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# **Group Finance Structures in German Insolvency Proceedings**

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# Group finance structure

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Typical scenario:

- Holding company or s.p.v. procures **financing of group of companies** by taking up a **loan** with or issuing **bonds** to international investors
- Several (changing) **creditors** (borrowers, bondholders), represented i.a. by a **Security Agent** in favour of whom a **parallel debt** is established
- Several (German based) **debtors** (holding company and affiliates), either as jointly borrowers/issuers or guarantors or affected as security grantors
- **Collateral security** transferred to Collateral Agent to secure parallel debt
- Upon failure to pay (event of default) and acceleration of facility/bond claims debtors file for the **opening of insolvency proceedings**

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## Focus on liquidation proceedings

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German insolvency law (regulated in the Insolvency Code, *Insolvenzordnung*, “**InsO**”) provides for a uniform procedure, regardless of whether liquidation or reorganisation is intended.

Any insolvency proceeding starts with a **court order** declaring the debtor insolvent. After commencement of insolvency proceedings, **two types of proceedings** are provided:

- **Liquidation proceedings** (standard insolvency proceedings, either sale of the debtor’s business as a whole or, regularly, asset by asset)
- **Insolvency plan procedure** (consensual reorganisation requiring an agreement between a qualified majority of creditors, either to maintain the debtor’s business or to liquidate it in accordance with the agreement).

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## No proceedings without insolvency

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Both, liquidation proceedings and the insolvency plan procedure require the **debtor's insolvency** (illiquidity or over-indebtedness).

- **No pre-insolvency reorganisation procedure** (such as the postępowanie naprawcze, procedure de sauvegarde, scheme of arrangement)
- Widely perceived as **serious locational disadvantage** (cf. new German government's coalition agreement as of 26 Oct 2009)
- Immediate liquidation may be **favourable for sufficiently secured creditors**

**Exception:** If the debtor files for insolvency, **imminent illiquidity** (i.e the likely inability to meet the obligations on the date of maturity) is sufficient, but the result is still the commencement of **ordinary insolvency proceedings**.

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## No proceedings for group of companies

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Insolvency proceedings are conducted for **any single insolvent** entity:

- **No insolvency proceedings for a group of companies** (e.g. holding company and its affiliates)
- German courts **might**
  - **assume jurisdiction** for each member of the group (at least in all-German cases, e.g. Arcandor) upon such application
  - appoint the **same insolvency administrator** (or several persons from the same office) for all or several companies of a group
- Thus: Even if holding company and affiliates are jointly and severally liable, **all proceedings are separate** (sec. 43 InsO)

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# Liquidation of the debtor's assets

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Typical features of liquidation proceedings:

- **Appointment** of an **insolvency administrator** by the **insolvency court** (no other institution provided, such as trustee, court supervisor etc.)
- **Going-concern** usually only if debtor's business is sold within **3 months** after opening of proceedings during which state authorities pay salaries – if **no going-concern**: single assets are sold by insolvency administrator, **proceeds** eventually **distributed to claimants** according to list of claims
- Secured creditors generally have **right to separate satisfaction** (= right to the proceeds from the sale of the security collateral) – **enforcement** of the security collateral either by creditor or insolvency administrator, depending on who is in **possession** of the security collateral – proceeds (minus costs) forwarded to creditor **immediately upon receipt** (no distribution plan)

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## How filed claims are dealt with

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The insolvency administrator may react to claims filed by creditors by

- **Acknowledgement** (= creditor will participate in the final distribution of the estate's proceeds according to its quota)
- **Objection** (= creditor will not participate in any distribution unless objection was successfully challenged in court, **deadline**: 2 weeks before distribution)
- **Contingent acknowledgement** (*“Anerkennung für den Ausfall”*, applies only to secured creditors = full claim acknowledged, but future proceeds of collateral reduce the amount acknowledged, **deadline** for proof of shortfall: 2 weeks before final distribution)

**All claims are treated independently**, even if debtors (as guarantors) are jointly and severally liable: sec. 43 InsO.

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# Parallel Debt

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## Parallel Debt

- **Required** for security collateral established under German law which is **accessory** (in particular liens on shares or movables)
- Acknowledged as a matter of **freedom of contract**, perceived as **abstract acknowledgement of debt** according to sec. 780, 781 German Civil Code
- **Must be filed separately** from the original claims, in order to safeguard security agent's rights to separate satisfaction
- Parallel debt claims and original claims acknowledged **as claims** by joint and several creditors or **"like" claims** by joint and several creditors (payment to one creditor reduces the claim of the respective other)

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## Rights of the secured creditor

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Secured creditors are entitled to

- **enforce** all security collateral in their (the Agent's) **possession**
- **enforce mortgages** (however more often consensual sale by insolvency administrator for higher proceeds)
- claim from the estate the **contractual interest** on the claim filed, in case of any **undue delay of enforcement** action by the insolvency administrator
- **claim damages** from the insolvency administrator for any **wrongful violation** of the duties incumbent on him under the insolvency code.

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## Mathematical issues: Sec. 43 InsO

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### Sec. 43 InsO:

*„A creditor holding claims against several persons for the whole of one single payment may file the full amount in insolvency proceedings against any debtor until he is fully satisfied if he had a claim to such full amount on the date when the insolvency proceedings were opened“*

- Proceeds (security collateral, distribution) reduce the claims (contingently) acknowledged **only** in the insolvency proceedings in which these proceeds were produced and **leave all other** insolvency proceedings **unaffected**
- Ensures a **higher grade of quota** in each debtor's insolvency proceedings.

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## Sec. 43 InsO: Case study

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- Creditor holds a claim of **100.000** against 3 jointly and severally liable debtors who are all in insolvency proceedings. The quotas of the final distribution are 50% (A), 30% (B) and 20% (C).
- **Sec. 43 InsO** enables the creditor to retrieve his claim in full, he receives 50.000 in the A-proceedings, 30.000 in the B-proceedings, and 20.000 in the C-proceedings → Creditor fully satisfied because the added insolvency quotas (50% + 30% + 20%) account for 100%.
- **Without sec. 43 InsO**, Creditor would receive 50.000 in the A-proceedings, which reduces his claims against B and C to the remaining 50.000. Creditor would subsequently receive (30% of 50.000 =) 15.000 in the B-proceedings and (20% of 35.000 =) 7.000 in the C-proceedings. → In total Creditor would receive **72.000** instead of **100.000**.

Thank you.