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Restructuring Across Borders

Germany:

Corporate restructuring and insolvency procedures | October 2020

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Contents

Introduction

The German Insolvency Code (Insolvency Code) encompasses a standard procedure and several alternative procedural options. The default procedure is liquidation of the assets, with the estate being managed by a court-appointed administrator. The main alternative options are: (i) an insolvency plan instead of liquidation; and (ii) self-administration by the debtor instead of an administrator. In the latter case, the debtor is supervised by a custodian.

German insolvency proceedings always go through two phases: first, preliminary proceedings which run from the filing for insolvency until the opening of main proceedings are used to establish, among other things, whether the estate has sufficient funds for an in-court procedure. Debtors may use this stage to apply for a protective "umbrella" or "shield" (*Schutzschirm*) in order to prepare an insolvency plan ("German pre-pack"). Second, if there are sufficient assets and other requirements are met, the court will order the opening of main proceedings.

Consensual out-of-court restructuring is possible unless there is a mandatory reason to file for insolvency. Corporations and companies are obliged to file for insolvency if they are either unable to pay their debts as they fall due or over-indebted. They may also apply for insolvency if they are threatened by an inability to pay their debts as they fall due.

German insolvency law aims to satisfy all creditors on a pro rata basis according to their claims, ensuring the equal treatment of all (unsecured) creditors. It tends to be creditor-friendly, giving creditors various rights to information and voting, and thus giving creditors the opportunity to influence the procedure.

The Insolvency Code is subject to constant improvement. A change of particular note has been implemented in 2012 by the "Act on the Simplification of the Restructuring of Enterprises" (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* (**ESUG**)), which strengthened creditors' rights, in particular in the period between the filing for insolvency proceedings and the opening of insolvency proceedings.

Outlook: In June 2019, the EU legislator adopted the EU Directive on Preventive Restructuring Frameworks (Directive (EU) 2019/1023) (the **Preventive Restructuring Framework Directive**) dealing with pre-insolvency frameworks, introducing a moratorium outside of insolvency proceedings and providing for a safe harbour for new (interim) financing. Germany needs to implement the Preventive Restructuring Framework Directive until 17 July 2021. As a pre-insolvency proceeding is new to German law, the implementation will require substantial changes to German law, but not necessarily as part of the Insolvency Code.

In September 2020 the Federal Ministry of Justice and Consumer Protection presented a first draft for the adoption of the Preventive Restructuring Framework Directive, the "German Act on the Further Development of Restructuring and Insolvency Law" (*Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts* (**SanInsFoG**)), which contains in particular the long-awaited "German Act on the Stabilisation and Restructuring Framework for Companies" (*Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen* (**StaRUG**)).

This first draft of the StaRUG closes the gap between a consensual out-of-court restructuring and an in-court-restructuring. The adoption of the StaRUG would therefore be an important step to further strengthen the restructuring culture in Germany.

Liquidation (*Liquidation*)

Liquidation results in a compulsory distribution of the company's assets. After the commencement of the main insolvency proceedings, the creditors' assembly resolves either to liquidate the company or to continue its business. Liquidation proceedings involve selling either the assets of the company, the entire company, or part of its business (*übertragende Sanierung*) in order to satisfy creditors' claims on a *pari passu* basis. The competent insolvency court (*Insolvenzgericht*) appoints the (preliminary) insolvency administrator (*Insolvenzverwalter*) who supervises the company's management through the preliminary proceedings and, upon commencement of the main proceedings, takes control of the company and collects, realises and distributes its assets, including challenging pre-insolvency transactions detrimental to the estate.

Insolvency plan (*Insolvenzplan*)

An alternative to liquidation proceedings is to establish an insolvency plan. The model for the insolvency plan was the reorganisation plan under Chapter 11 of the U.S. Bankruptcy Code. This legal structure offers the debtor, its shareholders, and its creditors a legal instrument for the mutually agreed management of the insolvency estate (*Insolvenzmasse*). Thus, the insolvency plan – in the shape of a reorganisation, transfer, liquidation or other plan – offers comprehensive reorganisation proceedings. Within a regulatory framework (ie preservation of minority rights and compliance with certain procedural steps), the creditors may decide to reorganise, rescue or liquidate the insolvent company or may indeed choose a route lying somewhere between these alternatives.

