

Acquiring a Company Out of Insolvency Proceedings in Germany

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For U.S. investors seeking distressed opportunities in Europe, Germany presents a compelling landscape. As Europe's largest economy, it offers a mature insolvency framework that provides robust mechanisms for acquiring businesses free of legacy liabilities.

This article outlines the two principal pathways available under German law: via an *asset deal*, also referred to as a *transferring restructuring* (*übertragende Sanierung*); and via a *share deal*, effecting a change in the shareholder structure within the framework of an insolvency plan.

Transferring Restructuring (Asset Deal)



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A transferring restructuring is a specific form of asset-realization effected through an asset deal — *i.e.*, the sale of discrete assets of the insolvent entity to an acquirer (either an existing entity or a newly formed special purpose vehicle (“NewCo”). The structure achieves a bifurcation of assets and liabilities: while the assets are transferred to the acquiring entity in exchange for a purchase price, the liabilities remain with the insolvent entity and are satisfied — typically on a *pro rata* basis — through the insolvency proceedings, using the sale proceeds (and any other remaining realizations).

Consequently, the investor can acquire the target's assets unencumbered by liabilities. This includes all categories of liabilities, including bank debt, mezzanine financing, trade payables, tax liabilities, pension obligations and other obligations. Where substantially all material assets are sold, the transaction is structured as a going-concern sale. The specific assets to be transferred are typically listed individually in a schedule attached to the purchase agreement.

However, this bifurcation of assets and liabilities only occurs if the sale is executed after the formal opening of insolvency proceedings. In practice, negotiations regarding the asset-purchase agreement typically commence during the preliminary insolvency proceedings, which begin with the filing and generally last approximately three months. Ideally, negotiations are prepared to such an extent that the transaction can be carried out immediately upon the opening of the main insolvency proceedings. This is because it is generally advantageous for the business to exit insolvency as fast as possible, enabling unrestricted business operations.

During the preliminary insolvency proceedings, restructuring measures may already be prepared for implementation immediately upon the opening of main proceed-

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ings. Upon the opening of main proceedings, the insolvency administrator gains access to a comprehensive suite of restructuring instruments under the German Insolvency Code (InsO), including expedited workforce reduction and the right to terminate burdensome contracts.¹

Advantages and Disadvantages of a Transferring Restructuring



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A principal advantage of a transferring restructuring is its speed of execution. Standardized purchase agreements can be readily adapted to the specifics of each transaction and negotiated between the investor and the insolvency administrator. In more complex proceedings requiring a creditors' committee, the committee may grant its legally binding consent to the proposed transfer even prior to the final creditors' meeting. This enables the transaction to be completed and become legally effective within a compressed timeframe.

A key disadvantage of the transferring restructuring is that material contractual relationships — except for employment agreements, which automatically transfer by law under Section 613a of the German Civil Code (BGB) — including insurance policies, supply contracts or governmental permits and concessions, do not automatically transfer to the acquiring entity. Each such contract requires the consent of the respective counterparty. This is typically addressed through so-called “tri-party” agreements involving the acquirer (representing the “new” company), the insolvency administrator (representing the “old” company) and the original contractual counterparty.

By contrast, pursuant to Section 613a BGB, employment agreements — including all individually negotiated terms — transfer automatically by operation of law. Accordingly, it is generally advisable to develop and implement a workforce transition plan (*Erwerberkonzept*) in coordination with the insolvency administrator prior to closing. This plan typically contemplates workforce rationalization measures. Additionally, each noninsolvent subsidiary to be acquired requires a separate share purchase

¹ Sections 103 et seq. InsO.

and transfer agreement (share deal).

Second Option: Share Deal via Insolvency Plan

An alternative structure for acquiring a company is the takeover of the legal entity through a share deal, effecting a change in the shareholder structure within the framework of an insolvency plan. Under this approach, unlike an asset deal where only discrete assets — and, pursuant to Section 613a BGB, the employees — are transferred, the investor acquires the entire legal entity.

The insolvency plan is fundamentally a form of settlement between the insolvent debtor and its creditors, designed to discharge the legal entity of liabilities. In consideration of specific distributions paid to creditors — financed through contributions by existing shareholders or outside investors — the creditors waive their remaining claims against the insolvent debtor.

Historically, the principal purpose of the insolvency plan was to facilitate the debtor's restructuring while preserving its original shareholder structure. Since 2012, pursuant to Section 225a(3) InsO, the insolvency plan may also incorporate any corporate reorganization measures, including a change of shareholders, even over the objection of incumbent shareholders. This is typically effected by reducing the share capital of the insolvent entity to zero and simultaneously recapitalizing it with the newly issued (and unencumbered) shares being subscribed for by the investor. In this process, preemptive rights of existing shareholders and third parties are excluded. The new shares may be allocated to one or multiple new shareholders, for example, where a separation between holding and operating companies is contemplated.

