


# DLA PIPER SUMMARY OF GERMAN INSOLVENCY LAW



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# INTRODUCTION TO GERMAN INSOLVENCY LAW

## OVERVIEW

All insolvency proceedings in Germany are governed by the Insolvency Act (*Insolvenzordnung* “**InsO**”). Insolvency proceedings can be commenced against all individuals and generally against all legal entities (corporations) as well as against several forms of unincorporated entity. However, certain – mainly public – entities are exempt from insolvency proceedings, including federal, state and local government bodies.

The main purpose of German insolvency proceedings is to provide a method for the realisation of a debtor’s assets in a manner that treats all unsecured creditors equally. Some creditors, however, are entitled to preferential treatment, including those with a right to segregation or a right to separate satisfaction.

This guide provides a summary of the insolvency and restructuring business and company rescue procedures that may be employed in Germany to save businesses or where that is not possible, simply to realise their assets.

It considers first the procedures that may be adopted to effect an **out of court restructuring**, and then proceeds to consider the German court-based insolvency procedures (described in this guide as **regular insolvency proceedings** which can be divided into:

- **preliminary insolvency proceedings** and **opened insolvency proceedings**;
- **insolvency plans** (based upon the US Chapter 11 procedure and most similar, in England, to schemes of arrangement where it is usually intended that the debtor’s business will continue and where rights which creditors would otherwise have in regular insolvency proceedings can be altered – creditors are thus divided into groups so that each group may be treated differently); and
- **self administration** (again, based on Chapter 11 in the US, and providing for the debtor to remain in possession).

The guide explains the circumstances under which **self administration** can be combined with other insolvency procedures, most commonly, an insolvency plan and highlights that the main difference between self administration and regular insolvency proceedings is the role of the insolvency professional: in regular insolvency proceedings, the **insolvency administrator** assumes control of the debtor’s business and affairs; whereas, in self administration, the management’s powers are preserved and they conduct the business simply under the supervision of a **custodian**.

The opening of insolvency proceedings creates a moratorium on all proceedings against the company (whether in relation to litigation or steps to realise assets) but does not preclude secured creditors from taking steps to realise their security. This applies even to preliminary insolvency proceedings if the insolvency court ordered such a prohibition.

## RECENT CHANGES

In late 2008, several changes were made to German statutes which had a direct influence on insolvency law.

The Act to Modernise the Law Governing Private Limited Companies and to Combat Abuses (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen – MoMiG*) came into force on 1 November 2008 and led to numerous changes which affected insolvency law and the manner in which companies can be restructured in Germany. The Financial Market Stabilisation Act (*Finanzmarktstabilisierungsgesetz – FMStG*) which came into force on 18 October 2008 contains further amendments of relevance to general insolvency law. The new provisions under the MoMiG and FMStG are intended to make German corporate and insolvency law more coherent and to enhance legal certainty for banks and creditors in restructuring situations.

### **Some of the key aspects of both acts from a restructuring and insolvency law perspective are:**

- Under the new rules, no mandatory insolvency request has to be filed in the event of over-indebtedness if, after having taken into account all relevant circumstances, the recovery of the company is more likely than not to continue business. The underlying reason for this change was the deterioration of value in shares and real estate in the wake of the financial crisis, which would have led to numerous companies being formally over-indebted and required to file for insolvency despite the fact that their financial strength is sufficient to continuing trading.
- Another intention of the MoMiG is to tackle certain practices aimed at circumventing the managements' obligations to file for insolvency. Under German law, the management of a corporation (e.g. a limited liability company) is obliged to file for insolvency in certain insolvency events. Certain service providers offering company "burying services" have fraudulently circumvented this obligation by removing all managing directors of the company. According to the new law, the absence of management will now result in the shareholders being obliged to file for insolvency if the limited liability company becomes illiquid or over-indebted and the shareholder was aware of those facts. The same applies to the supervisory board members in case of a stock operation without management.
- Further, new rules for shareholder loans apply. The rules developed by German courts with respect to the treatment

of equity replacing loans and other shareholder loans do no longer apply. Under the MoMiG, loans by shareholders will be treated as subordinated debt in insolvency. Prior to insolvency, the repayment of shareholder loans is no longer prohibited in general.

■ In accordance with the transitional rules as set out in Article 103 d Introductory Act to the Insolvency Act (*Einführungsgesetz zur Insolvenzordnung – EGlInsO*), the following applies:

- Opening of insolvency proceedings and voidable transaction before 1 November 2008: Only old law is applicable.
- Opening of insolvency proceedings after 1 November 2008 and voidable transaction before that date: New law is applicable, unless the challenge pursuant to the old law is more beneficial for the shareholder/creditor. By way of example, this applies where the debtor has effected payments on a loan which is not considered as being equity substituting before 1 November 2008, but insolvency proceedings are opened

after 1 November 2008. Pursuant to the new law, the shareholder would have to reimburse the payments. Since the old law was favourable because no reimbursement was necessary, the old law remains applicable.

- Opening of insolvency proceedings and voidable transaction after 1 November 2008: Only new law is applicable.

# OUT OF COURT RESTRUCTURING

An out of court restructuring is a debtor's attempt to reorganise its business without having to commence insolvency proceedings at court. Usually, having first obtained the protection of a standstill agreement, the debtor will attempt to renegotiate its debts, persuading the creditors that this would be preferable to the company being wound up.

An out of court restructuring has clear advantages for the debtor's business. First, in contrast to formal insolvency proceedings, an out of court restructuring will not be publicly announced, thus avoiding the debtor encountering difficulties when seeking to contract with suppliers and customers. Suppliers who learn of the debtor's financial difficulties might otherwise insist on payments being made in advance for essential supplies, thus hampering the debtor's liquidity and chances of survival.

From a creditor's perspective, out of court restructuring can be faster and tends to be less expensive than formal insolvency proceedings, not least because certain cost deductions (e.g. court costs and fees for the administrator) do not have to be made. Creditors may also be entitled to participate in important decisions such as whether existing management should be retained or replaced, although power to make a final decision on any matter will always rest with the shareholders.

In out of court restructurings, creditors should ensure that they do not act or purport to act as a shareholder for fear, should they do so, that they might be treated as a shareholder with all the legal consequences that that would entail (following a decision of the German Federal Supreme Court (*Bundesgerichtshof*), by being treated as a "quasi shareholder"). This is vital for an investor/creditor since in insolvency proceedings, according to sec. 39 (1) no. 5 InsO, loans made by a shareholder are subordinated. It appears that in recent rulings, the German Federal Supreme Court has shown an inclination to be more reluctant to hold that a creditor should be treated as a quasi-shareholder. However, this may be subject to further judicial consideration and creditors should continue to be wary of acting in any manner that may be deemed to amount to acting as a quasi shareholder.

