groups of companies are often sophisticated corporate structures which are economically highly

64 *Idem*, s 231.
65 *Idem*, s 232.
66 *Idem*, s 250.
67 *Idem*, s 254-254b.
68 *Idem*, s 227.
69 *Idem*, s 270b.
70 *Idem*, s 270b, para 3, sentence 1.
71 *Idem*, ss 3a *et seq*, 269a *et seq* and 269d *et seq*.

interdependent. The insolvency of one legal entity has the potential to cause a "domino effect" of further insolvencies within the group.

The German legislator recently introduced rules to mitigate the coordination risks associated with separate insolvency proceedings over German group companies. They resemble the rules on group insolvencies already included in the Recast EIR if insolvent group members in more than one member state are involved:

(i) Insolvency proceedings over group companies can now be pooled at the same group insolvency court (*Gruppengerichtsstand*) and even with the same judge.[72] In addition, various Federal States have recently introduced provisions allowing for a concentration of group insolvency proceedings before a (single) special insolvency court within the district of selected courts of appeal (*Oberlandesgerichte*).

(ii) All involved insolvency courts have to consult on appointing the same person as insolvency administrator within each of the insolvent group companies if it is in the interest of the creditors[73] and (only in cases of potential conflicts of interests) a special (supervising) insolvency administrator can be appointed.[74] A preliminary creditors' committee can propose a candidate for the office of an insolvency administrator (by unilateral vote)[75] and before the appointment of an insolvency administrator by the insolvency court the preliminary creditors' committee has to be heard.[76]

(iii) On request of a creditors' committee the insolvency court can appoint a group creditors' committee (*Gruppengläubigerausschuss*) which functions as a common forum for all involved creditors (the latter is not foreseen by the EIR).[77]

(iv) Each debtor within the group can now apply for the opening of group co-ordination proceedings and the appointment of a co-ordinator (*Verfahrenskoordinator*).[78] The co-ordinator is an independent mediator whose aim is to propose a (non-binding) co-ordination plan (*Koordinationsplan*) which would usually include a set of rules and guidelines for a co-ordinated approach between the involved group companies.

(v) The provisions on group insolvencies also apply to self-administration, meaning a debtor who has the support of the relevant stakeholders may successfully initiate and complete these proceedings.[79]

Despite the sophisticated rescue instruments described above, in practice debtors will still often first try to reach an amicable restructuring agreement with their creditors and shareholders out of court. If such consensual (that is, consent

72 *Idem*, ss 3a *et seq*.
73 *Idem*, s 56b, para 1, sentence 1.
74 *Idem*, s 56b, para 1, sentence 2.
75 *Idem*, s 56b, para 2, sentence 1.
76 *Idem*, s 56b, para 2, sentence 2.
77 *Idem*, ss 56b and 269c.
78 *Idem*, ss 269d *et seq*.
79 *Idem*, s 270d.

from 100% of the relevant stakeholders) restructuring turns out to be impossible, they may consider the alternative of a (compulsory) plan. There have even been restructurings where, when the consensual agreement out of court became unattainable, the debtor and its supporting creditors used the agreement which they had tried to conclude outside court proceedings as a precedent for the plan ("pre-pack").

(4) Does the instrument qualify as an insolvency procedure under the European Insolvency Regulation (Regulation 2015/848 (recast))?

Yes, as all rescue-oriented instruments outlined above are part of insolvency proceedings and such are specifically listed in Annex A of the EIR.

II. AVAILABILITY

(5) To whom is the restructuring instrument accessible?

Insolvency plans (whether as part of self-administration or ordinary proceedings) are available to debtors who are either illiquid, over-indebted or pending illiquid. They are available to legal and natural persons, as well as to partnerships. The same is true for self-administration and group insolvency proceedings.

The "protective shield" (*Schutzschirm*), which gives the debtor special protection during a period of up to three months to devise a plan before the court officially opens insolvency proceedings, may be used by debtors who are either over-indebted or pending illiquid (but not yet illiquid).[80]

Some legal entities like financial institutions, insurance companies or state entities are subject to special restructuring provisions instead.

