Update Restructuring

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New German pre-insolvency restructuring proceeding and changes to German insolvency law – first draft bill implementing EU Directive 2019/1023 on preventive restructuring frameworks and improving the instruments introduced by ESUG in 2012, with a focus on self-administration

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On 18 September 2020, the German Federal Department of Justice published a first draft bill for the implementation of the EU Directive 2019/1023 on preventive restructuring frameworks of 20 June 2019 (the „Draft Bill"). Besides implementing EU Directive 2019/1023 by way of a new law, the Business Stabilization and Restructuring Act (*StaRUG*), the Draft Bill implements a number of changes to the German Insolvency Code (*Insolvenzordnung*) and other relevant laws, mainly aimed at further improving the instruments newly implemented into German insolvency law as of March 2012 by the Act for the further facilitation of the restructuring of enterprises (*ESUG*). The Draft Bill is now subject to discussion. If it becomes law by January 2021 (which is possible), it will help German companies currently benefitting from the recent extention of the suspension of the insolvency-filing duty until the end of 2020 to resolve their over-indebteness outside of formal insolvency proceedings. We introduce you to the main features of the Draft Bill.

Business Stabilization and Restructuring Act (*StaRUG*)

Early crisis -detection and -management

The Draft Bill aims at enhancing liquidity crisis-detection and crisis management at an early-stage, i.e. before the company becomes insolvent: Managing directors of legal entities will owe a legal duty to (also) safeguard the interests of the creditors (in addition to those of the shareholders) when the company enters the stage of threatened illiquidity (*drohende Zahlungsunfähigkeit*). To enhance the directors' ability to comply with their new legal duty, the Bill also introduces a new legal duty for tax advisors and auditors to inform their

clients about their exposure to insolvency or other risks threatening their going concern.

Restructuring plan: pre-insolvency, similarity to insolvency plan

The Draft Bill introduces a new key instrument to remedy a company's crisis at an early-stage and outside of formal insolvency proceedings: The reduction of the debtor's debt by way of a restructuring plan (*Restrukturierungsplan*) is the key instrument of the EU-wide harmonization of restructuring regimes required by EU Directive 2019/1023. In its German version, the restructuring plan will largely resemble the insolvency plan (*Insolvenzplan*) in formal insolvency proceedings. However, to take account of its pre-insolvency nature, a restructuring plan will not have to include all of the company's creditors; the company will be largely free to select the creditors whose claims it intends to include in the restructuring plan proceedings. Further, while the insolvency plan requires approval by a simple majority of the creditors (heads and claim amounts) in each group, the restructuring plan requires the approval by three quarters of the creditors (only claim amounts) in each group.

Debtor selects creditor groups to be included in restructuring plan

Further restructuring tools, including rescission of cumbersome contracts

The Draft Bill introduces a tool-box of new instruments aimed at assisting businesses to remedy their crisis at an early stage, i.e. prior to the occurrence of illiquidity or over-indebtedness, but subsequent to notifying the court of their intention to initiate a restructuring proceeding: Thus, the court can rescind contracts deemed too cumbersome for the debtor and failing a consensual adaptation with the creditor. Further, the court can stay creditors' actions of claim enforcement and collateral realization for up to three months, provided the debtor has submitted a comprehensive and coherent restructuring planning. Where a restructuring plan has been approved by the creditors, but the required court-approval is still pending, the court can stay claim enforcement and collateral realization actions for up to eight months. Where the court interferes with such creditors' actions, the creditors shall be compensated by way of damages and/or interest payments.

