Insolvency - Germany

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Introduction

The law governing insolvency and insolvency proceedings is regulated in Germany by the Insolvency Code (*Insolvenzordnung* –' InsO'), which entered into force on 1 January 1999. The particularity of the Insolvency Code is that it contains not only procedural, but also substantive provisions. For example, the provisions determining the effects of opening insolvency proceedings are substantive provisions (Sections 80 to 147 of the InsO).

The primary objective pursued by the Insolvency Code is collective satisfaction of a debtor's creditors, either by realisation of the debtor's assets and distribution of the proceeds, or by reaching an alternative arrangement set out in an insolvency plan, particularly with a view to maintaining the enterprise in being (Section 1, first sentence, InsO). 'Collective satisfaction' (*gemeinschaf*

tliche Befriedigung) means that the creditors will in principle receive satisfaction in proportion to their respective claims. In addition, the insolvency proceedings are intended to give honest debtors the opportunity to free themselves of their remaining debts (Section 1, second sentence of the InsO).

A defining principle of German insolvency proceedings, in addition to the principle of equal treatment of creditors, is that of creditor autonomy (*Gläubigerautonomie*). Extensive rights are available to creditors to shape the proceedings, especially with regard to the way in which the debtor's assets are realised. The creditors also decide on the concrete form of the insolvency proceedings, since, in addition to the standard procedure, the Code opens up the possibility for secured and ordinary creditors to exercise their autonomy by drawing up an insolvency plan that departs from the provisions of the Insolvency Code to settle the realisation of the insolvency estate, the distribution to the parties concerned, the course of the insolvency proceedings and the debtor's liability subsequent to the termination of the insolvency proceedings. The insolvency plan is particularly important in the case of a reorganisation of an enterprise, although it can also provide a framework for winding up the enterprise.

German law on insolvency proceedings is also characterised by the principle of unity. This means that the Act on Reorganisation and Winding-up (*Gesetz für Sanierung und Liquidation*) does not provide for any separate types of proceeding. Both winding-up and reorganisation can be conducted by the standard procedure or by the insolvency plan procedure.

1 Who may insolvency proceedings be brought against?

Insolvency proceedings may be opened in respect of the assets owned by any legal or natural person, even if this person does not engage in a commercial or self-employed professional activity (a natural person who does not engage in such an activity is referred to as a 'consumer'). Insolvency proceedings may also be opened in respect of the assets of a partnership without legal personality (e.g. a general commercial company (*offene Handelsgesellschaft*) or limited partnership (*Kommanditgesellschaft*) or for a separate fund, such as the estate of a deceased person. For legal persons governed by public law, the special provision in Section 12 of the Code applies, which specifies that insolvency proceedings may not be opened in respect of the assets owned by the Federal Government or a *Land* (Section 12(1), subparagraph 1 of the InsO).

2 What are the conditions for opening insolvency proceedings?

Insolvency proceedings are opened only on application, and not automatically by any public body. The application can be submitted by the debtor or by a creditor. In order to protect court and debtor against applications made prematurely or purely with intent to cause damage, a creditor making an application has to demonstrate plausibly that grounds for insolvency exist and that the creditor does indeed hold a claim.

When a limited company is insolvent, its governing bodies must make application or face penalties. If that requirement is infringed, the creditors may be able to bring a claim for damages. If a debtor in crisis acts culpably, he may make himself liable to prosecution in certain circumstances (Sections 283 *et seq.* of the Criminal Code (*Strafgesetzbuch*)).

The general reason for opening insolvency proceedings is inability to pay. There is inability to pay if a debtor is not in a position to meet payment obligations that have fallen due; insolvency is presumed as a rule if the debtor has stopped payments (Section 17 (2) of the InsO). If the debtor is a legal person or a company in which none of the partners is a natural person with unlimited liability, proceedings may also be opened on grounds of overindebtedness. There is overindebtedness if the debtor's assets no longer cover the existing liabilities, unless it is highly likely in the circumstances that the enterprise will continue in being (Section 19 (2) of the InsO). If, considering the circumstances, the continued existence of the enterprise is highly likely, it must be taken as a basis when the value of the debtor's assets is assessed. An application can also be brought by a debtor if he faces imminent inability to pay (Section 18(1) of the InsO). The debtor is deemed to face imminent inability to pay if he is likely to be unable to meet his existing obligations to pay on the date on which they fall due (Section 18(2) of the InsO).

It is also necessary to ensure the financing of the insolvency proceedings. The request to open insolvency proceedings will therefore be refused if the debtor's assets will probably be insufficient to cover the costs of the proceedings (Section 26(1), first sentence, InsO).

If the conditions are met, the court in charge of the insolvency or 'insolvency court' (*Insolvenzgericht*) issues a decision to initiate proceedings, which is published. The public announcement is made by the court on the Internet (http://www.insolvenzbekanntmachungen.de/). In the decision to initiate proceedings, the court calls on the ordinary creditors to file their claims within a specific time-limit with the insolvency administrator. It sets a date for a meeting at which the creditors, on the basis of the insolvency administrator's report, decide on the course to be taken by the insolvency proceedings, and set a date for a verification hearing at which the filed claims will be verified.

As already stated in the introduction, the Insolvency Code does not provide for separate types of proceedings for reorganisation and winding up. In addition to the standard procedure, the Code opens up the possibility of an insolvency plan as a path to winding up or as a path to reorganisation.

