Germany introduces legislation to facilitate corporate group insolvencies (Konzerninsolvenzrecht)

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Germany's major legal reform aiming to facilitate group insolvencies comes into effect on April 21, 2018 (full German text). The new law allows insolvency proceedings over companies within a corporate group to be concentrated at a single German insolvency court and/or to be administered by one insolvency administrator.

Where a unitary approach is not appropriate, the legislation imposes an obligation on competent courts and insolvency administrators to cooperate with each other and provides a mechanism to establish a group creditors' committee which can initiate group coordination proceedings.

The new statutory provisions should increase the efficiency and certainty of group insolvency proceedings and lead to better results for creditors and other stakeholders.

As part of the reform, for the first time in the context of insolvency, Germany has provided a legal definition of "corporate group":

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A corporate group (Unternehmensgruppe) consists of legally autonomous companies, that have the center of their main interests in Germany and that are directly or indirectly connected with each other via either (1) the opportunity to exert a dominating influence; or (2) being brought together under the same administration.

The term "group insolvency" refers to parallel insolvency proceedings of related companies and subsidiaries, usually from the same corporate group. In practice, and because group companies are often operationally and financially interdependent, there is a risk that if one company within a corporate group files for insolvency, the other related companies may soon follow.

Germany took some time to formulate these new rules. The reform started in 2013, with the draft bill under the previous German government. Discussions continued until May 2014 but, once the EU started to consider putting corresponding rules in the recast European Insolvency Regulation, the German process was put on hold so that, if necessary, appropriate amendments could be made to the German rules. This took a while because the scope of the provisions at EU level was changing and in the end, was partly influenced by the earlier German draft. As the recast European Insolvency Regulation (EU) 2015/848, would come into force on June 26, 2017 (full text available here), it was now high time to enact the corresponding reform in Germany.

Need for and scope of the reform

Like most jurisdictions, until now Germany has approached group insolvencies on the basis of each legal entity being subject to a separate insolvency proceedings. In principle, this could result in various insolvency courts in Germany having jurisdiction in relation to various group members, leading to the appointment of various different insolvency administrators and making synchronization and cooperation between the courts and insolvency administrators cumbersome. In practice, group insolvencies were still managed reasonably well, provided the courts and administrators cooperated with each other. More sophisticated preparation, e.g. national COMI shifts to one or more approachable insolvency courts and/or implementing the same DIP management, resulted in even better results. However, the absence of strict legal guidelines to compel or encourage cooperation made advance planning very challenging and could cause friction among the different insolvency judges and insolvency administrators. In some instances this even led to a plethora of simultaneous and inconsistent parallel insolvency proceedings.

Even in cases where one administrator was appointed to all entities within a group, difficulties still arose regarding intercompany conflicts of interest. These were usually resolved by the appointment of additional insolvency administrators whose role was limited to addressing the conflict issues (Sonderinsolvenzverwalter). In fact, this may remain a concern even after the new legislation is in place: situations will always arise where it would still be good practice to have different administrators, to avoid conflict issues, but the advantage of the new provisions is that there will be rules governing their cooperation.

In support of the need for this reform, the draft proposal cited some of the major group insolvencies (KirchMedia, Babcock-Borsig, BenQ and Arcandor/Quelle) and stated that Germany's current decentralized approach to the resolution of group insolvencies has negative effects and leads to uncertain outcomes. Practical attempts to mitigate these risks were deemed to be sometimes unsuccessful by the legislature. The proposal highlighted the potential advantages of group insolvency rules in cases where the whole corporate group or significant parts of its business are to be preserved and restructured, especially as there are often considerable economic assets and numerous employees at stake.

Substantive consolidation not part of the reform

After extensive discussions, the reform stopped short of facilitating substantive consolidation (which is available in theory in the US). Substantive consolidation in the context of insolvency law means piercing the corporate veil of the separate legal entities and merging their individual estates into one single insolvent estate from which all creditors receive distributions. In contrast, the current model of German reform is based on procedural coordination, which would leave each legal entity and its estate separate, so that creditors could only demand distributions from "their" specific debtor, not from a merged estate of all debtors. This is in line with mainstream German legal theory which holds that it is necessary to respect and preserve each individual legal entity, by all means, in an insolvency proceeding. However, it may be questioned whether, in practice, this is still a legitimate expectation of creditors, at least on a national level.
On an international level, both the recast European Insolvency Regulation and UNCITRAL’s draft legislative provisions on facilitating the cross-border insolvency of multinational enterprise groups (full text available here) focus primarily on procedural coordination. UNCITRAL’s draft legislative provision currently goes one step further and considers the use of so-called synthetic proceedings in lieu of commencing main proceedings over group entities in other states. While this approach would not give rise to substantive consolidation, it might allow even closer coordination of insolvency proceedings affecting group companies.