For group insolvencies please see under (3) and (14).

(6) Who can initiate a preventive restructuring instrument in your jurisdiction, for example debtors, creditors and / or public authorities?

A debtor may propose a plan and may apply for self-administration as well as for "protective shield" proceedings.[81] If the proceeding is not a self-administration proceeding, the insolvency administrator may also propose a plan. A creditors' assembly may order the insolvency administrator to prepare a plan.

(7) Is there a viability test?

Yes. The court will deny opening of proceedings altogether if the debtor has insufficient funds.[82] The court will also deny the application for self-administration, if self-administration would be to the detriment of the creditors.[83] In addition, to use the "protective shield" the debtor has to provide a reasoned statement from a tax advisor, auditor, lawyer or similarly qualified person, which shows that the debtor is over-indebted or under threat of becoming illiquid (but is not yet illiquid) and that the restructuring it seeks has a chance of being

80 *Idem*, s 270b.
81 *Idem*, s 218 (regarding who may propose plans), ss 270 *et seq* (regarding self-administration and "protective shield").
82 *Idem*, s 26.
83 *Idem*, s 270.

successful.[84] Finally, the court will dismiss an insolvency plan if there is no chance that the creditors will accept it or the court will confirm it, or if the claims ascribed to the creditors in the plan obviously cannot be fulfilled.[85] The court may also dismiss the plan for violating procedural law. The court is supposed to give its decision within two weeks after having been presented with the insolvency plan. The person who presented the insolvency plan may appeal the court's decision.

III. CONSEQUENCES OR EFFECTS OF INITIATION OF THE RESTRUCTURING INSTRUMENT

(8) What are the consequences or effects of the initiation of the restructuring instrument?

Offering an insolvency plan to creditors and shareholders does not in itself affect the status of the debtor, its ability to transact or its existing legal obligations. However, the plan can only be voted upon and confirmed as part of insolvency proceedings, which in themselves have various practical and legal consequences and effects on the debtor (for example, a stay on enforcement (see (9)), potential avoidance actions being initiated by an administrator or custodian, avoidance of *ipso facto* clauses (see (10)), special termination rights for certain contracts, such as leases). As the plan is a part of insolvency proceedings, there is either an insolvency administrator (who takes over the debtor's business) or (in the case of self-administration) a custodian appointed (who supervises the debtor). Additionally, the approved and confirmed plan will affect the debtor and its creditors legally and economically depending on its content.

(9) Is there a stay on individual enforcement actions?

Yes. During preliminary proceedings, the court may order a stay on individual enforcement. The stay covers all ongoing and future formal enforcement proceedings. Set-off is also restricted in certain circumstances.[86] For limitations on the termination of executory contracts see (10).

If the debtor is using "protective shield" proceedings, the court has to order the stay upon the debtor's request.[87]

Once the court has opened the main proceedings, any security a creditor has obtained through enforcement proceedings during or in the month prior to interim proceedings becomes void retroactively.[88]

The debtor in self-administration or insolvency administrator may liquidate assets in favour of the secured creditors if and to the extent he is in possession of secured assets,[89] otherwise the secured creditors can in general enforce their security on their own. They may also halt individual enforcement proceedings regarding real estate under certain circumstances, including if the enforcement

84 *Idem*, s 270b, para 1, sentence 3.
85 *Idem*, s 231.
86 *Idem*, s 96.
87 *Idem*, s 270b, para 2, 2nd half of third sentence and s 21, para 2, No 3.
88 *Idem*, s 88, para 1.
89 *Idem*, ss 165 *et seq*.

would endanger an insolvency plan or unduly hinder the utilisation by the estate.[90]

(10) What are the consequences of the restructuring instrument for *ipso facto* clauses?

As a rule, *ipso facto* clauses in contracts trying to circumvent or deviate from the statutory insolvency law are void.[91] This applies to all variants of insolvency proceedings; it is not specific to insolvency plans.