The insolvency court has to verify that the conditions for opening the proceedings are met, which may take some time, and in the opening proceedings the court will take any interim measures which appear necessary, in order to avoid any change to the financial status of the debtor that might be detrimental to the creditors pending the decision on the application (Section 21(1), first sentence, InsO). In practice, the court designates a provisional insolvency administrator (*vorläufiger Insolvenzverwalter*), who may be 'weak' or 'strong'. If a 'weak' provisional insolvency administrator is appointed, the debtor retains power of disposal and the specific duties of the administrator are determined by the court, although these may not go beyond the duties of a strong provisional insolvency administrator (Section 22(2), second sentence of the InsO). The court may, for example, order that disposal by the debtor is valid only with the approval of the administrator. The appointment of a weak provisional insolvency administrator does not result in the interruption of pending legal disputes (BGH NZG 1999, 939, 940). The provisional insolvency administrator is 'strong' if the court imposes a general prohibition preventing the debtor from making any disposal, so that the right to manage and dispose of the debtor's property is vested in the administrator (Section 22(1), first sentence, InsO).

3 Which assets form part of the insolvency estate? How are the assets treated which are acquired by or which devolve on the debtor after the opening of the insolvency proceedings?

The insolvency estate (*Insolvenzmasse*) includes the assets owned by the debtor on the date when the proceedings were opened and those newly acquired by him during the proceedings (i.e. until the proceedings are terminated or discontinued). The estate does not include strictly personal rights of the debtor and objects not subject to attachment, since these would not be subject to individual enforcement proceedings either. Earned income, for example, is part of the insolvency estate only to the extent that it exceeds the debtor's minimum subsistence level. The insolvency administrator may also release assets, which then belong to the debtor's own assets and are not attachable.

In German law, the right to manage and dispose of the assets belonging to the insolvency estate is in principle transferred to the insolvency administrator on the opening of the proceedings (exception: debtor-in-possession management (*Eigenverwaltung*), Sections 270 *et seq.* of the InsO), so the provision of collateral in favour of lenders who grant debtorin-possession financing, for instance, is incumbent on the insolvency administrator. For transactions of particular importance, such as entering into a loan contract with considerable burdens on the insolvency estate, the insolvency administrator needs the approval of the creditors' meeting or of an appointed creditors' committee (Section 160(2), subparagraph 2 of the InsO). Loan commitments and other liabilities entered into by the insolvency administrator are obligations incumbent on the estate which are satisfied from the estate as a priority, i.e. before the ordinary creditors. In this way, it is ensured that, after the opening of the insolvency proceedings, contracting partners will be prepared to do business with the insolvent debtor.

4 What powers do the debtor and the insolvency practitioner have, respectively?

Since, with the opening of the insolvency proceedings, the insolvency administrator as a rule assumes an important role (exception: debtor-in-possession management), at this stage of the proceedings the insolvency court essentially has powers of supervision and direction (see Section 58, 76 of the InsO) (in addition to special powers, for example in the insolvency plan procedure or in the context of debtor-in-possession management). Once the insolvency proceedings have been opened the key decisions (realisation, winding-up, reorganisation and insolvency plan) are left to the creditors. The court has special powers and tasks, however, at the stage of opening the proceedings. Here it takes decisions on the opening, on interim measures of protection, and on the appointment of an insolvency administrator. The court is also responsible for supervising the insolvency administrator. It supervises the lawfulness of his acts, but not their advisability, and it cannot give instructions. In order to expedite the insolvency proceedings, decisions of the insolvency court are open to appeal only in cases where the Code provides for an immediate appeal (*sofortige Beschwerde*) (see Section 6(1) of the InsO). An immediate appeal can be filed with the insolvency court itself or with the regional court (*Landgericht*) above the insolvency court, in writing or orally at the court office (*Geschäftstelle*). It does not have suspensory effect; the court hearing the appeal or the insolvency court may however order a temporary stay of execution.

The insolvency administrator is the key player in the insolvency proceedings. Only natural persons, and not legal persons, can be appointed as insolvency administrator (Section 56(1), first sentence, InsO). In particular lawyers, businessmen, accountants or tax advisers come into consideration for this appointment. With the opening of the insolvency proceedings, the right to manage and dispose of the debtor's property is vested in the insolvency administrator. His main duty is to clear the assets he finds on the opening of the insolvency proceedings of any items that are not the property of the debtor. He also has to transfer to the debtor's assets items which belong to the debtor's assets under liability law, but which were not yet entered among the debtor's assets at the time insolvency proceedings were opened. The debtor's assets determined in this way constitute the insolvency estate (*Insolve*

nzmasse, Section 35 of the InsO) which will be realised by the insolvency administrator and from which the creditors will be satisfied. Further duties of the insolvency administrator include:

- payment of wages to the employees of the insolvency debtor,
- deciding whether to continue or end pending legal disputes (Sections 85 *et seq.* of the InsO) and how to deal with contracts which have not been (completely) performed (Sections 103 *et seq.* of the InsO),
- drawing up a statement of assets and liabilities (Section 153(1), first sentence, InsO),
- contesting transactions entered into prior to the opening of insolvency proceedings that are likely to disadvantage the ordinary creditors (Sections 129 *et seq.* of the InsO).

The insolvency administrator is subject to the supervision of the insolvency court (Section 58(1) of the InsO). If a creditors' committee is appointed, it monitors the insolvency administrator in the performance of his duties (Section 69, first sentence, InsO).

After the opening of the insolvency proceedings, when the right to dispose of the debtor's property has been vested in the insolvency administrator, the administrator can in principle dispose freely of all the assets belonging to the insolvency estate. There are limits on transactions of particular importance, such as the sale of the enterprise or the entire stock. These transactions of particular importance require the approval of the creditors' meeting or the creditors' committee. The fact that the approval requirement has been infringed, however, has no effect on outside parties, but results only in the liability of the administrator. The administrator also has to comply with a decision of the creditors' meeting to wind up the enterprise or to continue in business (Sections 157, 159 of the InsO).

If the insolvency administrator wrongfully violates the obligations incumbent on him under the Insolvency Code, he is liable for damages to all parties to the proceedings (Section 60(1) of the InsO). Section 60(1) of the Code provides: 'The insolvency administrator shall be liable to compensate the damage suffered by any party to the proceedings if he wrongfully violates the duties incumbent on him under this Code. He shall conduct himself with the care expected of a proper and diligent insolvency administrator.'

