

Major Positive Changes in the German Restructuring and Insolvency Landscape — Preventive Restructuring Process & Changes to the Insolvency Code

25 September 2020

Germany is close to making a huge step towards international best practice for restructuring. On 19 September 2020, the German Ministry of Justice published a draft bill introducing a new stand-alone preventive restructuring process, accompanied by targeted amendments to insolvency law and related areas. The bill is currently available in draft form only, expected to be debated in and passed by Parliament and relevant committees in 2020, and – hopefully without significant changes – to enter into force on 1 January 2021. Timing is of the essence as COVID-related relief of insolvency filing duties, although very recently extended until year end with regard to balance-sheet insolvency, will end on 31 December 2020.

Preventive Restructuring Process

The preventive restructuring process combines features of well-tested restructuring proceedings, such as English schemes of arrangement and U.S. chapter 11 proceedings. Upon the occurrence of imminent cash-flow insolvency, the debtor-led process allows the implementation of tailor-made restructuring plans by majority decision and provides for an effective mechanism to bind dissenting creditors while protecting minority rights. The debtor can restructure its financial liabilities in an efficient and quick process while its business continues to operate. Court involvement is mostly optional, as is supervision by a restructuring practitioner. It remains to be seen whether the new restructuring process will be capable of restructuring leases and other non-financial liabilities. Claims of employees cannot be compromised in the restructuring process. In addition to introducing a new restructuring process, the

draft bill provides for key changes to the German Insolvency Code – including provision for the release of upstream collateral and guarantees provided by the debtor’s subsidiaries; this marks a first in German restructuring and insolvency law and reduces the need for multiple proceedings.

Key elements of the restructuring process

- Court involvement is largely optional, though mandatory in the case of a moratorium or termination of executory contracts.
- Debtors are able to propose a restructuring plan. Pre-negotiated plans are possible.
- The plan is accepted with 75% majority (by value, of those voting) in each class, subject to a cross-class cram-down mechanism.
- Selective restructuring process – may, for example, involve only financial creditors.
- Plan can restructure guarantees of other group entities.
- Debtors remain in possession of their assets and day-to-day operation of their business.
- Debtors have access to the restructuring process in case of imminent cash-flow insolvency (drohende Zahlungsunfähigkeit).
- Key aspects of the procedure may be monitored by an independent restructuring officer.

Key aspects in detail

Eligibility

The Preventive Restructuring Process is available to all debtors (with the exception of financial institutions) with their COMI in Germany that are not yet insolvent but will more likely than not become cash-flow insolvent within the next 24 months (impending illiquidity).

Moratorium

The debtor can request a (general, partial or individual) moratorium for up to three months.

The moratorium can be extended to a maximum of eight months if and to the extent necessary to safeguard a restructuring plan procedure once plan confirmation by the court has been requested by the debtor. During the moratorium, the obligation to file for insolvency is suspended.

Restructuring Plan

(Only) the debtor can prepare a restructuring plan. Such plan can bind the debtor's shareholders as well as secured and unsecured, financial and non-financial creditors (with the exception of employees).

Claims against, and security provided by, debtor subsidiaries can be compromised in return for adequate compensation.

Plan Acceptance and Sanction

Plan acceptance requires a 75% majority (by value, of those voting) in each class. As a minimum, secured creditors, unsecured creditors, subordinated creditors, creditors with claims against or benefitting from security provided by subsidiaries, and shareholders each need to vote in separate classes.

The plan does not need court approval but the debtor has the option to apply for court approval of the plan.

Cram-Down

Dissenting classes can be "crammed down" if (i) a majority of classes has accepted the plan, (ii) the class members can be expected to be no worse off with the plan than without the plan, and (iii) the class members receive an adequate share in the value created by the plan.

Adequate value means (a) no other creditor receives more than par value, (b) no junior or pari passu creditor receives more value than the members of the dissenting group, and (c) neither a subordinated creditor, nor the debtor, nor a shareholder receives any additional value (subject to limited exceptions).

