

BY DR. CHRISTOF SCHILLER

The Debtor Has Assets in Germany: Now What?

Dealing with German Cross-Border Insolvency Law

The two most common scenarios in which U.S. insolvency practitioners will have to deal with German cross-border insolvency laws are if the debtor (1) has assets in Germany or (2) is engaged in litigation in Germany. In the first instance, the crucial questions are how to realize these assets and how to protect them against other creditors. In the second instance, the U.S. practitioner has to be aware of the consequences of the U.S. proceeding for the litigation in Germany.

By now, Europeans have gotten used to the Regulation (EC) 1346/2000 on insolvency proceedings (the “EU Regulation”), which came into force on May 31, 2002. There are numerous cases involving the EU Regulation, and the labor pains that marked the beginning of the EU Regulation have pretty much gone away. The Regulation (EU) 2015/848 on insolvency proceedings was adopted on May 20, 2015 (and will become effective on June 26, 2017); it will certainly cause hiccups again, but since it is based on the previous regulation, things should go smoother than when the EU Regulation first came into being.

The most important feature of the EU Regulation is the automatic recognition of insolvency proceedings initiated in another member state. Things are slightly more difficult if one looks at the consequences of insolvency proceedings opened in countries that do not belong to the European Union.

German cross-border insolvency law is regulated in §§ 335 to 358 of the Insolvency Code (*Insolvenzordnung*). When these provisions were introduced in 2003, Germany — unlike the U.S. — did not follow the UNCITRAL Model Law on Cross-Border Insolvency 1997. Even if the German provisions have similarities to the UNCITRAL Model Law, differences remain.

Which Proceedings Are Eligible for Recognition?

The scope of foreign proceedings eligible for recognition is defined in § 343(1) of the Insolvency Code. According to this provision, foreign insolvency proceedings will be recognized unless (1) the foreign court lacks jurisdiction to open the proceedings according to German law, or (2) recognition of the proceedings would violate the German *ordre public*.

The law does not say what constitutes a foreign insolvency proceeding. However, it is generally accepted that the definition is very broad. The crucial case in this regard — the so-called *Norsk-Date* decision¹ — was handed down in 1996 by the German Federal Supreme Court for Civil Matters (*Bundesgerichtshof*). A German creditor did not want to accept a Norwegian reorganization procedure concerning an insurance company. The court recognized the Norwegian proceeding, but stated that a foreign proceeding has to be compared to proceedings available under German law and should be recognized if it is similar. The court concluded that the Norwegian proceeding was sufficiently close to comparable German insolvency proceedings available at the time and thus recognized the Norwegian proceeding. Moreover, the court stated that in a world of ever-closer international relationships and cross-border activities, foreign insolvency proceedings should be recognized if they fulfill the requirements set out by the court. The court adopted the principle of universality of the insolvency proceedings, which is to say that insolvency proceedings cover all of the debtor’s assets wherever they are located. The decision is still the basis for recognition of foreign proceedings.

Will a Chapter 11 Proceeding under the U.S. Bankruptcy Code Be Recognized in Germany?

As a U.S. practitioner, you might wonder why recognition of chapter 11 procedures is even a question. However, until 1999, German law did not allow for the debtor to stay in possession of its assets and the appointment of a trustee was mandatory. This changed with the new Insolvency Code in 1999. Until the reform, it was a matter of intense debate whether chapter 11 proceedings should be recognized.

In two more recent decisions, one from 2007 by the Higher Court in Frankfurt (*Oberlandesgericht Frankfurt*) and one from 2009 by the Federal Supreme Court for Civil Matters, chapter 11 proceedings were recognized. Both courts discussed the nature of the proceedings and compared them



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¹ BGH, Urt. v. 14.11.1996 - IX ZR 339/95, available at bundesgerichtshof.de (unless otherwise indicated, all links in this article were last visited on May 10, 2016).

to German proceedings. The facts that a U.S. proceeding — unlike a German insolvency — does not have provisional proceedings and the debtor does actually not have to be insolvent to initiate proceedings did not impress the courts. Since German law also allows the debtor to administer the case, the debtor-in-possession rules also did not hinder recognition.

What Constitutes a Violation of the German *Ordre Public*?