The insolvency administrator is entitled to remuneration in consideration of the exercise of his office and to reimbursement of appropriate expenses (Section 63(1), first sentence, InsO). The remuneration is regulated in the Insolvency Law Remuneration Regulation (*Insolvenzrechtsvergütungsverordnung* – 'InsVV') and is determined according to the value of the insolvency estate at the time the insolvency proceedings come to an end. The Regulation provides for graduated standard rates, which may however be increased according to the scale and difficulty of his duties.

Even after the insolvency proceedings have been opened, the debtor against whom the claims of the ordinary creditors are made remains the owner of the assets to be realised (Sections 38, 39 of the InsO). In principle, he is liable to the extent of all his assets. However, the right to manage and dispose of the assets within the scope of the insolvency proceedings is vested in the insolvency administrator. In exceptional cases, at the request of the debtor, the court decision initiating the proceedings may also order debtor-in-possession management in accordance with Section 270 *et seq.* of the Code, provided no circumstances are known that would lead one to expect that the order will place the creditors at a disadvantage. In principle, the general provisions of insolvency law apply here too (Section 270(1), second sentence, InsO). However, in debtor-in-possession management, the debtor retains his right to manage and dispose of his assets, which he exercises under the supervision of a monitor (*Sachverwalter*) appointed by the court (Section 270(1), first sentence, InsO). In the case of debtor-in-possession management, the powers usually incumbent upon the insolvency administrator are shared between debtor and monitor.

The opening of the insolvency proceedings gives rise to a large number of obligations on the debtor to provide information and to cooperate. At the same time, however, the debtor is also entitled to participate in the proceedings.

5 Under which conditions may set-offs be invoked?

Sections 94 *et seq.* of the Code deal with the issue of whether an ordinary creditor can set off a claim on an insolvent debtor. The Code makes a fundamental distinction depending on whether the possibility of a set-off already existed at the time when the insolvency proceedings were opened or whether the possibility arose only afterwards. In the first case, the set-off is admissible in principle, which means that the ordinary creditor does not have to register a claim for inclusion in the schedule of debts (*Tabelle*), but can obtain satisfaction by declaring the set-off to the insolvency administrator. However, the declaration of set-off is invalid if the creditor acquired the opportunity to set off a claim as a result of a voidable transaction (Section 96(1), subparagraph 3, InsO).

In the second case, where the possibility of setoff arose afterwards, a distinction has to be made:

If at the time when the proceedings were opened the claim for set-off already existed, but was not yet due, did not yet provide for a similar consideration, or was still conditional, the set-off is admissible after the opening of the proceedings as soon as the impediment to set-off is removed.

If at the time when the proceedings were opened the claim was not yet established, or if the creditor acquired the claim against the debtor only the proceedings were opened, set-off is prohibited (Section 96(1), subparagraphs 1 and 2, InsO), with the consequence that the debtor can require the creditor to perform his side of the contract for the benefit of the insolvency estate, but the creditor can only register his claim for inclusion in the schedule of debts, and will be satisfied only at the dividend rate.

But if the creditor did not acquire the claim from another creditor after the insolvency proceedings opened, and acquired it in his own person after the opening of proceedings, for instance by concluding a contract with the insolvency administrator, he is entitled to set-off as creditor of the insolvency estate itself.

6 What effect do insolvency proceedings have on current contracts the debtor is a party to?

The effects of the insolvency proceedings on current contracts is regulated in German law in Sections 103 *et seq.* of the Code. In principle, upon the opening of the insolvency proceedings, existing contractual relationships may cease to exist or may continue, or the insolvency administrator is given the choice between performance and termination.

For some transactions, the effects of the insolvency proceedings are explicitly regulated by law (Sections 103 to 118 of the InsO). For example, orders, contracts for work or services or authorisations to act in respect of assets forming part of the insolvency estate expire upon the opening of the insolvency proceedings, whereas contracts concluded by the debtor for the lease of property and employment contracts continue to exist and bind the insolvency estate.

For contracts not or not completely performed by the debtor and the other party, Section 103(1) of the Code gives the insolvency administrator a choice between performance and non-performance of the contract. If the insolvency administrator decides in favour of performance for the account of the insolvency estate, the creditor's counterclaim is to be satisfied as a priority, because it represents a debt incumbent on the estate pursuant to Section 55(1), subparagraph 2, of the Code. If the insolvency administrator decides against performance, he may not demand anything further under the contract. The creditor can assert his claim for compensation for non-performance only as an ordinary creditor, by registering his claim for inclusion in the schedule of debts (Section 103(2), first sentence, InsO). If the insolvency administrator makes no choice, the contracting partner can require him to choose. In this case, the administrator has to declare without delay whether or not he intends to require performance. If he fails to do so, he may no longer insist on performance of the contract. For financial services and fixed-date transactions, the Code precludes the administrator's right of choice (Section 104 InsO).

If the fate of the contractual relationship is not specifically regulated in Sections 103 to 118 of the Code, the contract continues even after the opening of the insolvency proceedings.

The reliability of cancellation clauses in contracts is controversial. The starting point is the provision in Section 119 of the Code, which states that agreements excluding or limiting the application of Sections 103 *et seq.* in advance are invalid. Under this provision, cancellation clauses independent of the insolvency, which are not linked to the opening of the insolvency proceedings or the lodging of the application, but for instance to the debtor's failure to pay, are permissible. But cancellation clauses that do depend on the insolvency are problematic — especially against the background of the Federal Court of Justice (*Bundesgerichtshof*) ruling of 15 November 2012 (BGHZ 195, 348). In that judgment the Federal Court of Justice found that a cancellation clause in an energy supply contract that was dependent on the insolvency at issue was invalid. But the Court said that cancellation clauses dependent on an insolvency were not invalid *per se*: cancellation clauses corresponding to a possibility of cancellation provided for by law were permissible. Thus the assessment of cancellation clauses dependent on an insolvency has not been conclusively settled. For contractual solution clauses in financial services and fixed-date transactions, Section 104(3) and (4) of the Code contains special rules.