Legislation provides at sec 39 (4) 2 InsO that certain creditors are excluded from the shareholder subordination rule. Creditors or investors who acquire shares in the company in order to assist its restructuring and then lend money to the company also for the purposes of restructuring the company, fall within the so-called "**restructuring privilege**". Any monies advanced to the company for the restructuring will not be subordinated.

Similarly, the shareholder subordination rule does not apply to minority shareholders who hold up to ten percent of the debtor's shares (provided they are not also involved in the management of the company).

Shareholder loans are only subordinated if the company fails to achieve a "sustainable restructuring". The term "sustainable restructuring" was new when first introduced at the end of 2008 and has not been defined in the law or, as yet, judicially clarified. For now, the most helpful guidance on the meaning of this term is to be found in the criteria under which the Federal Ministry of Justice (*Bundesjustizministerium*) considers a restructuring to be sustainable:

- There must be a rigid test to determine whether a sustainable restructuring has been achieved. Under such a test, it will not be sufficient for the company to show, upon completion of the restructuring, that it has merely reached a position where it has marginally escaped satisfying the criteria to be deemed insolvent.
- The purpose of the restructuring is to lead to a viable company which will not collapse back into insolvency when faced with minor financial difficulties.
- Simply taking a company to a place where it is no longer officially considered to be insolvent will not be sufficient. Rather the company must be left with a solid basis for survival.

# REGULAR INSOLVENCY PROCEEDINGS

## OVERVIEW

Section 1 of the InsO provides that insolvency proceedings should satisfy a debtor's creditors by (i) realising its assets and distributing the proceeds; or (ii) continuing the debtor's business under formal insolvency proceedings; or (iii) instituting an **insolvency plan** if possible with **self-administration**.

German insolvency proceedings consist of two key phases: **preliminary proceedings** and **opened proceedings**. Once an petition to open insolvency proceedings has been filed on the basis that one of the insolvency criteria exists, namely (i) **illiquidity**; (ii) **imminent illiquidity**; or (iii) **over-indebtedness**, the court is obliged to take all necessary steps to protect the debtor's assets. Such steps are set out in Section 21 InsO under which the court will usually appoint a **preliminary insolvency administrator** whose powers and duties will depend on whether or not the court has chosen to impose a prohibition to prevent the debtor disposing of any of its assets. The preliminary insolvency administrator will usually continue the debtor's business and will provide the court with a report summarising the debtor's financial position, confirming whether in his view one of the insolvency criteria has been satisfied and whether the debtor's assets are sufficient to cover the costs of the insolvency proceedings.

After examining the report, the court will decide whether to open insolvency proceedings or refuse to do so due to a lack of assets. A refusal for want of assets will normally lead to dissolution of the insolvent company. However, where insolvency proceedings are opened, the court will appoint a "fully fledged" **insolvency administrator** who becomes responsible for the insolvency estate (*Insolvenzmasse*), preserving and realising its assets and making payments to creditors. In the same court order, the court will set the date for the first creditors' meeting, the **report meeting** (*Berichtstermin*).

Once insolvency proceedings have been opened, creditors can lodge their claims with the administrator which he will register in the **insolvency schedule** (*Insolvenztabelle*).

In addition to the report meeting, a **verification meeting** (*Prüfungstermin*) will be held at which the amount and appropriate ranking of claims that have been lodged are verified. The insolvency administrator and creditors have the right to dispute any claims which have been lodged. However, if they are not disputed then the claims are deemed to have been determined (meaning that such claims are acknowledged and accepted as existing, granted definite voting rights and the right to participate in distributions by the insolvency administrator). If a claim has been disputed, it is up to the creditor of the disputed claim to instigate proceedings to determine the claim.

No amounts may be paid to unsecured creditors until the verification meeting has taken place. The insolvency administrator keeps a record of sums to be paid to creditors in a **distribution register** (*Verteilungsverzeichnis*) which is available for inspection at the insolvency court. Interim distributions may be made to all creditors except those who are “lower ranking” i.e. loans due to shareholders which, this guide explains, are usually subordinated. A final distribution can be made as soon as all assets have been realised, even though, at that time, the insolvency estate may be continuing to receive income. However, the insolvency administrator must obtain the court’s consent before making final distributions.

Once the debtor’s assets have been distributed, the court will declare the insolvency proceedings to be at an end.

## INSOLVENCY CRITERIA

The InsO specifies three different criteria for establishing insolvency:

- (i) over-indebtedness;
- (ii) inability to pay debts as they fall due – illiquidity; and
- (iii) imminent illiquidity.

When one of the first two insolvency criteria has been established, formal insolvency proceedings must be commenced. The third

insolvency criteria – imminent illiquidity – entitles but does not oblige management to commence insolvency proceedings.

### Illiquidity

A company is deemed to be illiquid if it is unable to pay its debts as they fall due. Illiquidity is generally presumed when a debtor has ceased making payments.

However, the German Federal Supreme Court has specified that if a debtor can reasonably be expected to be able to pay those of its debts which are already due and those which will fall to be paid within the next three weeks, it should not be considered to be illiquid.

If the amount which the company is unable to pay constitutes less than 10 per cent of the total payments falling due in that period, it will only be considered to be illiquid if the shortfall is likely to increase to more than 10 per cent in the near future or if the shortfall cannot be discharged in the near future. Conversely, if the liquidity shortfall amounts to 10 per cent or more of the total amount due for payment, the company will be presumed to be illiquid, unless there is a strong likelihood that the shortfall can be met completely, or almost completely, and the creditors can reasonably be expected to wait. Accordingly, a mere **temporary interruption in payments** (*vorübergehende Zahlungsstockung*) does not constitute illiquidity.

When determining liquidity, all liabilities which have fallen due for payment must be taken into account, but all deferred liabilities are ignored.

Both debtors and creditors are entitled to file for insolvency on grounds of illiquidity. Moreover, the debtor is obliged to do so without delay and at the latest, three weeks after the occurrence of the insolvency event.

In the event that a company is illiquid or over-indebted, if the directors fail to file for insolvency within the requisite time period, or file incorrectly or not at all, they will face criminal liabilities if they acted intentionally or negligently. Where the debtor is a limited liability company, the managing director may also be liable under civil proceedings for damages (sec. 64 and 43 (3) and (4) German Limited Liability Companies Act (*GmbHG*)).