(11) What are the options for new interim financing (with super priority status)?

There are three options to give new interim financing priority status:

(a) During preliminary proceedings (including “protective shield”), the debtor may request the court to vest it with the power to create liabilities against the estate (*Masseverbindlichkeiten*). Such claims rank after certain costs, but have priority over ordinary (unsecured) insolvency claims. The court has to grant the debtor’s request for such power if the debtor is using “protective shield” proceedings.[92] During main insolvency proceedings, all financing raised by the debtor or an administrator will automatically be in the form of liabilities against the estate (*Masseverbindlichkeiten*).

(b) Insolvency plans may include a provision for a credit umbrella agreement (*Kreditrahmen*) under which any new credit may benefit from a priority ranking.[93] The priority is over ordinary (unsecured) insolvency claims in a later insolvency. The priority is granted in insolvency proceedings that are opened within three years after main proceedings were closed, and while the implementation of the insolvency plan is still under supervision.

(c) More often in practice, a super priority for new or new interim financing will only be achieved contractually by agreeing first ranking security over available assets for such financing or by entering into an inter-creditor agreement with secured creditors to provide prior ranking security for the fresh money. The validity of the new security is comparatively safe from claw-back if it is granted in exchange for and in a timely manner with the new financing. However, there is no statutory super-privilege for fresh money (no “priming” as in US Chapter 11). In addition, there is no “priming” of security rights.

An important interim financing measure is the pre-financing of insolvency money (*Insolvenzgeldvorfinanzierung*) for employees. Under the applicable social security scheme, the Federal Employment Agency (*Bundesagentur für Arbeit*), which is financed by a contribution of each employer, usually pays employees’ wages for a period of up to three months prior to opening of main proceedings. Such payments are almost always pre-financed by banks and savings institutions within the period after filing and before opening of main proceedings. The banks are re-paid from the money provided under the applicable social security scheme. The relevant state entity will file a corresponding insolvency claim in the insolvency proceedings.

90 Act regarding the Enforcement concerning Real Estate (*Zwangsversteigerungsgesetz*), s 31d.
91 InsO, s 119.
92 *Idem*, s 270b, para 3.
93 *Idem*, ss 264-266.

(12) Are other restructuring-related transactions protected?

Restructuring-related transactions generally benefit from the same protections granted to all transactions, namely they are protected from avoidance rights if they can be considered cash-transactions.[94]

While claims from shareholder loans are usually subordinated during insolvency proceedings, claims may be protected from this effect if the creditor of such claims only became a shareholder of the debtor's company to rescue the company or corporation (for example, after swapping part of its debt into equity).[95] The protection will then hold until the company has been rescued successfully.

IV. CONTENT OF RESTRUCTURING INSTRUMENT AND PROCESS

(13) Is the restructuring instrument a debtor-in-possession procedure?

Yes, it can be. Insolvency proceedings may be debtor-in-possession proceedings if the debtor requests it (so-called self-administration (*Eigenverwaltung*)). The court usually grants the request for self-administration if no circumstances are known that would lead to the expectation that the self-administration is detrimental to the debtor's creditors. The "protective shield" is always a debtor-in-possession proceeding.

(14) What are the measures that can be taken under the restructuring instrument (haircuts, debt-to-equity swaps, amendments of contracts / claims, group restructuring, recourse rights)?

The debtor is largely free to determine the specific content and form of the insolvency plan, as well as the terms and conditions thereof – as long as they are able to obtain the required majority votes of the debtor's creditors. For example, the plan may include provisions regarding corporate and / or financial restructuring, including debt-to-equity swaps and other changes to the shareholder structure, haircuts, debt or asset push-downs and asset push-ups, extension of payment schedules and new financing. Amendments of contracts and claims are possible in some specific ways, for example payment or repayment of a debt may be structured differently from what it was originally.