If a prohibition of assignment was effectively agreed between debtor and creditor in accordance with the rules of ordinary law, this is also binding on the insolvency administrator. However, in business transactions, such a prohibition of assignment is regularly ineffective, because even if there is a contractually agreed prohibition of assignment, the assignment of a monetary claim is nevertheless effective if debtor and creditor are traders (Section 354a(1) of the Commercial Code (*Handelsgesetzbuch*)).

7 What effect does an insolvency proceeding have on proceedings brought by individual creditors (with the exception of pending lawsuits)?

Since the insolvency proceedings aim for equal satisfaction of all creditors, Section 87 of the Code makes it clear that the ordinary creditors are permitted to enforce their claims only under the provisions governing the insolvency proceedings. The opening of the insolvency proceedings therefore brings about an enforcement ban, preventing ordinary creditors from enforcing their claims

against the insolvency estate or against the debtor's other property during the insolvency proceedings (Section 89(1) of the InsO). The enforcement ban is to be observed by operation of law, so enforcement already started is suspended automatically, regardless of whether the creditor was aware of the opening of the proceedings and whether the debtor has applied for a stay of execution.

Section 88 of the Code provides that the opening of the proceedings has retroactive effect (*Rückschlagsperre*) on prior enforcement measures, and specifies that security interests acquired by virtue of enforcement during the last month preceding the application to open the insolvency proceedings or after such application was made become legally ineffective when the insolvency proceedings are opened. Here too it is irrelevant whether the creditor knew of the intended application to open the insolvency proceedings.

If the security was acquired by virtue of an enforcement measure some time before the application to open the insolvency proceedings, the security is not ineffective pursuant to Section 88, first sentence, of the Code, but may be contestable under certain conditions (BGH NJW 2004, 1444).

On the opening of the insolvency proceedings, the debtor loses his capacity to be a party to legal actions on behalf of the estate. This right is vested in the insolvency administrator, who is entitled to act as a party to legal proceedings by virtue of his office. The insolvency administrator can therefore assert claims belonging to the insolvency estate in his own name.

8 What effect does an insolvency proceeding have on the continuation of lawsuits pending at the moment of the opening of the insolvency proceeding?

Since the insolvency debtor loses the capacity to take legal action on the opening of the insolvency proceedings, a pending lawsuit, if it concerns the insolvency estate, will initially be interrupted (Section 240, first sentence, Code of Civil Procedure (*Zivilpro zessordnung* – ZPO)).

If the debtor is the plaintiff (for example, in a lawsuit in which the debtor is a claimant or in which he raises objections to an already enforceable claim), the insolvency administrator may resume the proceedings or refuse to do so (Section 85(1), first sentence, InsO). If he accepts, the proceedings are continued. If he refuses, the asset is released from the insolvency estate, and the action may be resumed by either the debtor or the defendant (Section 85(2) of the InsO).

If the debtor is the defendant, a distinction must be made: if at the time the insolvency proceedings open a lawsuit is pending concerning a claim within the scope of the insolvency, the claim must be registered for inclusion in the schedule of debts (see Section 87 InsO). If the insolvency administrator or an ordinary creditor objects, the determination of the claim is to be pursued by resumption of the interrupted lawsuit (Section 180(2) InsO).

On the other hand, if the claim is not within the scope of the insolvency, but for example is a claim for exemption or for a debt incumbent on the insolvency estate itself, the lawsuit can be resumed either by the insolvency administrator or by the plaintiff (Section 86 of the InsO).

9 What are the main features of the participation of the creditors in the insolvency proceeding?

As already explained in the introduction, the Insolvency Code grants considerable influence over the insolvency proceedings to the creditors. The creditors exercise their rights through the creditors' meeting (*Gläubigerversammlung*, Sections 74 *et seq.* of the InsO) or a creditors' committee (*Gläubigerausschuss*) that may optionally be appointed by the creditors' meeting (Sections 67 *et seq.* of the InsO). Whereas the creditors' meeting is the central body through which the creditors take their decisions, the creditors' committee is a body through which they exercise supervision. The creditors' meeting is convened by the insolvency court (Section 74(1), first sentence of the InsO), which also chairs it (Section 76(1) of the InsO). All preferred creditors, all ordinary creditors, the insolvency administrator, the members of the creditors' committee and the debtor are entitled to attend the creditors' meeting (Section 74(1), second sentence of the InsO). Decisions of the creditors' meeting are in principle adopted by simple majority, with the majority being decided not by the number of votes, but by the sum of the claims held by the creditors voting (Section 76(2) of the InsO). If an enterprise exceeds certain size criteria, the insolvency court has to appoint a provisional creditors' committee even before the opening of the insolvency proceedings (Section 22a of the InsO). This committee is involved in the appointment of the insolvency administrator and plays a role in any decision on the ordering of debtor-in-possession management (Sections 56a, 270(3) of the InsO).

The importance of the creditors' meeting is reflected in the fact that it decides the course to be taken by the proceedings, and especially the way in which the debtor's assets are to be realised. Further duties of the creditors' meeting are:

- the election of a different insolvency administrator (Section 57, first sentence, InsO)
- the supervision of the insolvency administrator (Sections 66, 79, 197(1), subparagraph 1 of the InsO),

- the decision to close down or continue the enterprise (Section 157 of the InsO),
- the approval of certain transactions of particular importance entered into by the insolvency administrator (Section 160(1) of the InsO),
- cooperation in drawing up and implementing the insolvency plan.

10 In which manner may the insolvency practitioner use or dispose of assets of the estate?

For the powers of the insolvency administrator with regard to assets of the insolvency estate, see above under the question ‘What powers do the debtor and the insolvency practitioner have, respectively?’