Once a company has become illiquid or over-indebted, if the directors can justifiably believe that there is a reasonable prospect of saving the company and are taking every step to procure its salvation, they may be excused from filing immediately. However, unless the company is returned to liquidity within the three week period, the directors *must* petition for insolvency before the period expires.

In contrast, if it appears that filing for insolvency will be unavoidable, or if it is not clear whether an attempt to restructure the business will be successful within such period, the management is obliged to file for insolvency even if the three weeks period is still running. For example, by way of a standstill agreement, illiquidity can be abolished for a certain period of time in order to assess possibilities to restructure in a period being longer than three weeks.

This also applies in cases of over-indebtedness.

### **Over-Indebtedness**

The definition of “over-indebtedness” has recently been amended in the context of the financial market stabilisation measures enacted in Germany. A company is deemed to be over-indebted if its assets are insufficient to meet its current liabilities. This was the definition prior to the amendment and will be the definition again, after the temporary regulation expires. However, the definition has been temporarily refined by providing that even in circumstances where liabilities exceed assets, a company will not be deemed to be illiquid if circumstances indicate that it is highly probable that the business will be able to survive. This temporary regulation will only apply until 31 December 2013.

The change will inevitably lead to new questions: were the directors justified in assuming that the continuation of the business was highly probable? According to the definition of the term “over-indebtedness”, positively forecasting a business’s continuation merely meant that its assets may be considered by reference to their going concern value rather than at a forced sale, liquidation value. Under the new rules, the positive prognosis is the vital criterion upon which the fate of the company will be decided. Although the new rules provide greater flexibility and scope for businesses to survive, the directors’ positive outlook must be based on economically plausible accounting, cash flow and profit forecasts that will need to stand up to later scrutiny in court.

### **Imminent illiquidity**

Where a company is considered to be imminently illiquid, only the debtor is entitled to petition for insolvency. A company is deemed to be imminently illiquid if it is highly probable that at some date in the future, it will be unable to pay its debts as they fall due. When it appears that the company is more likely to become illiquid than to recover, it is deemed to be imminently illiquid. In cases where the management decides not to file for insolvency, it must closely monitor the company’s financial situation on a “worst case” basis, because management is obliged

to file for insolvency without delay if the perceived imminent illiquidity turns into or is, in fact, actual illiquidity.

However, imminent illiquidity does not give rise to a mandatory obligation on the part of the directors to file for insolvency. Consequently, once imminent illiquidity has been determined, the debtor can decide whether to file for insolvency or to initiate a process of restructuring.

In situations where the company becomes imminently illiquid, management may use the consequent threat that they may imminently apply for insolvency proceedings to be opened as a means to persuade creditors to cooperate with out of court restructuring proposals, such as entering into a standstill arrangement or granting new facilities.

## **THE INSOLVENCY ADMINISTRATOR**

Insolvency proceedings hinge upon the pivotal role played by the **insolvency administrator**. As insolvency proceedings are divided into two phases, namely preliminary proceedings and opened proceedings, there are also two types of insolvency administrators.

### **Preliminary insolvency administrator**

A **preliminary insolvency administrator** will be appointed by the responsible judge at the competent local court, in most cases on the same day on which the petition for

insolvency is filed. Only an individual can be appointed as a preliminary insolvency administrator. His/her key objective is to ensure that the assets are preserved for the creditors and to prepare a report for the court which states whether there are sufficient grounds for the company to file for insolvency and whether there is a reasonable prospect of the debtor's enterprise being restructured. Furthermore, the report will state whether the debtor has sufficient assets to cover the costs of proceedings. Since, under German law, wages will be paid by the government for up to three months, these preliminary proceedings normally cover a time frame of up to three months before the preliminary insolvency administrator will report back to the court and propose either that insolvency proceedings be opened or not, usually, in the latter case, on the basis that there are insufficient assets to justify the proceedings.

The preliminary insolvency administrator's powers and duties depend on the court's decision as to whether the preliminary insolvency administrator's role should be "weak" or "strong".

When the court appoints a "weak" preliminary insolvency administrator the debtor remains in charge and in possession of its assets. However, the debtor may dispose of its assets only with the consent of the administrator.

A "strong" preliminary insolvency administrator has full powers to manage and to dispose of the debtor's assets. Hence he can take possession of the debtor's assets, continue the debtor's business and, within certain limits, sell the debtor's goods and collect the receivables the debtor has against third parties. It is, however, rare for a strong administrator to be appointed in preliminary proceedings. Such an appointment tends only to be made where fraud is an issue or where third parties urge the administrator to be strong in order that he can act in a manner more akin to an administrator in the final proceedings and may also take steps to establish liabilities of the estate (*Masseverbindlichkeiten*) during the preliminary proceedings period. By contrast, a weak preliminary insolvency administrator may establish liabilities of the estate only with the consent of the insolvency court.

### **Final insolvency administrator**

Once insolvency proceedings are opened, the court will appoint an administrator and determine the date for the first creditors' meeting, known as the report meeting, where creditors are asked to decide on the future conduct of the proceedings.

The court will normally appoint the same person who acted as preliminary insolvency administrator to be the final administrator.

Upon appointment, the administrator takes full control of the insolvent company which then loses the right to manage and transfer its assets.

The insolvency administrator must establish which assets belong to the company and which do not.

This not only covers the assets belonging to the debtor at the time the insolvency proceedings are opened but also further assets acquired by the debtor during insolvency proceedings.

The debtors' assets determined in this manner constitute the **insolvency estate** (*Insolvenzmasse*) which will be applied in the prescribed manner in satisfaction of creditors claims.

Further duties of the insolvency administrator include:

- paying wages to the debtor's employees (does not apply if the employee is released from work);
- deciding whether he wishes the company to perform outstanding contracts;
- preparing a **register of assets** (*Vermögensübersicht*);
- realising assets within the insolvency estate;
- making distributions.

## THE DEBTOR'S POSITION

Insolvency does not effect a transfer of the debtor's assets. The debtor continues to own them, albeit that the power to manage and dispose of them lies with the insolvency administrator. The opening of insolvency proceedings establishes numerous obligations for the directors to provide information and to cooperate with the insolvency administrator.

## PARTICIPATION AND INFLUENCE OF CREDITORS

German insolvency law provides different methods by which creditors may participate in insolvency proceedings and thus influence the progress of proceedings.

### Creditors' Meeting

The **creditors' meeting** (*Gläubigerversammlung*) is the main body established in the proceedings to pursue the interests of the creditors vis-à-vis the insolvency court, the insolvency administrator and the debtor. It is responsible for the determination and enforcement of the joint interests of the creditors.