An acquisition via an insolvency plan with a shareholder change results in the following:

- Preservation of the existing legal entity, which is discharged of its debt through the insolvency plan. As a result, the investor — unlike in a share deal outside of insolvency proceedings — does not assume any liabilities of the insolvent target (e.g., bank debt, mezzanine financing, tax liabilities, contingent claims and other obligations).
- Preservation of all contractual relationships associated with the legal entity (such as licenses, concessions, customer and supplier contracts, employment agreements and subsidiaries) without the need for “tri-party” agreements. Where such relationships are not desired by the investor, they may still be terminated prior to the transaction by the insolvency administrator using the instruments available under insolvency law² or via a carve-out of subsidiaries.

Analogous to a purchase price in an asset deal, the investor contributes a specified amount for the acquired

assets to the insolvent entity via a (cash) capital increase. These proceeds are then applied to satisfy creditor claims in accordance with the terms of the insolvency plan (comparable to a settlement).

Advantages and Disadvantages of the Share Deal

The principal advantage of a share deal via an insolvency plan is that essential contractual relationships remain in force automatically, unless the investor affirmatively elects to terminate them. On the other hand, contractual counterparties cannot enforce change-of-control provisions in this context.³ This enables the investor to retain favorable contracts while shedding unfavorable or unprofitable arrangements, and facilitates a workforce restructuring.

A share deal via an insolvency plan is particularly well-suited to situations where the debtor has multiple subsidiaries that would otherwise require individual transfer, or where governmental permits, licenses, concessions or specific contractual relationships must be preserved. In addition, as noted above, all types of (complex) corporate restructuring measures may be implemented, including mergers and changes in legal form.

The insolvency plan also provides a framework for negotiating arrangements with existing financial creditors (e.g., banks), enabling a restructuring of liabilities. This may include, among other measures, haircuts or debt-to-equity swaps. This structure therefore offers substantially more flexibility than the transferring restructuring described above.

The primary and indeed almost only disadvantage is the time requirement. An insolvency plan process is complex and time-consuming, typically requiring two to three months longer than an asset deal — and considerably more in complex cases — before the plan and its corporate actions become legally effective.⁴ First, the plan must be drafted and negotiated with stakeholders, then reviewed by the court and distributed to all creditors, before being submitted for a vote at the plan-confirmation hearing. Absent any appeals, the insolvency plan becomes legally binding two weeks following the creditors' approval.

To provide both parties — the investor and the insolvency administrator — transactional certainty until the insolvency plan becomes effective, a so-called investor agreement is typically executed before the plan process is initiated. Pursuant to this agreement, the investor commits to acquiring the shares of the debtor once it has been discharged of its debt through the insolvency plan. Transaction security for the insolvency administrator is achieved through the requirement to notarize the share acquisition, thereby creating a legally binding commitment of the investor.

Concurrently, to enable the continuation of operations during the interim period, the investor agreement often



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² Sections 103 et seq. InsO.

³ Section 225a(4) InsO.

⁴ Section 254 InsO.

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includes the investor's undertaking to cover operating losses incurred during business continuation after the opening of insolvency proceedings. It may also include provisions granting the investor influence over the strategic and operational repositioning of the company at this early stage. Moreover, the investor agreement should set forth the principal terms of the insolvency plan, though only in outline to permit flexibility in making necessary adjustments during the confirmation process.

In essence, the agreement can only be overruled by creditors at the plan-confirmation hearing if they refuse to approve the proposed insolvency plan. This risk can generally be mitigated by engaging all key stakeholders at an early stage. The investor agreement should address this contingency and define the financial consequences.

The execution of a well-prepared investor agreement typically represents the critical milestone of a share deal via an insolvency plan; the subsequent implementation of

the plan becomes largely procedural. With the agreement in place, the company can resume operations and accept new customer orders.

Conclusion

The foregoing overview is not intended to be exhaustive, particularly with respect to tax considerations or detailed labor law implications, but it does demonstrate that the acquisition of a company out of insolvency — whether by means of an asset deal or a share deal through an insolvency plan — constitutes a highly complex undertaking.

Given the compressed timeframes inherent in insolvency proceedings, it is essential to involve local counsel and advisors with specialized expertise in distressed M&A. Practitioners accustomed to conventional M&A transactions — with their emphasis on comprehensive representations and warranties — might find that such protections are largely unavailable in distressed transactions. **abi**

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