Court-appointed restructuring practitioner to safeguard interests of debtor and creditors in scenarios of intense restructuring measures

In order to assist debtors and their creditors in implementing a restructuring plan and to safeguard the legitimate interests of all participants involved, the Draft Bill allows the court to

appoint a practitioner in the field of restructuring (*Restrukturierungsbeauftragter*). The Draft Bill mandatorily requires the court to appoint such a practitioner where the debtor contemplates (i) curtailing the claims and rights of consumers or SMEs, (ii) subjecting all (or substantially all) of its creditors to a stabilization measure, (iii) rescinding existing contracts, (iv) staying or restructuring the claims or security interests of creditors in relation to collateral provided by any of the debtor's subsidiaries, or (v) cramming the restructuring plan down on a group of creditors, in which the plan failed to receive the approval of the required majority, except where only creditors of the financial sector (or their successors-in-title) are subjected to the restructuring plan.

Restructuring moderation – a „light"-version for debtors who cannot afford a restructuring practitioner

If small businesses lack the financial means for a restructuring practitioner, the Draft Bill allows for a „light"-version of restructuring proceedings: A restructuring moderator (*Sanierungsmoderator*) negotiates a restructuring settlement agreement with the relevant creditors, which also requires the confirmation by the court, but – contrary to the restructuring plan - cannot be crammed down on dissenting creditors.

Changes and amendments to the instruments introduced to the German Insolvency Code by ESUG

Another part of the Draft Bill deals with **improvements to the instruments introduced to the German Insolvency Code by ESUG as of March 2012**: In an attempt to afford the debtor with more comfort as to how the court will respond to its insolvency filing and, in particular, its request to be granted the benefit of protective shield proceedings (*Schutzschirm*) or preliminary self-administration (*vorläufige Eigenverwaltung*), the Draft Bill provides the debtor with the right to request, prior to actually filing for insolvency, a **preliminary judicial hearing**. Further, the Draft Bill responds to the widespread criticism of the insolvency ground of over-indebtedness (*Überschuldung*): While not abolishing over-indebtedness as a mandatory reason to file for insolvency, the Draft Bill clarifies that **over-indebtedness** shall not be an issue if the debtor's liquidity (*Zahlungsfähigkeit*) is secured **over a prognosis period of the upcoming twelve months**. On the other hand, **the prognosis period for the determination of threatened illiquidity** (*drohende Zahlungsfähigkeit*) shall be **24 months**.

Over-indebtedness remains mandatory reason for insolvency filing, but legislator limits duration of prognosis period for determination of over-indebtedness to 12 months, while setting prognosis period for determination of the facultative insolvency of threatened illiquidity to 24 months

Higher admission requirements for debtor's access to self-administration

The main focus of the Draft Bill in terms of improving the existing insolvency regime is on the self-administration (*Eigenverwaltung*). ESUG had significantly facilitated the debtor's access to self-administration, in lieu of administration by an insolvency administrator, which also resulted in cases of abuse to the detriment of the creditors' interests. The Draft Bill therefore increases the hurdles for the debtor's access to preliminary self-administration (*vorläufige Eigenverwaltung*) when filing for insolvency: The debtor will be required to submit a comprehensive and coherent **planning for the self-administration**, which must contain, among other things, a financial plan for six months, a concept to remedy the insolvency, a presentation of the status of negotiations with creditors and relevant third parties in relation to the restructuring measures contemplated by the debtor, a presentation of the measures taken by the debtor to ensure fulfilment of its duties under insolvency law and a cost-comparison between self-administration and ordinary insolvency proceedings. Another area of reform is the custodian (*Sachwalter*), who is often viewed as lacking the required independence from the debtor and / or creditors. The Draft Bill proposes that, where the court followed the suggestions of the debtor or the creditors when appointing the custodian - the court may appoint a **special custodian** *(Sondersachwalter)* charged with the examination and pursuit of liability claims against current or former members of the debtor's management and of claw-back claims against creditors. Further, the Draft Bill addresses the **liability of members of the corporate bodies of the self-administering debtor** when breaching their respective duties which shall **correspond to the liability of an insolvency administrator** in regular insolvency proceedings.

Court may appoint special custodian (*Sondersachwalter*) to examine and pursue liability claims against debtor's managers and claw-back claims against debtor's creditors

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