The creditors' meeting will be convened by the insolvency court (sec. 74 InsO). All creditors with a right to separate satisfaction, all insolvency creditors, the insolvency

administrator, the members of the creditors' committee and the debtor are entitled to attend the meeting.

The creditors' meeting plays an important part in determining the direction of the insolvency proceedings since it is not bound by the opinion of the court and/or the insolvency administrator. Therefore, its decisions can be autonomous and made without ceding to pressure from other parties. Consequently, the creditors' meeting is entitled to make major decisions concerning the insolvency proceedings which are then generally binding on the administrator.

The Insolvency Act provides for several different aspects of the proceedings to depend on the approval of the creditors meeting including:

- election of members of the creditors' committee, sec. 68 InsO;
- decision on the further proceedings, sec. 157 InsO. At the report meeting, the creditors may decide whether the debtor's business should be closed down or temporarily continued. The creditors' meeting may commission the insolvency administrator to draw up an **insolvency plan** and determine the plan's objective. The creditors' meeting may also modify its decisions at subsequent meetings;

- election of a different insolvency administrator, sec. 57 InsO. During the first meeting after the appointment of the insolvency administrator, the creditors may decide to replace him. The court may only refuse to appoint the proposed alternative if he is not qualified to assume such an office;
- dismissal of the insolvency administrator, sec. 57 InsO. The creditors meeting is even entitled to request that the insolvency administrator be dismissed but only upon substantial grounds. When such a request is made, the court will hear the insolvency administrator before making its decision.

Pursuant to sec. 76 (2) InsO, voting at creditors' meetings is determined by a simple majority of the value of claims voting at the meeting. In the event of a tie, the majority of creditors will be decided on a poll (head count).

There is no minimum requirement and a meeting is quorate provided one creditor attends.

Where a creditor's claim has been disputed the right to vote will only be determined for the respective creditors' meeting, sec. 77 InsO, meaning that as long as the claim is disputed, a voting right can only be determined for every creditors' meeting separately.

However, where a decision has not yet been made in relation to a claim, unless and until it is disputed the creditor is entitled to vote for the full amount claimed, sec. 77 InsO.

Special regulations apply for voting in respect of insolvency plans, where commonly creditors will be divided into groups for voting purposes.

### **Creditors' Committee**

The court may initially appoint a **creditors' committee** (*Gläubigerausschuss*). However, at the report meeting, the creditors' meeting is entitled to decide whether that committee should remain in place, as constituted by the court or whether any changes to its membership should be made. Alternatively, if the court has not appointed a creditors' committee, then the creditors meeting may do so.

The creditors' committee is intended to represent the most important groups of creditors. Pursuant to sec. 67 (2) InsO this should be creditors with a right to separate satisfaction, representatives of the largest (by value) of creditors and a representative of the minority creditors and a representative of the debtor's employees (if the employees are involved as creditors holding considerable claims).

Creditors' committees can have such a direct influence on insolvency proceedings in Germany that financial institutions

should always seek to become members. Some opinions in legal literature even state that the contribution of a representative of financial institutions is required by sec. 67 (2) sent. 1 InsO. In syndicated or consortium arrangements, the lead lender would usually be the most appropriate person to act as a representative of all lenders in the syndicate. Even without express contractual provisions to that effect, the interests of the other members of the consortium are protected due to the fact that such representative must – as a member of the creditors' committee – exercise its rights as a committee member in the interest of all creditors.

All members have to officiate personally, thus representative members are not permitted.

In addition, all members of the creditors' committee are required to keep the business of the committee confidential. This is not provided for by statute but is usually addressed by requiring each member to enter into a confidentiality undertaking. As the members are required to take decisions in the interests of the company's creditors as a whole, the duty extends to keeping information received from the committee confidential even from the creditor whom they represent.

If members of the committee breach the duty of confidentiality, for example by releasing information to journalists, it will

give rise to a claim for damages pursuant to sec. 71 InsO or can lead to the dismissal of the member pursuant to sec. 79 InsO. Furthermore, the member *could* possibly be criminally liable pursuant to sec. 266 or 203 Criminal Code (*Strafgesetzbuch*). There is some debate regarding the extent of criminal liability in this area as no case law yet exists. However, each member of the creditors' committee should be made aware of such possible consequence.

The members of the creditors' committee are required to support and monitor the insolvency administrator's execution of his office. They can demand information regarding the manner in which the affairs of the company are progressing, have the right to inspect the books and business documents and have to approve the administrator's accounts sec. 69 InsO. Furthermore, the creditors' committee is responsible for ensuring that creditors' rights to participate in the proceedings are observed and to ensure that the insolvency administrator complies with his powers and duties. Additional powers which are reserved to the creditors' committee include:

- requesting that the court should dismiss the insolvency administrator, sec. 59 (1) 2 InsO;
- demanding the debtor's disclosure and cooperation, sec. 97 (1) InsO;

- deciding whether to authorise the insolvency administrator to close or dispose of the debtor's business prior to the report meeting, sec. 158 (1) InsO;
- consenting to any proposed distributions to creditors, sec. 187 (3) 2 InsO;
- advising in relation to any proposed insolvency plan proceedings, sec. 218 (3) InsO.

The creditors' committee shall be able to make decisions if the majority of members participated in the resolution. A decision is valid if the majority of such members voted for the respective decision, sec. 72 InsO. In the event of a tie of votes, the decision of the creditors' committee is declined.

## LODGEMENT OF CLAIMS

After the opening of insolvency proceedings, creditors should lodge their claims with the administrator who records their claims in an **insolvency schedule** (*Insolvenztabelle*). The creditor must state the circumstances under which its claim arose and the amount of its claim. German law (Article 184 Judicature Act (*Gerichtsverfassungsgesetz*)) requires that the claim must be lodged in German. However, pursuant to the European Insolvency Regulation creditors domiciled in another member state of the European Union may lodge their claims in the language of that member state. The only

linguistic requirement is that the lodgement states at the beginning “Anmeldung einer Forderung”.

The insolvency administrator must review all lodged claims and must determine whether or not he intends to dispute any of them at the forthcoming **verification meeting**.

Based on the insolvency schedule which has been prepared by the insolvency administrator in accordance with sec. 174, 175 InsO and archived at the insolvency court pursuant to sec. 175 (1) sent 2 InsO, a court hearing will take place where claims which have been lodged and recorded in the insolvency schedule will be verified.