**Main provisions of the reform**

The reform contains the following key provisions:

- **Group insolvency proceedings can be concentrated at a single German insolvency court.** If one member of a corporate group files for insolvency at a particular court, that court can declare that it also has jurisdiction over all the other members of the corporate group. However, there are some safeguards to prevent smaller subsidiaries being used to facilitate forum shopping. Concentration at one insolvency court will not occur if:

  - Less than 15 percent of the corporate group’s employees work at the subsidiary which first files for insolvency and
  - The subsidiary amounts to less than 15 percent of the balance sheet total of the corporate group or
  - The revenues of the subsidiary are less than 15 percent of the revenues of the corporate group

- **Where proceedings are not concentrated within one insolvency court, the courts at which petitions for the opening of insolvency proceedings are filed are obliged to consider whether it would be advisable to have only one insolvency administrator appointed to all of the debtor companies and if so, whether the administrator would have the necessary independence to manage all the proceedings together.** The various courts are also obliged to cooperate and share information with each other about the status of their insolvency proceedings.

- **Similarly, where different insolvency administrators are appointed to different members of a corporate group, they are now obliged to cooperate and share information with each other about the status of their insolvency proceedings.** This applies equally to cases where some of the group companies are pursuing debtor-in-possession proceedings (Eigenverwaltung). When that is the case, the debtor, *i.e.* its management, is obliged to cooperate with the other insolvency administrators/debtors in possession.

- **It is now possible for the various creditors’ committees to have an overarching group creditors’ committee for the whole corporate group.** Its role is to support the insolvency administrators and various creditors’ committees in order to pursue a coordinated resolution of the proceedings.

- **The law introduces a new group coordination procedure (Koordinationsverfahren) governed by a coordinating administrator (Verfahrenskoordinator),** whose role is to ensure that the proceedings are synchronized. Importantly, however, in order to encourage use of the new coordination regime, the legislature decided that appointing the coordinating administrator should not usually increase the statutory fees for the administration. This is achieved in the following way: while the coordinating administrator will receive statutory fees paid pro rata from the debtors’ estates, the statutory fees of the other insolvency administrators will be correspondingly reduced (*cf.* see corresponding changes made to sec 3 para 2 lit. f) of the German Insolvency Fees Regulation, Insolvenzrechtliche Vergütungsverordnung). The argument, of course, is that the coordinating administrator is shouling some of the work on behalf of the other insolvency administrators.

- **There will be an option to formulate an overarching, coordinated restructuring plan (Koordinationsplan),** which in theory would make it possible to have a more coherent resolution of a corporate group insolvency than via multiple (coordinated) restructuring plans. The overarching restructuring plan would describe all measures necessary for a coordinated resolution of the insolvency proceedings, including proposals:

  - For the restoration of the economic viability of the individual group companies and the corporate group as a whole
  - To resolve internal conflicts within the group and
  - For contractual agreements to be entered into by the insolvency administrators

Subsequently, the insolvency administrators of the various group companies are required to explain the coordinated restructuring plan to “their” creditors and state whether and if so, how far, the insolvency administrator wants to deviate from the plan. However, even if he does so, it is still open to the creditors’ to demand that “their” group company’s restructuring plan must conform with the coordinated restructuring plan.
It will be interesting to see whether this overarching plan mechanism is used in practice, as similar results have been achieved under the current law where, for procedural reasons, the plan only has to be structured so that the relevant part must be submitted to the relevant court.

**Commentary: A significant and positive step forward**

These new rules should encourage and facilitate improved planning of group insolvency proceedings. It is now no longer left to the various insolvency administrators and courts to figure out, each time after a group insolvency filing, whether and, if so, how they may interact and coordinate with each other. The new statutory provisions should therefore increase the reliability and certainty of group insolvency proceedings.

The German legislature hopes that with these rules in place, together with the related European regulation, corporate group insolvencies will be handled with more synergy, faster and more efficiently and with better results for creditors, employees and the overall economy.

Many restructuring experts in Germany agree that this reform is a useful step in the right direction to improve and accelerate group insolvency proceedings. Until the reform comes into force in April 2018, Germany will contribute to the coordination of cross-border group insolvencies by applying the very similar regime set out in the recast EIR; however, for national group insolvencies, practitioners will be limited to the traditional coordination tools based on national COMI shifts and/or cooperation among insolvency courts.

It will be worth evaluating the use and success of the new group coordination regime after a few years, not least to determine whether additional tools might be needed and perhaps questioning whether measures to facilitate substantive consolidation or synthetic proceedings might be considered helpful.

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