11 Which claims are to be lodged against the debtor's insolvency estate and how are claims arising after the opening of insolvency proceedings treated?

1. Creditors entitled to exemption

Creditors entitled to exemption (*aussonderungsberechtigte Gläubiger*, ‘creditors with a right of separation’) are those who are entitled to claim the exemption of an asset from the insolvency estate under a right *in rem* or *in personam* (Section 47, first sentence, InsO). Creditors entitled to exemption are not ordinary creditors and therefore do not have to register their claims for inclusion in the schedule of debts, but can enforce them by way of an action in accordance with the ordinary rules of law (Section 47, second sentence, InsO). However, they bring such an action not against the debtor, but against the insolvency administrator, who acts as a party by virtue of his office. Entitlement to exemption may derive from ownership of the asset (provided it is not ownership transferred by way of security, as this makes the owner a secured creditor only (Section 51, subparagraph 1, InsO)) or from simple reservation of title, but also from a claim to restitution under the law of obligations (e.g. a landlord against a tenant).

2. Secured creditors

Secured creditors (*absonderungsberechtigte Gläubiger*, ‘creditors with a right to separate satisfaction’) are those who have a right to priority satisfaction from the realisation of an asset belonging to the insolvency estate. They do not participate in the procedure for the verification of claims, but are given preferential treatment, since they are entitled to satisfaction before the other lower-ranking or unsecured ordinary creditors from the proceeds of the asset in question. Any surplus proceeds from the realisation accrue to the insolvency estate, and only those are available for the satisfaction of the other creditors. A right of security of this kind may derive *inter alia* from liens, pledges on movables or ownership by way of security (Sections 50, 51 of the InsO).

If the proceeds obtained are insufficient for satisfaction and the secured creditor has a claim *in personam* against the debtor in addition to the right *in rem*, he can also demand proportional satisfaction from the insolvency estate by registering his personal entitlement, in so far as it has not been satisfied, for inclusion in the schedule of debts (Section 52, second sentence, InsO).

3. Creditors with claims against the estate itself

Creditors with claims against the estate itself (*Massegläubiger*) do not have to register their claims, which are settled in advance. According to Section 53 of the Code, the debts incumbent on the estate include the costs of the insolvency proceedings and the other liabilities created by the administrator after the opening of the proceedings in connection with the handling of the insolvency (e.g. salary claims of the workers still employed in the enterprise or claims of a lawyer retained by the insolvency administrator to deal with pursuit of claims before the courts). The reason for the preferential satisfaction of these claims is that the insolvency administrator can conduct the procedure properly only if he can enter into new commitments for which complete performance is ensured.

4. Ordinary creditors

Only the ordinary creditors (*Insolvenzgläubiger*, ‘insolvency creditors’) take part in the procedure for the verification of claims (Section 174(1), first sentence, InsO). The ordinary creditors, according to Section 38 of the InsO, consist of all personal creditors holding well-founded claims against the debtor on the date when the insolvency proceedings are opened. There are subordinated ordinary creditors (*nachrangige Insolvenzgläubiger*), listed in Section 39(1) of the Code, who need file their claims only if specifically requested to do so by the insolvency court (Section 174(3), first sentence, InsO). Subordinated insolvency claims are settled after the other claims of the ordinary creditors. They include fines, for example, and the interest and penalties for late payment accruing on claims of the ordinary creditors since the opening of the insolvency proceedings.

12 What are the rules governing the lodging, verification and admission of claims?

Claims must be filed in writing with the insolvency administrator within the timelimit set by the insolvency court in the opening decision, indicating the cause and the amount of the claim and accompanied by copies of the documents evidencing the claim (Section 174 (1), second sentence, and (2) InsO). However, in the event of late filing, claims will still be considered (Section 177 of the InsO). All insolvency claims are to be filed, regardless of whether the underlying legal relationship is governed by the ordinary civil law or by public law (such as, for example, tax liabilities).

The following particularities apply to foreign creditors: Article 55 of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the EU Insolvency Regulation) will in future enable foreign creditors to lodge claims using a standard claims form. Claims may be lodged in any official language of the institutions of the Union. The creditor may, however, be required to provide a translation into the official language of the Member State of the opening of proceedings or in another language which that state has indicated it can accept. In principle, claims must be lodged within the period stipulated by the law of the state of the opening of proceedings. In the case of a foreign creditor, that period is not less than 30 days following the publication of the opening of insolvency proceedings in the insolvency register of the state of the opening of proceedings.

The insolvency administrator must enter every properly filed claim in a schedule of debts (*Tabelle*). The contents of the claim are not verified at this point. Only at a verification hearing at the insolvency court are the claims verified and their amount and rank established (Section 176, first sentence, InsO). If no objection is raised to the claim at the verification hearing by either the insolvency administrator or an ordinary creditor, or if any objection raised is overcome, the claim is considered to have been admitted and the creditor will receive his dividend from the proceeds. An objection on the part of the debtor does not affect the determination of the claim (Section 178(1), second sentence, InsO), but after the termination of the insolvency proceedings an ordinary creditor will not be able to enforce the remainder of his claim on the basis of registration in the schedule, and will have to bring a separate action against the debtor (Section 201(2), first sentence, InsO).

If, on the other hand, at the verification hearing, an objection is raised by the insolvency administrator or by another ordinary creditor, the creditor can bring an action for admission against the contesting party (Section 179(1) of the InsO). He shares in the proceeds only if the action for admission establishes that his claim is indeed valid (Sections 180 *et seq.* of the InsO). Within a period of two weeks from the publication of the distribution list, he has to prove that he has brought an action for admission of the claim (Section 189(1) of the InsO). If he fails to do so, the claim will not be taken into account in the distribution of the proceeds, even if it has been finally admitted in the meantime (Section 189(3) of the InsO). If, however, he shows that he has brought the action in good time, the share allocated to the claim will be retained from the distribution as long as the action is pending (Section 189(2) of the InsO). If the action for admission of the claim is finally dismissed, the retained share will be distributed to the other ordinary creditors. If an enforceable title already exists for the contested claim, an action must be brought not by the creditor but by the objector (Section 179(2) of the InsO). The judgment determining a claim or sustaining an objection is not merely effective *inter partes* but is also binding on the insolvency administrator and all ordinary creditors (Section 183(1) of the InsO).