Following the implementation of ESUG, the shareholders may also participate (or may be forced to participate) in the insolvency plan proceedings. They will usually form a separate voting group. The consequence of shareholder involvement is that claims and rights of the shareholders, in particular voting rights and other participation rights, can also become the subject of an insolvency plan and may be modified pursuant to the insolvency plan. The rights of the existing shareholders may, for example, be reduced and, at the same time, the creditors may become shareholders of the debtor pursuant to a debt-to-equity swap, though no creditor can be forced to become a shareholder.

Creditors and shareholders can only veto a proposed insolvency plan if that insolvency plan would put them in a less favourable position than they would otherwise have been in or if they do not adequately share in the economic value which would accrue to them on the basis of the insolvency plan. It is assumed that a shareholder receives an adequate share of the economic value if no creditor receives more than the full amount of its claims and no shareholder that would otherwise rank equally with the other shareholders is put in a better position as a result of the plan.

Self-administration (*Eigenverwaltung*)

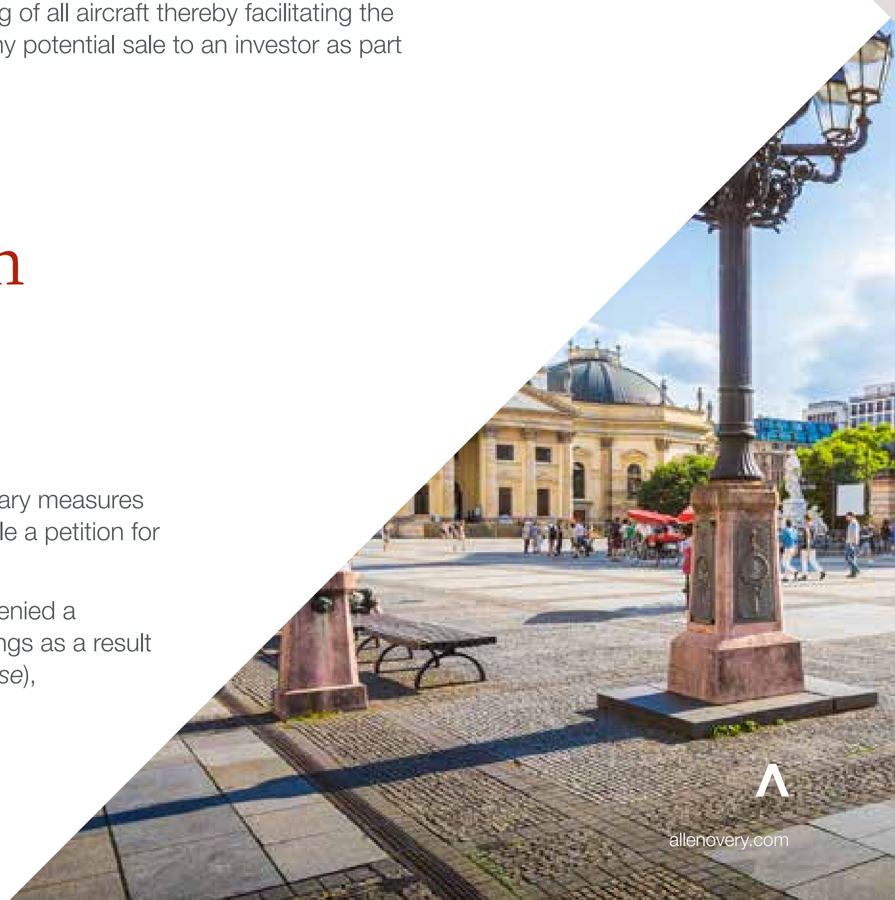
In standard insolvency proceedings, the insolvency administrator takes possession of the insolvency assets and is entitled to dispose of them. The management of the insolvent company is prohibited from possessing and disposing of the insolvency assets. However, on application of the debtor the court may grant the "self-administration" procedure (*Eigenverwaltung*) set out in the Insolvency Code. This procedure was influenced by the U.S. model of "a debtor in possession".