There are some provisions that facilitate amending or discharging employment-related contracts (including labour contracts) if the debtor is the employer or terminating leases if property of the debtor is sold or if the debtor is the tenant and wishes to terminate the lease.[96] These provisions apply in any proceedings; they are not specific to restructuring.

The German legislator has recently introduced provisions into the Insolvency Code concerning group insolvencies. These provisions allow for opening the insolvency proceedings of all group companies in one place, with the same judge being responsible for all of them.[97] The definition of "group" for this is very wide – even a partnership and its limited liability partner may constitute a group. The same restructuring expert may be appointed as custodian (or insolvency

[94] *Idem*, s 142.
[95] *Idem*, s 39, para 4.
[96] *Idem*, ss 190-113 and 120-128.
[97] *Idem*, s 3a.

administrator) for all insolvent group members (subject to special (supervising) insolvency administrators or custodians in case of conflicts of interest).[98] Different insolvency courts and administrators for companies of the same group are encouraged to co-operate.[99] A co-ordination plan may be established and implemented.[100] These provisions help stabilise the group and allow the parties to the insolvency proceedings to realise the added value that stems from the individual debtors being part of a larger group. For more on group proceedings see also (3)0 above.

(15) Do creditors vote in separate classes and if so, what are the criteria for class formation?

Yes. Class formation is based on the types of claim involved.[101] Classes include:

(a) secured claims to the extent the plan affects them;

(b) ordinary insolvency claims;

(c) the various types of subordinated claims;

(d) shareholdings;

(e) employee claims (optional); and

(f) small claims (optional).

The plan may differentiate more finely between different types of classes if that is appropriate. The criteria for class formation must be laid out in the plan.

A creditor may be divided into separate classes in relation to the same claim, for example, because its claim is partially secured and partially unsecured.

(16) Can equity holders be included?

Yes, equity holders can be included in an insolvency plan. In relation to the shareholders, the plan may include any provision permitted under corporate law.[102] This includes, for example, changes to the shareholding structure, debt-to-equity-swaps or the continuation of a debtor entity that would otherwise be dissolved due to insolvency.

In accordance with the class formation rules described under (15), in case an equity holder also holds claims or other rights against the company (for example, shareholder loans) they cannot be placed in the same class for those claims or rights as for their equity rights. See also the description of insolvency plans under (3)0 above.

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98 *Idem*, s 56b.
99 *Idem*, s 269a-c.
100 *Idem*, s 269h.
101 *Idem*, s 222.
102 *Idem*, s 225a.

(17) Can creditors (and / or equity holders) be included or excluded from the instrument at will?

No. All insolvency creditors automatically take part in the proceeding. Whether or not a creditor or an equity holder is allowed to vote on the plan depends on whether or not the insolvency plan affects their claim or legal right or position. If the plan affects a certain claim, the holder of that claim is allowed to vote. Claims not affected by the plan do not have a voting right.[103] Claims against the estate (*Masseschulden*) do not give their creditors a right to vote, as they may not be affected by the plan but have to be paid in full. Disputed claims give a right to vote only insofar as this is agreed or court-ordered in the voting meeting.[104]

(18) What are the voting requirements (head count test / majority in value test)?

The voting requirements are twofold:[105]

(a) For each class of claims, the majority of the creditors who have cast their votes must have consented to the plan (majority *per capita*).

(b) Additionally, for each class of claims the sum of the claims of the creditors who have consented to the plan has to be more than half of the sum of the claims of the creditors in that class who voted on the plan (majority of total claims).

See (20) for voting requirements in case of a cross-class cram-down.

(19) Does the instrument provide for cram-down of dissenting creditors?

Yes. See (18) for the majorities required to cram-down dissenting creditors within a group, and (20) for a cross-class cram-down.

(20) Does the instrument provide for cross-class cram-down?

Yes.[106] A class is deemed to have consented to the plan if:

(a) its claims will likely not be treated worse than if there was no plan ("no creditor worse off" test);

(b) its creditors will participate adequately in the economic value which the creditors are supposed to receive; and

(c) the majority of the voting classes have consented to the plan.