If an ordinary creditor has not registered his claim for inclusion in the schedule, he cannot share in the proceeds of the realisation and he is also unable to enforce his claim in any other way (Section 87 of the InsO). Claims for payment against the insolvency administrator are to be dismissed as inadmissible.

13 What are the rules governing the distribution of proceeds? How are claims and the rights of creditors ranked?

Unless otherwise provided in an insolvency plan, the insolvency administrator realises the assets belonging to the insolvency estate in order to convert the estate into money and to distribute this money to the creditors. The administrator decides how to carry out the realisation at his proper discretion, with the aim of maximising the proceeds. Possibilities include selling the debtor's enterprise or individual plants as a whole, or breaking up the enterprise and selling the individual assets separately.

Before the proceeds of the realisation can be distributed to the ordinary creditors, it is first necessary to satisfy the claims of the secured creditors and creditors with claims on the estate itself. The distribution of the proceeds is based on a distribution list (*Vertei lungsverzeichnis*) to be drawn up by the insolvency administrator on the basis of the schedule of debts (Section 175 of the InsO). This list must contain all insolvency claims to be taken into account in the distribution. The proceeds are then distributed to the creditors in proportion to the amount of their claims. In the rank after the ordinary creditors, and therefore at the last level, are the subordinated ordinary creditors listed in Section 39(1) of the Code. They are satisfied only if all other ordinary creditors have been satisfied in full.

As a rule, the distribution does not wait until the realisation of the insolvency estate has been completed. Rather, as soon as sufficient cash is available in the insolvency estate, payments are made on account (Section 187(2), first sentence, InsO). When the realisation has been completed, the final distribution takes place (Section 196(1) of the InsO). It requires the approval of the insolvency court (Section 196(2) of the InsO). If the claims of all ordinary creditors can be satisfied in full (which is rarely the case in practice), the administrator transfers any remaining surplus to the debtor (Section 199, first sentence, InsO).

If a creditor has a right *in rem* over one of the assets belonging to the insolvency estate and the proceeds obtained are insufficient to satisfy his claim in full, the creditor may register a claim *in personam* for inclusion in the schedule, but only to the extent that his secured claim has failed (alternatively, he may waive his secured claim and instead register a claim *in personam* against the debtor for inclusion in the schedule for the full amount) (Section 52, second sentence, InsO).

It has not yet been conclusively settled whether this also applies if the creditor's claim is only partly extinguished by set-off. The view in some legal literature (e.g. Brandes/Lohmann in *MüKo InsO*, Section 94 paragraph 55) is that an ordinary creditor can register his claim for inclusion in the schedule of debts initially in full, and after he has received his corresponding dividend can then set off to the amount of the counterclaim. The Federal Court of Justice has not yet expressly ruled on the issue, but it has suggested that it would follow this view (BGH, judgment of 9 May 1960 - II ZR 95/58). Other writers, on the other hand, would apply Section 52, second sentence, of the Code by analogy, in which case the creditor could register only the excess amount for inclusion in the schedule, and the dividend would be reduced accordingly (for instance, Uhlenbruck/Sinz, *InsO*, Section 94 paragraph 61).

If a third party satisfies the claim of a creditor holding *in rem* security against the debtor, the third party does not automatically take the place of the secured creditor. However, in certain cases, subrogation is provided for by law and can also be agreed contractually. This is not a special feature of insolvency proceedings, but results from the rules of ordinary law. If the creditor for example has *in rem* security and receives satisfaction not from the debtor but from a third party who stands guarantor for the claim on the insolvent debtor, the creditor's claim against the debtor is transferred to the guarantor under statutory subrogation (Section 774, first sentence, Civil Code (*Bürgerliches Gesetzbuch* – BGB)). For accessory security rights, such as a mortgage or pledge for example, the Civil Code expressly provides that these are transferred to the guarantor (Sections 412, 401 of the BGB). Non-accessory security rights, such as a land charge created to secure a claim, are not transferred by operation of law to the guarantor. However, a creditor with a contractual claim is required, by analogy, in accordance with Sections 412 and 401 of the Civil Code, to transfer the non-accessory securities to the guarantor, unless otherwise agreed between the parties. The guarantor then takes the place of the creditor with *in rem* security.

14 What are the conditions for, and the effects of closure of insolvency proceedings (in particular by composition)?

1. Standard procedure

After the final distribution has been carried out, the insolvency proceedings must be terminated (Section 200(1) of the InsO). The termination decision is published. With the termination of the insolvency proceedings, the right to manage and dispose of the assets caught by the insolvency reverts to the debtor.

After the termination of the insolvency proceedings, the ordinary creditors can in principle enforce their residual claims against the debtor without restriction, since the claim is extinguished only to the amount of the dividend paid. For the enforcement of the share of the claim not satisfied, Section 201(2) of the Insolvency Code provides that ordinary creditors may enforce their claims against the debtor on the legal basis of their entry in the schedule, as if under an enforceable judgment, provided that the claims have been determined and have not been contested by the debtor at the verification hearing. Conversely, it can be inferred from the same Section 201(2) of the Code that in other cases the creditor must enforce his claim against the debtor by bringing a legal action.

An exception applies for natural persons. They have the option of applying for a discharge of residual debt (*Restschuldbefreiung* , Sections 201(3), 286 *et seq.* of the Code). A discharge of residual debt may be granted after a period of good conduct of six years, in which the debtor must assign all income that is available for attachment to a trustee (*Treuhänder*); the discharge has binding effect upon all ordinary creditors, including those creditors who did not file their claims (Section 301(1) of the InsO). This means that the ordinary creditors are definitively prevented from enforcing their claims against the debtor (exception: the claims referred to in Section 302 of the InsO).