All insolvency creditors (including members of the creditors’ committee) are entitled to attend the verification meeting (whether in person or by representative) and would be advised to do so if their claim is likely to be disputed. The insolvency administrator must attend the meeting in person and whilst it is suggested and nearly always advisable for the debtor or its managers to be present, their attendance is not compulsory.

During the meeting, each claim is considered – those that are disputed are separated from those which are to be approved which are then confirmed in respect of the amount claimed and their ranking/place which they should take in the order of priorities.

The insolvency administrator as well as those creditors whose claims have been approved are entitled to dispute a claim but the debtor is not entitled to do so. Any dispute must be raised orally during the verification meeting. Where no dispute is raised in relation to a debt during the meeting, it will be deemed to have been approved. Where a debt is disputed, reasons must be given. If disputes cannot be resolved during the meeting, the creditor is entitled to commence proceedings against those parties opposing the claim for the issues to be determined, sec. 179 InsO. To avoid being excluded from distributions, the creditor must commence **debt determination proceedings** (*Feststellungsklage*) at any time after the lodged claim has been disputed and before two weeks have expired following any statement of an intended distribution. Notice of the proceedings must be given to the administrator.

As between creditors, the costs of the debt determination proceedings tend to follow the event. Consequently, whichever of the creditors loses the case (whether they are the party seeking to lodge the claim or disputing it) they will be liable for the costs in accordance with section 91 Code of Civil Procedure (*Zivilprozessordnung*, “ZPO”). However, the insolvency administrator’s costs will be treated as liabilities of the insolvency estate, sec. 55 InsO.

# INSOLVENCY PLAN

## OVERVIEW

Insolvency plans were introduced in 1999, based upon the US Chapter 11 procedure. An insolvency plan provides freedom and flexibility to provide the best solution for creditors and enables the insolvent company to continue as a restructured business.

It was not very commonly used in practice for some time. However, the number of insolvency plans has been rising steadily over the last few years as the solution's popularity increases. Recently, the stationer Herlitz AG, chemist Ihr Platz, electronics retailer ProMarkt and clothes retailer Sinn Leffers have used insolvency plans as a means to restructure quickly. These high-profile cases have brought insolvency plan proceedings more into the public consciousness.

Using an insolvency plan allows otherwise mandatory statutory provisions relating to realisation and distribution of proceeds in insolvency proceedings to be waived. An insolvency plan is used within court based insolvency proceedings, and is not, therefore, a stand-alone out-of-court restructuring tool.

Approval of an insolvency plan will result in the management of the company resuming its responsibilities and the insolvency

administrator stepping down. It is usual, once the decision to propose a plan is reached, to appoint a new managing director to the insolvent company in order to provide some comfort to the creditors and the court. The new managing director should be an expert in restructuring and insolvency as well as being an experienced manager.

The debtor or the insolvency administrator can propose a plan, but not creditors. Creditors can only instruct the insolvency administrator to make a proposal. The plan has to be approved by the majority of creditors and then confirmed by the court.

## TYPES OF INSOLVENCY PLANS

The parties may conclude a liquidation plan which results in the liquidation of the debtor's business. Liquidation through a plan will, however, allow the ordinary order of priority of creditor claims to be altered by agreement. Thus, depending on the terms of the plan and the agreement reached, senior ranking creditors may not necessarily be paid first. Alternatively, the parties may agree on a transfer plan, meaning that the debtor's business will be transferred to a new legal entity for a reasonable price. Under a rehabilitation or reorganisation plan, the company will be reorganised and released from its debts (at least partially).

## ORGANISATION OF THE PLAN

One of the most important principles of insolvency plans is that creditors are divided into a number of groups. Once divided, the plan can provide for creditor groups to be treated differently. An insolvency plan can for example form different groups for secured creditors, ordinary (unsecured) creditors, subordinated creditors and employees.

Each insolvency plan consists of two parts, the declaratory part and the constructive part.

### Declaratory part

The declaratory part contains a description of the method by which it is intended that the company can be rehabilitated, a summary of its assets and liabilities, a report about the management of the business, an explanation of the reasons for the current crisis and an estimated outcome statement comparing the situation with and without the plan.

The declaratory part may also mention transactions or other issues which could be considered to amount to offences under the insolvency law.

### Constructive part

The second part of an insolvency plan is the constructive part which specifies what amendments it proposes to make to the individual rights and claims of creditors. It will also include an explanation of how it is proposed the debtor's business will continue.

Where a reorganisation plan is proposed, the plan will provide an explanation of the extent to which the creditors will be expected to relinquish their claims.

For a liquidation plan, the constructive part will contain the manner in which the proceeds will be distributed amongst creditors.

### Parties affected by the plan

The legal position of a number of different parties may be affected by the plan. Some parties are obliged to participate in the plan such as insolvency creditors, subordinated creditors, creditors with a right to separate satisfaction, the debtor and, under certain circumstances, shareholders. Others are not, but may do so if they wish, for example preferred creditors to the insolvency estate, creditors with a segregation right, any conditional buyer and a rescue or transfer company.

## ADOPTION OF THE PLAN

The insolvency plan needs the consent of the creditors' meeting. The plan has to be presented to a creditors' meeting at the end of which the creditors vote on the adoption of the plan. Voting takes place within the established groups of creditors. The plan is adopted if the majority of the voting creditors in each group approves the plan and if the sum of the claims of the creditors approving the plan exceeds half of the sum of all claims of the voting creditors in that group.

Consent will be deemed given by any group in which the majority has not been reached but in which the creditors will not be worse off by implementation of the plan. The underlying purpose of this provision is to prevent the failure of an economically sensible plan because of the opposition of a disinterested minority.

The debtor's approval is also required. The debtor is deemed to have consented if it has not opposed the plan before the vote at the creditors' meeting. If the debtor will not be worse off than it would be without the plan, its opposition to the plan is irrelevant.

Finally, the plan has to be confirmed by the court. Prior to its decision, the insolvency court hears submissions from the debtor as well as, where applicable, the creditors' committee. After the decision of the court has

become legally binding, the plan becomes effective and the insolvency proceedings are terminated. As a consequence, the creditors' committee and creditors' meeting are released from their obligations. The debtor recovers the power to transfer its assets and has to fulfil its obligations under the insolvency plan.

The constructive part of the plan may provide for supervision of the plan by the administrator. Supervision may continue for a maximum of three years after the insolvency proceedings have been terminated if no new insolvency proceedings are filed. However, supervision should be revoked before that time if all requirements and provisions under the terms of the plan are either fulfilled or their fulfilment guaranteed.