One of the aims of ESUG was to promote self-administration as a standard procedure for insolvency proceedings. It appears that ESUG has had some success in promoting self-administration and making it popular as a restructuring tool. If the court approves self-administration, then the management of the insolvent company will continue to possess and dispose of the insolvency assets under the supervision of an insolvency monitor (*Sachwalter*). Typically, in self-administration proceedings the debtor will prepare, with the help of insolvency experts, an insolvency plan, which will be voted on by the creditors. The debtor may also use the protective shield procedure (*Schutzschirmverfahren*), a pre-insolvency procedure, to allow the debtor to prepare properly for insolvency proceedings and develop an insolvency plan. Upon the plan's approval by the creditors and the court, the debtor's management will implement the restructuring set out in the plan with the help of insolvency experts. "Protective shield" proceedings have been used particularly in the field of airline insolvencies (eg Air Berlin, Condor) in order to stabilise operations and prevent a grounding of all aircraft thereby facilitating the preparation for and execution of any potential sale to an investor as part of an insolvency plan.

Out-of-court restructuring or liquidation (*Außergerichtliche Sanierung oder Liquidation*)

Out-of-court restructuring by consensual agreement or solvent liquidation is relatively common in practice. As there is no formal procedure, the company, its shareholders, and its creditors are free to agree upon financial restructuring measures, reorganisation, liquidation, or anything in between. To avoid lenders' liability risks it has become market standard to validate the restructuring concept for any consensual out-of-court restructuring by a restructuring opinion validated by an independent third party expert. Such voluntary measures will only be successful if there is no reason to file a petition for insolvency proceedings.

For completeness, if an insolvency court has denied a petition for the opening of insolvency proceedings as a result of insufficient assets (*Abweisung mangels Masse*), a liquidation might be the final option.



European Insolvency Regulation

The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the **Recast Regulation**) applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the **Original Regulation**) continues to apply to all proceedings opened before 26 June 2017. Two of the key changes in the Recast Regulation are: (i) that it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation; and (ii) it introduces a coordination and cooperation regime for insolvency proceedings of several entities within the same group.

The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding up proceedings – secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to winding up proceedings) in Annex B.

The introduction of a coordination and cooperation regime for insolvency proceedings within the same group under the Recast Regulation coincides with the introduction of a similar regime in German national law that has come into force April 2018.

Of the above restructuring and insolvency regimes, liquidation (*Liquidation*), insolvency plan (*Insolvenzplan*), and self-administration (*Eigenverwaltung*) were available as main and secondary proceedings under the Original Regulation on Insolvency Proceedings.

Under the Recast Regulation these same procedures are listed under Annex A. Despite the Recast Regulation allowing for the inclusion of pre-insolvency rescue proceedings, no such proceedings exist currently in Germany. As discussed further in the section titled, "European Directive on Preventive Restructuring Frameworks" and the section titled "Adoption of the Directive: the StaRUG" below, provision for such proceedings is required under the Preventive Restructuring Framework Directive and thus, Germany will introduce pre-insolvency rescue proceedings by 17 July 2021. Under the first draft of the StaRUG the debtor can take the decision whether or not the proceedings qualify as "public proceedings" and thus as insolvency proceedings within the meaning of the Recast Regulation. The public procedure will be listed in Annex A of the European Insolvency Regulation.

Group Insolvency Law (*Konzerninsolvenzrecht*)

Pursuant to the new framework for group insolvency proceedings introduced by the Recast Regulation, in 2018 the German legislator also introduced statutory rules facilitating the management of group insolvencies. In accordance with the European approach, the reformed law provides a framework of sophisticated concentration, cooperation, and coordination provisions with the aim of safeguarding the intrinsic surplus value of the group.

Germany's new group insolvency law goes beyond the scope of the Recast Regulation.

Important elements of the new law include:

- provisions allowing for the concentration of all group proceedings at the same court (and even the same judge) as well as the same insolvency practitioner (subject to a special administrator being appointed in cases where there are conflicts of interest). However, concentration of proceedings does not mean that proceedings are substantially consolidated in that the assets of the individual debtor would become assets of the group. Accordingly, although the new group insolvency law provides for the concentration of all group proceedings in the same court, proceedings are still dealt with on an entity-by-entity basis.
- provisions facilitating effective cooperation between the main bodies in the insolvency proceedings (administrator, courts, and creditors' committees). In particular, creditors' interests can be pooled through the provision for a group creditors' committee – allowing for more efficient communication between the creditors and the other constituents.
- the option to install a coordinator who is personally independent from the individual debtors and their creditors and, whose task is to set up a coordination plan in order to harmonise certain elements throughout all proceedings concerning members of the group. The group coordination plan is non-binding; however, the creditors' assemblies in the individual proceedings can vote to make it binding on the insolvency administrator. A coordination plan can be used as a "blueprint" for insolvency plans in each individual proceeding which is particularly useful if the individual proceedings have different officeholders.