A legal person which has been the subject of insolvency proceedings and which no longer possesses any assets is automatically deleted from the commercial register and ceases to exist.

2. Insolvency plan procedure

The insolvency plan procedure enables the secured creditors and ordinary creditors to decide themselves on the realisation of the insolvency estate, its distribution among the creditors, the handling of the proceedings and the liability of the debtor after the termination of the insolvency proceedings; they do this in an insolvency plan, by way of derogation from the provisions of the Insolvency Code (Section 217(1), first sentence, InsO). A reorganisation and an insolvency plan are not the same thing. An

insolvency plan will play a key role in any reorganisation of an enterprise, but an insolvency plan can also be the basis for winding up the enterprise, and may for example provide for the realisation of the insolvency estate and its distribution to the parties involved by way of derogation from the provisions of the Code.

In addition to the possibility of discharge of residual debt, the insolvency plan offers an important means for the debtor to have obstructive creditors overcome. Section 245 of the Insolvency Code provides that under certain conditions the acceptance of a voting group can be deemed to have been granted even if the required majorities have not been reached. In practice, however, use of the insolvency plan procedure has so far tended to be cautious.

An insolvency plan may be put forward either by the insolvency administrator or by the debtor. The insolvency plan consists of a declaratory part (*darstellender Teil*) and an organisational part (*gestaltender Teil*). The declaratory part describes which measures have already been taken after the opening of the insolvency proceedings and which measures are still to be taken. The organisational part determines how the legal position of the parties involved is to change. Since an amendment enacted in 2012, Section 225a(2) of the Code explicitly provides that shareholders or members can also be included in the insolvency plan, and allows a debttoequity swap to convert creditors' claims into shares in debtor equity governed by company law. The voting mechanism provided for in Sections 243 *et seq.* of the Code is of particular interest. The organisational part of the insolvency plan defines various voting groups. The insolvency plan is accepted only if it is approved by a majority of voting creditors in each group (a majority of creditors) and the sum of the claims of the creditors voting in favour amounts to more than half the total claims of all the creditors voting (majority of total claims). Under certain conditions, however, the Code deems a voting group to have consented even if the necessary majorities have not been achieved (Section 245 InsO). This 'prohibition of obstruction' (*Obstruktio nsverbot*) is designed to prevent individual creditors or shareholders from causing the plan to fail. According to Section 247 of the Code, the debtor too must consent to the plan. But opposition on his part is irrelevant if the plan does not leave him any worse off than he would be without it, and if no creditor receives an economic value exceeding the full amount of his claim.

Following the acceptance of the insolvency plan by the parties involved, and the consent of the debtor, the insolvency plan has to be confirmed by the insolvency court. The court confirms the insolvency plan if all essential procedural requirements have been fulfilled and no application has been made by a creditor or shareholder claiming that he is likely to be left worse off by the plan than he would have been without it (Section 251 of the InsO). In order to prevent the plan failing as a result of such opposition, the organisational part of the plan may provide for funds to be made available in the event that a party shows that he will be left worse off (Section 251(3) of the InsO).

The decision confirming the plan can be contested only to a limited extent (Section 253 of the InsO).

Once the confirmation of the insolvency plan is no longer open to challenge, the insolvency court terminates the insolvency proceedings (Section 258(1) of the InsO). The right of disposal of the debtor's property reverts to the debtor. The effects provided for in the organisational part of the plan become binding for and against all parties involved, irrespective of whether they registered their claims or objected to the insolvency plan as parties with an interest (Section 254b of the InsO). This means that a waiver, suspension or the like provided for in the insolvency plan takes effect *ipso jure*, without the need for any separate declaration of intent (Section 254a(1) of the InsO). The insolvency plan does not affect the rights of ordinary creditors against third parties.

In order to ensure that the debtor complies with the obligations imposed on him by the insolvency plan, the plan may provide that the debtor is to be monitored by the insolvency administrator. During the period of monitoring, the insolvency administrator must every year report to the court and to the creditors' committee, if such a committee has been appointed, on the current situation and the future prospects of completion of the insolvency plan.

Irrespective of whether such monitoring is ordered, the 'revival clause' (*Wiederauflebensklausel*) provided for in Section 255 of the Code operates to ensure compliance with the plan by the debtor. If claims held by an ordinary creditor have been deferred or partly waived on the basis of the organisational part of the insolvency plan, it is provided that such deferral or waiver is no longer binding upon the creditor if the debtor falls substantially behind in the implementation of the plan with respect to that creditor. The same applies with regard to all ordinary creditors if, during the phase of implementation of the plan, new insolvency proceedings are opened in respect of the debtor's assets (Section 255(2) of the InsO). Ordinary creditors with admitted claims that were not contested by the debtor at the verification hearing, and which they hold under a confirmed and final insolvency plan in conjunction with entry in the schedule, may enforce those claims against the debtor in the same way as they would under an enforceable judgment.

If the insolvency plan is the basis of a reorganisation of the enterprise, loans will often be required for the operation. To protect lenders, the organisational part of the insolvency plan may provide for a ceiling on loans (Section 264 of the InsO). Provided that the new lender's claim remains below the ceiling, the effect is that in any fresh insolvency proceedings the ordinary creditors rank behind the new lender.

The insolvency plan procedure allows the debtor to achieve a discharge of residual debt irrespective of the procedure for the discharge of residual debt outlined above. The Code states that unless the insolvency plan provides otherwise, the debtor is discharged from his residual debts to his creditors if he satisfies his creditors in the manner provided for in the insolvency plan (Section 227(1) of the InsO).

15 What are the creditors' rights after the closure of insolvency proceedings?

For details of the creditors' rights after the closure of insolvency proceedings, please see the answer to the question 'What are the conditions for, and the effects of closure of the insolvency proceedings (in particular by composition)?'