# SELF ADMINISTRATION

The Insolvency Act also provides for self administration. Self administration is similar to the US concept of debtor-in-possession under Chapter 11.

Self administration is applicable in both formal insolvency proceedings and insolvency plan proceedings.

The main pre-conditions for self administration are:

- the debtor applies for the order at the insolvency court;
- where the petition for insolvency proceedings was filed by a creditor, that this creditor consents to the debtor's application for self administration; and
- that the order of self administration will not delay proceedings or disadvantage creditors.

During self administration the debtor's management retains control and continues to operate the business. The debtor is placed under the supervision of a **custodian** (*Sachwalter*). The advantage of self administration is that the experience, market knowledge and insight to the debtor's company of the existing management are retained. In contrast, an insolvency administrator who has been appointed for a specific case only has very little time to get detailed knowledge about the business

he has to administer. Further, the fees for a custodian are lower than for a full insolvency administrator. Consequently, self administration reduces costs for the insolvency estate so that creditors may receive a higher quota on their claims.

To increase the chances of obtaining a court order for self administration, the insolvent company often appoints restructuring experts to its management prior to applying for self administration.

The procedure may be combined with other types of proceedings, including insolvency plan proceedings. The difference between self administration and formal insolvency proceedings is not significant as the main contrast is the role of the custodian whose role is more limited than that of a formal insolvency administrator.

Self administration is not very common in practice and courts seem to be reluctant to sanction it. The underlying reason is that the same management which was not able to avert insolvency are often considered to be inappropriate to continue managing the company after the opening of insolvency proceedings.

Notable cases of self administration include Kirch Media GmbH & Co, Sinn Leffers and Babcock Borsig AG.

# RANKING OF CREDITORS' CLAIMS

## PREFERENTIAL CREDITORS

As a general rule, claims of **preferential creditors** (*Massegläubiger*) are paid undiscounted and directly from the insolvency estate – unless it transpires that the estate is unable to cover even these claims.

In practice, the main categories of preferential creditors are:

- the insolvency administrator and the insolvency court for their fees and expenses;
- contracting parties for claims arising from contracts entered into with the insolvency administrator (after the opening of proceedings) or from pre insolvency contracts which the insolvency administrator elects to perform;
- social plan creditors for costs incurred under special employment law agreements;
- creditors whose claims result from decisions or actions taken by the insolvency administrator in the performance of his duties;
- actions based on claims for unjust enrichment.

## SECURED CREDITORS

### Right to separate satisfaction

A right to separate satisfaction grants the creditor a right for preferred satisfaction with respect to an asset which forms part of the insolvency estate. By exercising the right to separate satisfaction, the secured asset will either be realised by the secured creditor itself (who may then keep the proceeds) or the insolvency administrator may realise the secured asset and is obliged to hand over the net proceeds to the secured creditor.

Creditors with a right to separate satisfaction include:

- creditors with security over real estate;
- creditors holding a lien over an asset which is part of the insolvency estate;
- creditors with security over tangible movable assets (*Sicherungseigentum*);
- creditors with security over rights and receivables (*Sicherungsabtretung*);
- creditors who hold a right of retention (*Zurückbehaltungsrecht*). This must be separated from normal retention of title rights (which are deemed to grant segregation rights);
- federal, state and municipal governments with respect to certain claims (such as customs duty).

The realisation of assets on grounds of a right to separate satisfaction depends on the assets involved and may be exercised e.g. by way of private sale, public auction or forced administration (following the rules of the Act Relating to Foreclosures and Forced Administration).

### Segregation right

A creditor with a segregation right is a creditor who holds a right in rem or a right in personam and can prove that an asset is not part of the insolvency estate because of that right. A segregation right is based on an asset not being part of the insolvency estate and thus not part of those assets which can be accessed or confiscated by the insolvency administrator.

Creditors with a segregation right include:

- a legal proprietor;
- retention of title creditors. There are several types of retention of title which are treated differently:
  - simple retention of title (*einfacher Eigentumsvorbehalt*): The vendor of a tangible movable asset reserves ownership until the complete purchase price has been paid. Simple retention of title grants a segregation right;
  - extended retention of title (*erweiterter Eigentumsvorbehalt*): Ownership will not automatically be transferred with the payment of the purchase price but with the fulfilment of additionally agreed conditions. If the purchase price has been paid but additional conditions not yet fulfilled, the creditor albeit being the owner has a right to separate satisfaction only. Where the purchase price has not yet been completely paid, the creditor has a segregation right; and
- prolonged retention of title (*verlängerter Eigentumsvorbehalt*): The purchaser has been granted the authority to sell the asset in the ordinary course of business. The receivables arising from the sale of those assets, i.e. the claim for payment of the purchase price, will in advance be assigned to the vendor by way of security assignment. This will grant the creditor a right to separate satisfaction.
- it is often the case that suppliers with similar security rights form a “supplier pool” which facilitates enforcement of the suppliers’ rights against the insolvency administrator. Communication between the pool and the insolvency administrator takes place with one of the members of the pool instead of having to negotiate with every supplier separately;
- a restricted beneficiary in rem (*beschränkt dinglich Berechtigter*);
- a possessor;

- the holder of a contractual claim for restitution (*schuldrechtlicher Herausgabeanspruch*)

Segregation rights will be asserted against the insolvency administrator under the rules which apply to each type of segregation right.

## ORDINARY INSOLVENCY CREDITORS/UNSECURED CREDITORS

These are creditors who had a claim against the debtor at the time insolvency proceedings were opened, such as bond holders, unsecured loan note holders or unsecured contractual parties (*Insolvenzgläubiger*).

## SUBORDINATED CREDITORS

The interests of subordinated creditors (*nachrangige Gläubiger*) will be addressed after all unsecured creditors have been paid in full.

A debt is subordinated either pursuant to a contractual agreement or because it constitutes a shareholder loan (see below).

Loans made by shareholders to the company and other arrangements equivalent to shareholder loans are subordinated to the claims of all other creditors by law. Consequently, they only receive a distribution in respect of those claims if there are sufficient funds available after all other creditors' claims have been satisfied.

There are two exceptions to this rule:

- First, shareholders who are not directors of the company and do not hold more than 10% of the registered capital (**minority privilege** – *Kleinbeteiligtenprivileg*).
- Second, the so-called **restructuring privilege** (*Sanierungsprivileg*) which applies to the rescue attempt of an investor who previously did not hold shares in the company or only less than 10%. If such an investor acquires shares in order to rescue the company from insolvency, any loans granted by him before or in connection with the acquisition of the shares will not be subordinated.