With its advanced group insolvency regime, Germany provides an attractive forum for group insolvency cases. One of the major benefits of the new law is that it interlinks with the very similar provisions in the Recast Regulation.

European Directive on Preventive Restructuring Frameworks

With the Preventive Restructuring Framework Directive, a formal procedure for pre-insolvency restructuring has now been adopted at the European level. The Directive has been extensively debated in German literature and a vast number of different suggestions on how to implement the Directive have been made. The Directive needs to be implemented into German law until 17 July 2021.

The restructuring framework as included in the Directive contains three novel elements: (i) a moratorium outside of the formal insolvency proceedings; (ii) a restructuring plan with an effective (cross-class) cram-down mechanism resembling an insolvency plan but applicable outside of the insolvency proceedings; and (iii) a safe-harbour for new and interim finance.

Adoption of the Preventive Restructuring Framework Directive: first draft of the StaRUG

In September 2020 the Federal Ministry of Justice and Consumer Protection presented a first draft for the adoption of the Directive, the SanInsFoG, which contains in particular the long-awaited StaRUG. Now, the hurdles of the legislative process need to be cleared, so that at the earliest, as provided for by the draft bill, the new law can take effect already on 1 January 2021.

If the StaRUG becomes legally effective, it will create a framework for restructuring outside insolvency which enables companies to take restructuring measures on the basis of a restructuring plan accepted by the majority of the creditors. With this, the StaRUG closes the gap between a consensual out-of-court restructuring and an in-court-restructuring within insolvency by way of self-administration and insolvency plan or transfer of assets.

The restructuring framework is already available upon threatening illiquidity, ie if the debtor is not expected to be in a position to meet its future payment obligations when due. In this context, a prognosis period of 24 months will generally apply in future.

Upon occurrence of the threatening illiquidity, the draft proposed a shift of duties, ie from this point in time the management must protect the creditors' interests (as well).

The debtor choses from a modular system the relevant elements in order to successfully implement the restructuring concept. The proceedings are not opened by the court, the latter is merely notified of a restructuring project, appoints a restructuring officer, if necessary, and is involved in specific instances for certain instruments of the restructuring framework.

The restructuring plan can change unsecured claims, claims for separate satisfaction and intra-group third-party collateral as well as intercreditor provisions and it can be narrowed down to certain claims. Voting takes place in groups. Minorities blocking the vote can be outvoted both within a group with a majority of 75% and by a cross-class cram down.

On application by the debtor, the restructuring court can also issue a stabilisation order (moratorium) protecting the company's business while a restructuring plan is prepared and voted on. By way of such moratorium, enforcement measures against the debtor are prohibited for three or four months and security created over movable assets may not be realised. Moreover, a creditor cannot refuse to fulfil its contractual obligations simply due to the fact that obligations of the debtor are outstanding on the date the order is issued.

On application by the debtor, the restructuring court can under certain circumstances terminate with effect after a three months period mutual agreements that were not fully performed by any party with corresponding damage claims becoming subject of the restructuring plan.

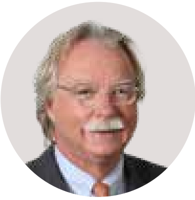
For moderation during the restructuring project, but also to protect the interests of all creditors jointly and keep the court in the loop, a restructuring nominee (*Restrukturierungsbeauftragter*) may be appointed by the court on application by the debtor and must be appointed by the court in certain cases of increased degrees of intervention.

The provisions and the implementation measures of a final and non-appealable restructuring plan are excluded from avoidance in a consequential insolvency (safe harbour). For the avoidance of doubt, it is noted that no risk of avoidance or liability arises solely from being aware of the restructuring framework. In this context, new financing, interim financing and other restructuring-related transactions are protected to some extent against insolvency avoidance.