16 Who is to bear the costs and expenses incurred in the insolvency proceedings?

Under German law, the costs of the insolvency proceedings are to be paid in advance from the insolvency estate and take precedence over the claims of the ordinary creditors (Section 53 of the InsO). The costs of the insolvency proceedings include the court fees in respect of the insolvency proceedings and the remuneration earned and expenses incurred by the provisional insolvency administrator, by the insolvency administrator, and by the members of the creditors' committee (Section 54 of the InsO).

17 What are the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors?

To prevent actions detrimental to the creditors, any acquisition of assets belonging to the insolvency estate after the opening of the proceedings is in principle void, whereas the acquisition before the opening of the proceedings of assets that would have belonged to the insolvency estate after the opening of the proceedings is in principle valid, but can be contested under certain circumstances.

Since on the opening of the insolvency proceedings the right of the debtor to dispose of his property is vested in the insolvency administrator, any disposal by the debtor of an asset belonging to the insolvency estate after the insolvency proceedings have been opened is in principle absolutely invalid (except where there is an acquisition in good faith of land, although this can be contested) (Section 81(1), first sentence, InsO). Nor is there any acquisition of rights to an asset belonging to the insolvency estate if the debtor has disposed of an asset belonging to the insolvency estate before the insolvency proceedings are opened but the result occurs only after the proceedings are opened (Section 91(1) of the InsO) (with the exception of an acquisition of land, Section 91(2) of the InsO). Rights of security acquired as a result of enforcement proceedings during the last month preceding the application to open the insolvency proceedings, or after such application, likewise become legally ineffective once the insolvency proceedings are opened (Section 88(1) of the InsO).

An acquisition from the insolvency estate before the proceedings are opened, unlike an acquisition after the proceedings are opened, is in principle valid, but can be contested under certain conditions (Sections 129 *et seq.* of the InsO). This right to contest an insolvent debtor's transactions is of decisive importance for the functioning of insolvency law, since it allows the insolvency administrator access to outflows from the debtor's assets that took place before the insolvency proceedings are opened. It can help greatly to increase the insolvency estate, and thus to ensure that insolvency law makes good on its claim to provide equal satisfaction for the creditors in an orderly fashion and to prevent preferential treatment of individual creditors. If the insolvency administrator successfully exercises a right to contest, the party who benefited as a result of the contested transaction must return everything that has been withdrawn from the insolvency debtor's assets by the transaction. If he cannot do so in kind, he has to pay compensation. The insolvency administrator can bring an action to enforce the right to restitution, and can rely on the right to restitution against any opposing claims brought by a creditor. If the recipient of a benefit under a contestable transaction restores the property received, any counterclaim he may have revives (Section 144 of the InsO).

To be contestable, a transaction entered into prior to the opening of insolvency proceedings must disadvantage the ordinary creditors (Section 129 of the InsO), and one of the grounds provided for in Sections 130 to 136 of the Code must be present. Any legal act, i.e. any conduct (including an omission, Section 129(2) of the InsO) that creates a legal effect, may be contested (Federal Court of Justice, judgment of 12 February 2004 IX ZR 98/03 – paragraph 12). Unless otherwise provided in the Code, it is immaterial whether the legal act is undertaken by the debtor. Furthermore, whether a contractual or legal effect is involved is not a decisive factor (Federal Court of Justice, judgment of 7 May 2013 - IX ZR 191/12 - paragraph 6).

A ground for contesting a transaction is provided in particular by

- a gratuitous benefit granted by the debtor, unless it was made more than four years before the application to open insolvency proceedings (Section 134 of the InsO);
- a legal act performed by the debtor in the last ten years prior to the application to open insolvency proceedings with the intention of disadvantaging his creditors, if the other party was aware of the debtor's intention (Section 133 of the InsO); the period is only four years if the act made it possible for the other party to provide a guarantee or payment.

- a legal act intentionally performed by the debtor in the last three months prior to the application to open insolvency proceedings that directly disadvantages the ordinary creditors, if the debtor was already insolvent, and if the other party was aware of such insolvency (Section 132(1), subparagraph 1, InsO);
- a legal act intentionally granting an ordinary creditor a security or satisfaction to which he is not entitled, if this act was performed in the last month prior to the application to open insolvency proceedings (Section 131(1), subparagraph 1, InsO).

In all of these cases both the debtor and the creditor receiving the benefit may also incur criminal liability (Sections 283 to 283d of the Criminal Code).

Consumer insolvency proceedings

Consumer insolvency proceedings (*Verbraucherinsolvenzverfahren*) deal with cases of natural persons who do not pursue and have not pursued any self-employed business activity, or natural persons who have pursued self-employed business activity but whose financial situation is straightforward and against whom there are no claims arising out of employment relationships (Section 304(1), first sentence, InsO). In contrast to the standard insolvency procedure, the focus is not on the realisation of assets, but on the consumer's discharge from debt.

The procedure differs from the standard one mainly when the application is made by the debtor alone or with others. In this case, the decision to open the insolvency proceedings is preceded by an out-of-court stage aimed at an arrangement with the creditors, based on a plan (Section 305(1), subparagraph 1, InsO). If an attempt to reach an out-of-court arrangement has failed, the debtor can file an application to open the insolvency proceedings.

A stage follows in which the opening proceedings are suspended and the insolvency court gives the creditors the opportunity to reach agreement with the debtor on a debt settlement plan (*Schuldenbereinigungsplan*). If the debt settlement plan materialises, the claims of the creditors are then governed only by the debt settlement plan, which is enforceable in the same way as a settlement reached in court proceedings (*Prozessvergleich*) (Section 308(1), second sentence, InsO). Applications for the opening of insolvency proceedings and for the grant of discharge of residual debt are deemed to have been withdrawn (Section 308(2) of the InsO). If agreement is not reached on a debt settlement plan, simplified insolvency proceedings take place.

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