# CHALLENGE OF TRANSACTIONS

Under German insolvency law, transactions which disadvantage creditors and which have been entered into within certain periods before the commencement of insolvency proceedings, may, in certain circumstances, be challenged by the insolvency administrator in later insolvency proceedings. This part of the guide commences with a consideration of the potential for an insolvency administrator to challenge a transaction on the basis that it amounts to **congruent cover** or **incongruent cover**. Where congruent cover arises, the creditor is paid or receives some form of security for the amounts due to it, but in each case, the value of the security or the amount paid matches the value of its claim and the manner originally agreed to between the parties. For incongruent cover, the creditor receives more by way of payment or security than would otherwise be due to it or earlier than would otherwise be due to it or in a manner which is otherwise inconsistent with the original agreement between the parties.

## CONGRUENT COVER

Where a transaction is entered into:

- in the period of three months leading up to the date on which the petition for insolvency proceedings is filed,
- which grants security in favour of a creditor or otherwise provides for that creditor's claim to be paid or satisfied,
- where the value of the security or payment does not exceed the value of the amount due and the performance of the debtor matches the manner originally agreed to, and
- at a time when the debtor was illiquid and the creditor was aware of its illiquidity,

that transaction may be challenged as congruent cover.

It is also possible to challenge transactions taking place after the petition for insolvency proceedings has been filed. Again, the creditor must either have known that the debtor was illiquid on the date of the transaction or that the debtor has already applied to court to open insolvency proceedings or have knowledge of circumstances that are pointing directly to this conclusion.

If a person with a close relationship to the debtor was involved in the transaction, it will be considered to be a connected party and will be presumed to have known of the debtor's illiquidity or of the filing of the insolvency petition.

## **INCONGRUENT COVER**

A transaction can be challenged pursuant to the provisions concerning **incongruent cover** where a creditor is granted security for or receives a payment in respect of an amount which he is not due to receive or is not yet due to receive or in a manner which is otherwise inconsistent with the original agreement between the parties.

It applies to transactions taking place during the month prior to the date of the insolvency petition – regardless of whether it can be shown that the company was illiquid at the time. It also applies to transactions taking place within the second and third month prior to the date on which the insolvency petition is filed, if the debtor was illiquid on the date of the transaction and the creditor knew that the transaction would be detrimental to other creditors or had knowledge of circumstances which would lead to that conclusion.

Connected parties are presumed to have known of the debtor's illiquidity or of the filing of the insolvency petition.

## **DIRECT DISADVANTAGE**

The insolvency administrator may challenge any transaction which directly prejudices the interests of creditors. To constitute a voidable transaction under the terms

of section 132 InsO, a transaction has to directly disadvantage the creditors, meaning that creditors were prejudiced at the time the transaction was carried out and not merely that they might be prejudiced as a result of the transaction.

Such a transaction is voidable if it has been made during the three months prior to the insolvency petition if the debtor was illiquid on the date of such transaction and if the other party had knowledge of the illiquidity on this date.

A transaction directly prejudicing other creditors is also voidable if it has been entered into after the insolvency petition and if at the time when the transaction was entered into the other party either knew of the illiquidity of the debtor or of the insolvency petition.

Provisions as to deemed knowledge and related parties are the same as set out above.

## **WILFUL DISADVANTAGE**

A transaction entered into during the ten years leading up to the filing of the petition for insolvency (or after the date of the petition) which was intended to prejudice creditors, may be challenged if the other party knew of the debtor's intent on the date of the transaction.

An onerous contract entered into with a connected party may also be challenged as a wilful disadvantage if it was entered into within two years of the commencement of the insolvency proceedings. However an order should not be made under this provision if the connected party was not aware, at the date of the transaction, of the debtor's intention to prejudice creditors. Knowledge will be presumed if the other party knew that illiquidity was imminent.

## **GRATUITOUS BENEFIT**

Gratuitous benefits granted by the debtor may be challenged. A gratuitous benefit occurs where the recipient of the benefit is not entitled to receive any payment or other consideration from the debtor but nevertheless receives something. A gratuitous benefit is voidable if it was granted in the four years prior to the filing of the insolvency petition. There are no further preconditions which must be satisfied.

## **SHAREHOLDER LOANS**

Transactions which grant security for or satisfy a claim to repay a shareholder loan are voidable.

Security granted to a shareholder is voidable if it was granted within the period of ten years leading up to the insolvency petition or was granted after the petition was filed at court. The repayment of a shareholder loan is voidable if it was repaid during the twelve months leading up to the presentation of the petition for insolvency or if it was paid after such petition.

A transaction entered into by a company within the year prior to the filing of the petition for insolvency in order to satisfy a third party's claim to repayment of a loan may be challenged if a shareholder had granted security for or given a guarantee for such claim. This also applies to payments made towards claims of equivalent economic effect.

# CROSS BORDER

## OVERVIEW

The Council Regulation (EC) No 1346/2000 (“**Regulation**”) was adopted by the EU Council on 29 May 2000 and came into force on 31 May 2002. It has direct effect in all member states of the European Union with the exception of Denmark, who instead intended to introduce parallel legislation. By this statute, the European Union provided, for the first time, uniform rules for the settlement of cross-border insolvencies.

The Regulation differentiates between main proceedings, territorial proceedings and secondary proceedings.

## MAIN PROCEEDINGS

As a fundamental principle, main insolvency proceedings shall be commenced in the member state where the debtor’s Centre of Main Interest (COMI) is located. The COMI is presumed to be the place of the registered office. In addition, insolvency proceedings may also be commenced in a member state where a debtor has an “establishment” for assets.

Main insolvency proceedings, once commenced, shall automatically be recognised across all member states. The law of the member state in which main insolvency proceedings are commenced will govern the proceedings. As a consequence,

the liquidator may also exercise all of the powers he has under the law of the member state where main proceedings have been commenced in any other member state.

## SECONDARY PROCEEDINGS

Secondary proceedings may be opened in a member state after main proceedings have been initiated in a different member state in order to protect local creditors and assist and support the main proceedings.

Secondary proceedings will usually be opened based on the request of either a creditor or the liquidator of the main proceedings without further assessment by the court as to the insolvency of the debtor.

Secondary proceedings are subordinated to main proceedings. The liquidators must co-operate and the liquidator of the main proceedings can advise the liquidator of the secondary proceedings.

Any surplus from secondary proceedings has to be passed to the liquidator of the main proceedings.

## TERRITORIAL PROCEEDINGS

Territorial proceedings (*Partikularverfahren*) are proceedings which are only directed to the debtor’s domestic assets without requiring the commencement of main proceedings.