This also allows for senior classes to be out-voted by junior classes ("cram-up").

Discharge of Contracts

The debtor can request the court to terminate executory contracts, e.g. lease agreements, if such request is accompanied by a restructuring plan.

Debt for Equity Swap

The plan can compromise shareholders' rights.

Restructuring Officer

The court will appoint a restructuring officer if the plan is to compromise SME or micro creditors, is accompanied by a moratorium or discharge of contracts, or is expected to require a cram down of dissenting classes (unless only claims originated by financial institutions are to be compromised).

For purely financial restructurings without the above-mentioned features, the restructuring plan procedure does not require the appointment of a restructuring officer.

The role of the restructuring officer is to monitor certain ongoing eligibility requirements relating to the plan procedure and a moratorium, and to comment on the restructuring plan and on requests for a discharge.

The debtor, or a quorum of 25% of creditors of a voting class, can further request the appointment of a restructuring officer to facilitate the development and negotiation of a restructuring plan. The restructuring officer has no mandate to assert liability claims or avoidance actions.

Court Involvement

The debtor can optionally petition the court to lead the voting on the plan or to sanction the plan. The debtor can also petition the court to opine on certain advance questions.

Court involvement is mandatory in case of a moratorium or if executory contracts are to be terminated.

Amendments to the German Insolvency Code & Related Measures

Directors' Duties

The new law provides for a shift of fiduciary duties of directors. Upon the occurrence of imminent cash-flow insolvency, directors must act in the best interests of creditors.

Directors also are now explicitly under a continuous obligation to monitor developments that could threaten the company's going concern and to take appropriate actions if necessary.

COVID-related Changes

Provided that the debtor: (i) was not cash flow insolvent on 31 December 2019; (ii) achieved positive profit from ordinary business operations in FY19; and (iii) revenue declined by more than 40% in 2020 (year-on-year), the following changes apply:

- in order to pass the going concern test and not have to file for insolvency due to balance sheet insolvency, debtors need only to demonstrate a "predominant likelihood" of subsisting as a going concern for the following four months (instead of 12 months, as per the intended change to the German Insolvency Code); and
- debtors have access to debtor-in-possession proceedings and the Preventive Restructuring Process, notwithstanding cash flow insolvency.

Release of Third Party Security

To facilitate the restructuring of groups of companies, upstream security and upstream guarantee claims against subsidiary obligors can be included in the debtor's insolvency plan (as well as in the restructuring plan).

Voting rights will be limited to the probable recovery amount attainable from the relevant credit support and the relevant creditor is entitled to receive adequate compensation for any compromise.

Debtor in Possession in Insolvency

The draft bill provides for changes to DIP ("self-administration") insolvency proceedings.

Going forward, debtors will need to provide a self-administration plan that includes, in particular, a broad concept of how the debtor intends to overcome the difficulties leading to its insolvency and a financial plan which demonstrates going concern status for the next six months.

Related Professionals

Leo Plank

Partner / Munich

Dr. Bernd Meyer-Löwy

Partner / Munich

Sacha Lürken

Partner / Munich

Dr. Wolfram Prusko

Partner / Munich

Dr. Josef Parzinger

Associate / Munich

Dr. Marlene Ruf

Associate / Munich

Ann-Kathrin Ziegler

Associate / Munich

Dr. Johannes Lappe

Associate / Munich

Michael Funk

Associate / Munich

Related Services

Practices

- Restructuring

Suggested Reading

- 24 September 2020 Kirkland Alert European Credit Derivatives Outlook
- 24 September 2020 Kirkland Alert UK Temporary Restructuring/Insolvency Measures – Certain Extended, But No Extension to Wrongful Trading Adjustments
- 08 September 2020 Kirkland Alert The First UK Restructuring Plan Sanctioned: Learning Points from Virgin Atlantic’s Plan Process

This communication is distributed with the understanding that the author, publisher and distributor of this communication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, this communication may constitute Attorney Advertising.

© 2020 Kirkland & Ellis International LLP.