Adequate participation of a class means that:

(i) no other creditor will receive more than the full amount of its claim;

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103 *Idem*, ss 237 and 238 for insolvency creditors; ss 217, 222, 225a, 238a and 243 for equity holders.
104 *Idem*, s 237, para 1, 1st sentence and s 77, para 2.
105 *Idem*, s 244.
106 *Idem*, s 245.

(ii) neither a creditor with a lower ranking claim nor the debtor nor a person holding the debtor's shares receives an economic value (absolute priority rule test); and

(iii) no creditor with the same ranking is better off than the dissenting creditors (no less favourable treatment test).

Shareholders are deemed to participate adequately if no creditor will receive more than the full amount of its claim and no equal ranking shareholder will be better off than the dissenting shareholders.[107]

(21) Is the restructuring instrument binding upon all affected parties?

Yes. A court-sanctioned insolvency plan is binding on all creditors and shareholders who were entitled to vote.[108] Once the court's confirmation of the insolvency plan has become final (that is, without the possibility of appeal) the plan grants a title for enforcement against the debtor and any person who has acceded to the insolvency plan as surety (for example, shareholders, group companies or any other third party), to all creditors who have claims against the debtor that the debtor had not disputed.[109]

V. CONFIRMATION / CHECKS AND BALANCES

(22) Does the restructuring instrument require confirmation by a judicial or administrative authority?

Yes, self-administration, protective shield proceedings and insolvency plans (including group co-ordination plans under German law) are court ordered or confirmed. Before the court gives its decision regarding confirmation of an insolvency plan it must hear the custodian or insolvency administrator, the creditors' committee (if appointed) and the debtor.[110] See also paragraph *(b)* under (3). Most other restructuring instruments have similar requirements.

(23) Which checks and balances are in place to protect the legitimate interest of creditors (for example no creditor worse off test, an absolute priority rule)?

For any insolvency plan, the following checks and balances are in place:

- All claims within the same group must be treated equally unless all affected participants agree.[111]

- Any agreement with a participant in the proceedings through which that participant receives an advantage "on the side", is null and void.[112]

- Creditors and shareholders may ask the court to not confirm the plan if they have objected to the plan during the hearing regarding the plan and they will probably be worse off due to the plan compared to a situation with no plan

[107] *Idem*, s 245, para 3.
[108] *Idem*, s 254.
[109] *Idem*, s 257.
[110] *Idem*, s 248, para 2.
[111] *Idem*, s 226, para 1.
[112] *Idem*, s 226, para 3.

(for which they have to offer reasonable proof during the voting session at the latest).[113]

- The person designing the plan may counter such objections by including baskets for cases where a creditor is made worse off by the plan compared to their situation without the plan. See also (25) below.

See also under (18) to (20) regarding cram-down rules (including the absolute priority rule and the no creditor worse off test).

(24) Does the judicial or administrative authority involved take decisions in respect of valuations prepared in connection with the restructuring instrument?

It is the obligation of the person presenting the plan to include all information the court and the voting parties need to make informed decisions. This includes information on the claims, the estate and the estate in case of liquidation.[114] If the creditors are supposed to be satisfied from the revenues generated by the debtor's business as a going concern, the insolvency plan has to include an overview of assets and liabilities and their value in case the plan becomes effective, as well as certain information regarding expected income and expenses.[115] Additionally, while not expressly required by law, it is best practice to include information on liquidation values for the no creditor worse off test (see (20) above).

(25) Is appeal possible?

Yes.[116] Creditors, shareholders and the debtor may appeal the court decision regarding confirmation of the plan. For their appeal to be admissible, the petitioner has to offer reasonable proof during the voting session that they would be considerably worse off with the plan than without the plan, and appeal the court decision within two weeks. The court may also proclaim in advance that such appeal is only admissible if the petitioner also objected to the plan in writing (at the latest during the voting session) and voted against the plan. The court will reject the appeal, *inter alia*, if the plan includes a basket for cases where participants are able to prove that they were indeed worse off. There are further provisions available in case the general interest of a speedy implementation of the plan supersedes the petitioner's interest.[117] It is generally possible for the debtor to appeal the opening of insolvency proceedings, but this is practically very rare. The petitioner can appeal against a decision denying the opening of insolvency proceedings.[118] Creditors, the creditors' assembly or the (preliminary) creditors' committee can also appeal against self-administration and protective shield proceedings.

