

Memorandum

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By: Dr. Thomas Hoffmann
Nils Dobratz

**Re: Memorandum prepared for the Association of European Lawyers
Debt Restructuring in Germany**

The German legal system does not provide rules for debt restructuring outside insolvency proceedings, i.e. restructuring is possible only upon unanimous consent of all affected creditors. However, the debtor's option to file a petition for insolvency in the event of (merely) *imminent* illiquidity allows debtors, without being forced into such proceedings, to present a restructuring plan (insolvency plan) which may be adopted within the insolvency proceedings by a mere (qualified) majority of creditors.

1. Debt Restructuring outside Insolvency?

Debt restructuring may be achieved only in two ways, either by consensus of all creditors affected, or within the framework of the insolvency procedure. Before a debtor qualifies for insolvency proceedings, there is no legal scheme for the debtor to enter into, in order to gain protection from claim enforcing creditors, or to alleviate negotiations with creditors, or to enable the majority of creditors to overrule a dissenting minority in adopting a restructuring plan.

1.1 Reasons for insolvency

German insolvency law provides for three reasons to open insolvency proceedings: illiquidity, imminent illiquidity, and over-indebtedness. Insolvency in a stricter sense is given only in the event of illiquidity, i.e. the debtor is unable to honour his payment obligations now due, and over-indebtedness (applicable only to legal entities), i.e. the debtor's assets no longer cover its liabilities. Legal entities are obliged by law to file for insolvency, if they are either illiquid or over-indebted.

1.2 Imminent Illiquidity

The third reason to open insolvency proceedings, imminent illiquidity, entails a certain degree of discretion on the side of the debtor. Being defined as the debtor's *likely* inability to honour its existing payment obligations when they become due, imminent illiquidity entitles the debtor (and the debtor only) to file for insolvency, but the debtor is neither obliged to do so, nor may creditors file for the debtor's insolvency on the basis of the debtor's imminent illiquidity.

2. Debt Restructuring inside 'Voluntary' Insolvency

In the event of imminent illiquidity a debtor may file for insolvency proceedings in order to agree with its creditors on restructuring the company within the framework of insolvency proceedings.

2.1 Insolvency Plan

Besides the regular way of liquidation of all debtor's assets in order to distribute the proceeds among its creditors, the German Insolvency Code provides for a specific procedure to implement an insolvency plan. Such plan enables the debtor's creditors to opt for consensual insolvency proceedings, usually involving the restructuring of the debtor, but also a preferred liquidation scheme may be adopted by the creditors.

The insolvency plan may be set up and submitted to the insolvency court by the debtor or by the insolvency administrator. Whereas various rules regulate the formal make-up of the insolvency plan, there are few regulations as to its content. The insolvency court passes on the plan for discussion and voting to the creditor's assembly. The adoption of the plan requires the majority of votes in all creditor groups, if this majority also holds more than half of the claims within each group. Hereby dissenting creditors can be overruled, but only if the implementation of the insolvency plan would not be more detrimental to the relevant creditor group than regular liquidation. Upon adoption of the plan and confirmation by the court, the insolvency proceedings are terminated and the debtor recovers the power to dispose over his assets and to further execute the insolvency plan. Unless otherwise provided in the insolvency plan, the debtor is released from all remaining liabilities as soon as it satisfies all creditors in accordance with the insolvency plan.

2.2 Self-managed Restructuring

The insolvency plan may be used as a means of restructuring a debtor that is facing financial difficulties. As the debtor in a state of only imminent illiquidity is not obliged, but entitled to file for insolvency, the debtor can prepare a proposal for an insolvency plan and file his petition for insolvency together with a pre-packaged plan, which is more likely to be adopted by the creditors facing the threat of the debtor's liquidation in regular insolvency proceedings. Only within the framework of the insolvency proceeding, the debtor may impose a restructuring plan with (only) a majority of creditors instead of the otherwise required unanimous consent. The regular change of control involved in insolvency proceedings can be avoided by a debtor's application for self-management, whereby the debtor remains in control over its assets and only a supervising trustee is appointed by the court.