## **Territorial proceedings under European law**

Under European law, territorial proceedings can only be commenced in a member state where the debtor has an establishment as defined in Articles 3.2 and 2 (h) of the Regulation and the effects of territorial proceedings are restricted to assets of the debtor in the member state in which the territorial proceedings are commenced.

Based on the unitary pan-European coverage of the debtor's assets, territorial proceedings can only be opened in certain circumstances. The first requirement is that main proceedings cannot be opened under the law of the member state where the debtor has the COMI. For example, this would be the case if the debtor in the member state of the COMI is not capable of becoming subject to insolvency proceedings but has an establishment in another member state. Secondly, the opening of territorial proceedings is possible if requested by a creditor of the local establishment or, thirdly, if the receivable of this creditor is based on a liability related to the business of the establishment.

## **Territorial proceedings under German law**

If the debtor's COMI is in another state, territorial proceedings may be opened in accordance with the German Insolvency Act if the debtor has an establishment or

other assets on German territory. Where the debtor has a local establishment, every domestic or international creditor is entitled to request the opening of territorial proceedings.

Where domestic assets of the debtor are deemed to be located depends on the type of assets. With respect to tangible assets, their actual location is decisive. Intangible assets (receivables) are located at the debtor's residence and where a security is provided for the receivable also at the location of the security.

If the debtor does not have an establishment but only "other" assets, the creditor has to show credibly that it has a special interest with respect to the opening of territorial proceedings. A special interest would for example be where the creditor's situation or recovery would be far worse if proceedings were opened in another state. In contrast, it would not be a special interest if the debtor only had few individual domestic assets such as a plot of land or a bank account which could as well be dealt with by the insolvency proceedings of the other state.

## **THE LIQUIDATOR**

A liquidator under the Regulation may be any person or body whose function it is to administer assets of which the debtor has been divested or to supervise the administration of its affairs. In Germany

this includes a (preliminary) insolvency administrator, a trustee (*Treuhänder*) or a custodian (*Sachwalter*).

All powers conferred on the liquidator by the law of the member state where proceedings have been opened are exercisable in any other member state as long as no other insolvency proceedings have been opened there nor any preservation measure to the contrary has been taken there further to a request for the opening of insolvency proceedings in that state.

However, the liquidator has, as a matter of course, to comply with the law of the other relevant member state. The liquidator is entitled to remove the debtor's assets from the territory of the member state in which they are situated. Furthermore, he may claim through the courts or out of court the removal of movable assets to the territory of his member state after the opening of insolvency proceedings or instigate an **action of challenge** (*Anfechtungsklage*) in the interest of the creditors.

# DIRECTORS' DUTIES AND LIABILITIES

## MANAGING DIRECTORS

German law provides that directors may be personally liable to the company, third parties and public bodies. The major risks for directors arise from not complying with their obligation to file for insolvency within the necessary time after the occurrence of an insolvency event. This applies only in the event of illiquidity and over-indebtedness.

In general, directors are required to exercise the diligence expected of a prudent businessman in their conduct of the affairs of the company. Failure to do so may lead to liability for any damage which is the result of the directors not meeting their duty of care.

Where a company becomes insolvent, the directors are obliged to file for insolvency without undue delay but at the latest three weeks after the occurrence of an insolvency event. Directors face criminal liabilities as well as civil liabilities in damages if they intentionally or negligently omit to file for insolvency, file incorrectly or not in time, despite the company being over-indebted or illiquid.

Consequently, directors must preserve the assets of the company, once illiquidity or over-indebtedness of a company is determined. A director is personally liable to the company in damages for effected payments, unless a prudent businessman acting with due care would have made such payments.

A director must not make any payments to shareholders (e.g. in respect of shareholder loans) which will inevitably lead to the company's illiquidity, unless a prudent businessman could not have foreseen the impending illiquidity. If the director made such payments nonetheless, he would personally be liable to the company for payments made in violation of the rule. It is for the director to prove that the illiquidity was unforeseeable. This new liability has been introduced by the MoMiG in 2008.

Furthermore, a director could be liable if he culpably infringed the duty not to pay out the company's nominal capital and thereby caused an adverse accounting balance (*Unterbilanz*). In such a case, all directors of the company responsible for authorising the payments are jointly liable.

German tax laws impose a direct responsibility on directors to ensure the company's compliance with its tax obligations. The directors may be held liable for the company's tax liabilities should they intentionally or negligently not pay such taxes, commit any breach of trust or embezzle wages or salaries.

Directors need to ensure by appropriate measures that in a crisis, wage tax (which in Germany is paid by the company to the authorities and is withheld from salaries) can be paid when due. A possible way of conforming with this obligation is to cut wages in order to retain a certain amount for income tax.

Tax legislation provides that directors are obliged to declare and forward wage taxes owed by a company in a timely fashion. Neither financial difficulties of the company nor filing for insolvency will in general release the director from his liability as long as he is in control of the finances of the company. Furthermore, if funds are available at the time the wage tax is due, the director must pay it.

Additionally, directors may face criminal and civil liability in damages if they hold back or use other social insurance contributions meant for employees. This criminal offence leads to a claim in damages from the social insurance authorities against the director.

Directors may face criminal and civil liability in damages where they conclude contracts or induce parties to trade despite reasons for opening insolvency proceedings being present and by way of recklessness ignore the fact that damages may arise for the counterparty.

If a director procures that the company enters into a contract primarily in order to receive payments which will delay the otherwise inevitable insolvency, he will be held liable. Any such creditor may subsequently claim an amount in damages that would put him in the same financial situation he would have been in, if he had never entered into the contract with the company.

## **PARENT COMPANY**

As a general rule, parent companies of limited liability company subsidiaries cannot be held liable for their subsidiaries' debts. However, a parent company may still be held liable in tort when interfering with the subsidiary's business. Additionally, the insolvency administrator may challenge and claim back certain payments effected by a subsidiary to its parent company.

# VOLUNTARY LIQUIDATION

Voluntary liquidations are only available to a solvent company to allow it to wind up its business. The shareholders will appoint a professional liquidator to organise the winding up. The business will then come to an end; operations will be closed down, employees laid off, agreements terminated and all remaining assets sold. After this process, all creditors will be paid in full and the remaining funds distributed.

If it transpires that there are insufficient funds to satisfy all creditors and outstanding claims, the company is over-indebted and the management must file for insolvency.

Every liquidation has to be publicly announced in the German Federal Gazette (*Bundesanzeiger*).

After the successful liquidation and the company's dissolution, the company will be removed from the Commercial Register.

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