The requirements for a violation of the German *ordre public* are construed extremely narrowly. One decision in this regard dealt with the recognition of Brazilian² and another one with Canadian insolvency proceedings.³ In both cases, the courts found no violation of German public policy and stated that foreign proceedings do not need to be comparable to German proceedings in every aspect and that results may differ if compared to German law. As it concerns U.S. proceedings, neither a chapter 11 nor a chapter 7 proceeding will be considered a violation of German public policy.

The question might only arise in particular decisions of the U.S. courts, which are to be enforced in Germany. One of the very few decisions under the EU Regulation dealt with a case of forum-shopping. A German debtor had moved to England to benefit from the more lenient rules regarding personal insolvency. The Higher Regional Court of Celle (*Oberlandesgericht Celle*) saw no violation of the German *ordre public* in the insolvency order of the English court, even if the debtor had moved to England just because of the English insolvency laws.⁴

The decisions indicate that it is very unlikely that German courts would find the order of a U.S. court to be in violation of the German *ordre public*.

What Are the Consequences of Recognition? Universality: The Foreign Proceeding Rules

The most important consequence of recognition is stated in § 335 of the Insolvency Code: The effects of a foreign insolvency proceeding are determined according to the laws of the country where the insolvency proceeding has been opened, unless German law provides otherwise. This is to say that the legal consequences of the foreign proceeding have to be recognized in Germany should they be relevant for the decision of a court or a government body. So, in principle, the assets of a U.S. debtor located in Germany will be covered by a U.S. proceeding.

Exceptions to Universality

However, there are exceptions to this principle, and the following are contrary to the UNCITRAL Model Law.

Contracts concerning rights *in rem* in real estate or rights to use real estate, ships or aircraft are governed by the laws of the jurisdiction in which the real estate is located, or where the ship or aircraft is registered.⁵ According to § 349 of the

Insolvency Code, real estate located in Germany will also be subject to German law and its formal requirements regarding transfer of real estate. Under German law, the transfer of real estate requires a notarial deed.

The German rules are not very user-friendly from the perspective of a foreign representative....

Pursuant to § 351 of the Insolvency Code, the rights *in rem* of a creditor to an asset that is located in Germany and part of the foreign insolvency estate remain unaffected by foreign insolvency proceedings. Two things are important in this regard. First, German law allows the forced sale of real estate based on a land charge even if the debtor is insolvent, and an automatic stay does not apply. Second, it is very easy for creditors to obtain a security interest in the debtor's assets. Only security interests in real estate are registered, while security interests in moveable assets or accounts receivable are not. These security interests will prevail in a U.S. bankruptcy if the assets are in Germany.

Transactions of the debtor can be avoided if they are voidable under the laws of the country in which the proceedings were opened, unless the defendant in the avoidance action can prove that a different set of laws applies. According to such laws, the chosen action of the debtor cannot be challenged.⁶ Lastly, there are other exceptions for employment contracts pursuant to § 337 and special rules for set-off according to § 338 of the Insolvency Code.

Stay of Litigation

Litigation concerning the insolvency estate is stayed if and when insolvency proceedings are opened outside of Germany and are pending when the proceedings are opened.⁷ The stay of the litigation is effective until a party competent to continue the litigation, according to the foreign law, files a motion to continue the litigation.

Can There Be Main and Secondary Insolvency Proceedings?

According to § 354, *et seq.*, of the Insolvency Code, German law allows secondary proceedings that only cover the assets located in Germany. This is a major exception from the principle of universality. Secondary proceedings are possible — even if foreign main proceedings are pending.⁸ Apart from creditors, the foreign representative is also entitled to file for secondary proceedings according to § 357(2).

The scope of the secondary proceedings is limited. They cannot aim to discharge a debt⁹ and an insolvency plan that stipulates a deferment of payments, a debt discharge or other limitations of creditors' rights, and can only be con-

2 See decision by the Federal Supreme Court for Labor Law (*Bundesarbeitsgericht*) (BAG) July 18, 2013, 6 AZR 882/11(A).

3 See Frankfurt Court (*Landgericht Frankfurt*).

4 OLG Celle, Nov. 27, 2012, 2 U 147/12.

5 Section 336 of the Insolvency Code. The Insolvency Code sections referenced in this article are available at www.gesetze-im-internet.de/insol.

6 Section 339 of the Insolvency Code.

7 Section 352(1) of the Insolvency Code.

8 Section 356(1) of the Insolvency Code.

9 Section 355 of the Insolvency Code.

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firmed in the secondary proceedings if all concerned creditors (including those of the main proceeding) have approved the plan. The secondary proceedings are not reserved for “German creditors.” Creditors in the main proceeding can file claims in the secondary proceeding. The same is also true for the foreign representative regarding the claims filed in his/her proceedings.