The debtor decides whether or not the proceedings are deemed to be insolvency proceedings within the meaning of the Recast European Insolvency Regulation.

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.



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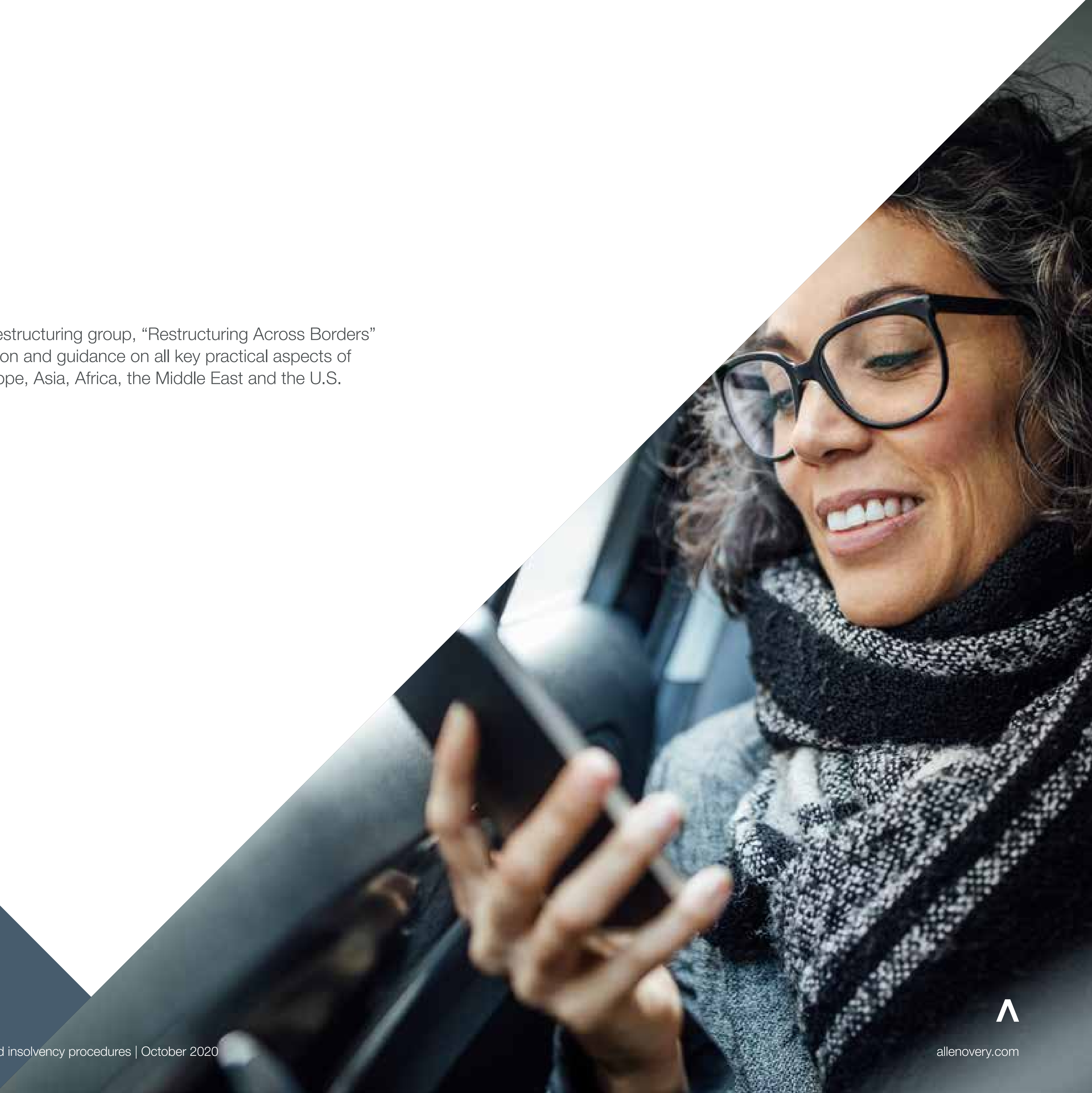
Further information

Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy to use website that provides information and guidance on all key practical aspects of restructuring and insolvency proceedings in Europe, Asia, Africa, the Middle East and the U.S.

To access this resource, please click **here**.



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