[113] *Idem*, s 251.
[114] *Idem*, ss 219-221, 229, 230.
[115] *Idem*, s 229.
[116] InsO, s 253 and German Code of Civil Procedure, s 569, para 1.
[117] InsO, s 253, para 4.
[118] *Idem*, s 34, para 1.

VI. SUPERVISION (CLASS FORMATION / VALUATION METHODS)

(26) Does the restructuring instrument provide for early court involvement?

Early court involvement prior to filing is not foreseen. However, for larger restructurings the debtor will often try to find out who the relevant judge will be and ask them to discuss the insolvency proceedings (including who could be become insolvency administrator or custodian) and / or the insolvency plan, before any formal application is made. Judges are not obliged to co-operate with this request and some do indeed refuse to do so. After filing the court is involved, in particular with respect to the insolvency plan, as outlined above, while the debtor-in-possession (for self-administration) or the insolvency administrator (for ordinary proceedings) is responsible for running the operational business.

(27) Is there a statutory basis to appoint a restructuring expert?

Yes. If the insolvency plan is part of self-administration, a custodian is appointed who monitors the debtor's business decisions (and a preliminary custodian during interim proceedings).[119] Otherwise, an insolvency administrator is appointed who takes over the debtor's business at the latest after the court has opened insolvency proceedings. Insolvency administrators and custodians must be suitably qualified to handle the individual case at hand. They must also be individual persons being independent of the creditors and the debtor. There is no specific formal qualification required, though these practitioners are usually formally qualified as lawyers, business managers, auditors or similar professions.

VII LIABILITIES

(28) What are the potential liabilities in connection with the preparation of a preventive restructuring instrument for managing directors and restructuring experts?

(a) Managing directors

The members of the board of directors may be personally liable towards the company if they fail to properly perform their duties to the company.[120]

It should be noted that the greatest insolvency-related liability risks that managing directors usually face arise from continuing the business without filing for insolvency, even though their company or corporation is illiquid or over-indebted. Illiquidity and over-indebtedness are both grounds for mandatory insolvency filings. Delaying a mandatory insolvency filing is a criminal offence and also creates civil liability for damages.[121] Possibly even more importantly, managing directors are liable for any payment made while their company is in a state of illiquidity or over-indebtedness, unless the payment was one a reasonable business person (considering the interest of the creditors as a whole) would have made.[122] The German Federal Court of Justice interprets this exemption in a very rigid way.

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[119] *Idem*, ss 270c and 270a, para 1, 2nd sentence.
[120] See, eg, German Code for Limited Liability Companies, s 43.
[121] See, eg, InsO, s 15a.
[122] See, eg, German Code for Limited Liability Companies, s 64.

Compared to these risks, any possible risks in relation to preparing an insolvency plan are much less prevalent.

That said and as very recently rendered by the German Federal Court of Justice, managing directors leading the company through self-administration proceedings are under the same duty of care and liability as any insolvency administrator (see below).

(b) De facto directors

Depending on the circumstances, third parties who are not members of the board of directors, but who do act as if they were, may be held liable on the basis that they performed acts of management. The conditions to be considered a shadow director are very case-specific but the main theme is that the shadow director has assumed a management role towards third persons (for example, creditors).

(c) Custodian or insolvency administrator

The custodian or insolvency administrator is liable for damages to all parties to the proceedings if they negligently or intentionally violate the duties incumbent on them under the Insolvency Code. They have to fulfil their duties with the care of a proper and diligent insolvency practitioner.[123]

[123] InsO, ss 60 and 61.

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