In practice, these rules can lead to extremely complicated situations. If a creditor lodges its claim in the main and secondary proceedings, and the insolvency administrators lodge the same claims in the other proceedings, the determination of the insolvency quotas can be an accounting challenge of considerable magnitude. Also, a foreign representative might think twice before starting secondary proceedings in Germany. The costs will increase, as will the complexity. The appointment of an administrator in Germany will also result in a loss of direct control. It is probably for this reason that there are not many secondary proceedings even under the EU Regulation, which has similar rules.

What Types of Relief Are Available to a Foreign Representative?

Enforcement of Court Orders

Under § 353 of the Insolvency Code, orders of the foreign court have to be declared enforceable if the foreign representative wants to enforce them in Germany. This concerns mainly the order opening the insolvency proceedings, but also applies to other orders.

Publication of the Foreign Proceeding

A foreign representative can request publication of the insolvency proceedings if this helps to administer the case.¹⁰ In particular, the foreign representative can ask the insolvency court to order the entry of the foreign insolvency proceeding in the relevant land register if the debtor has real estate in Germany.¹¹ Under German law, every piece of real estate is registered in a land register. If the foreign debtor is registered as the owner, he/she can sell the real estate and a buyer can obtain title if the land register does not contain any limitations regarding the foreign debtor’s right to dispose of such assets. Entering the insolvency proceedings in the register prevents the debtor from selling the real estate for his/her own account.

Protection of Assets

Under German law, the insolvency court will usually first issue an order for preliminary insolvency proceedings and in doing so also order the safeguard of assets of the future insolvency estate against dispositions by the debtor and foreclosures by creditors. In § 344 of the Insolvency Code, a foreign provisional insolvency administrator can ask the German insolvency court to make the same orders. If the foreign law does not provide for provisional administration, these rules

do not apply. To protect assets located in Germany, the foreign representative (who is not a provisional administrator) has to rely on the general principle that the order of the foreign court and its consequences are recognized, he/she can file for an injunction against the debtor or creditors, or he/she has to file for secondary proceedings concerning the assets in Germany, which stays foreclosures and prevents dispositions by the debtor.

Which Courts Have to Be Addressed for Relief?

Depending on the relief sought by the foreign representative, different courts have to be addressed. This creates probably one of the most confusing elements for foreign representatives when dealing with German cross-border insolvency law. To establish his/her appointment, the foreign representative must supply the court with a translation of the foreign decision.¹²

Publication of the Foreign Procedure

If the foreign representative wants to publish the foreign procedure in Germany or enter the procedure in the land register, he/she has to address the insolvency court where the debtor is established or, if there is no establishment, where the debtor’s assets are located.

Enforcement of Foreign Orders

As previously described, orders of a foreign court have to be declared enforceable. The petition also has to be filed with the courts for civil matters and not with the insolvency court. In addition, these courts are competent if the foreign representative needs an injunction to prevent the debtor from selling the assets or to protect the assets against foreclosure by individual creditors.

Secondary Proceedings

If the foreign representative wants to file secondary proceedings, he/she has to address the insolvency court where the debtor has his/her establishment or, in case of a lack thereof, where the debtor’s assets are. The insolvency court can also make preliminary orders (as previously described) to safeguard assets for the period between the filing of the petition for a secondary proceeding and the court’s decision regarding the petition.

Stay of Litigation

The stay of litigation will become effective as soon as the requirements are met, which are the opening of the foreign insolvency proceedings and pending litigation. The court dealing with the litigation will decide about the stay and, in so doing, decide about the recognition of the foreign procedure.

¹² Section 347 of the Insolvency Code.

¹⁰ Section 345 of the Insolvency Code.

¹¹ Section 346 of the Insolvency Code.

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Conclusion

The German rules are not very user-friendly from the perspective of a foreign representative because the rules regarding venue are rather confusing. The most important first steps are probably publishing the proceeding, entering the proceeding in the land register (should there be real estate involved) and seeking a judgment to get the insolvency order declared enforceable in Germany.

After these first steps, it really depends on the individual case. If there is a considerable amount of value located in Germany and there are numerous creditors, a secondary proceeding might be unavoidable. If there is only a limited amount of assets and there are no formal requirements for the sale of assets, a formal recognition might not be necessary at all. **abi**

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