HEUKING KÜHN LÜER WOJTEK

Update Restructuring

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Landmark changes to German restructuring law: New law on preventive restructuring framework (StaRUG) allows pre-insolvency balance sheet restructuring – we analyze what shareholders, creditors and new money lenders should prepare for.

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As of 1 January 2021, a new German law (known by its abbreviation *StaRUG*) affords debtors with COMI in Germany with a statutory regime for a non-consensual pre-insolvency balance sheet restructuring. This is a novelty: German restructuring law previously provided no tool allowing a debtor to impose a debt-restructuring concept agreed with the vast majority of its creditors upon a dissenting minority of creditors; minority creditor hold-outs forced debtors to commence formal insolvency proceedings unless they were willing and able to resort to cumbersome English law schemes of arrangements sanctioned by the High Court of Justice in London. While StaRUG now remedies this situation for mere balance sheet restructurings, the German legislator shied away from providing debtors with the tools for an operational restructuring.

This newsletter

(i) **introduces the key features** of the new preventive restructuring framework under StaRUG,

(ii) **highlights its strengths** and the restructuring-situations, for which StaRUG will be suitable,

(iii) **addresses its weaknesses** and the restructuring-situations, in which StaRUG will be less suitable, and

(iv) **identifies caveats** for shareholders, creditors and new money lenders in relation to restructuring proceedings under StaRUG.

This Newsletter Update Restructuring does not constitute legal advice. While the information contained in this Newsletter has been carefully researched, it only offers a partial reflection of the law and its developments. It can be no substitute for individual advice appropriate to the facts of an individual case.

StaRUG has become effective on 1 January 2021 as part of the SanInsFoG of 22 December 2020

On 1 January 2021, the **Act for the Further Development of the Restructuring and Insolvency law** (*Sanierungs- und Insolvenzrechtsfortentwicklungsgesetz,* ***SanInsFoG***) of 22 December 2020 entered into effect.

SanInsFoG combines three important legislative projects into one legislative act:

StaRUG implements EU Directive 2019/1023 on preventive restructuring frameworks into German law

(1) **Introduction of a new preventive and pre-insolvency restructuring scheme** by way of the **Act for a stabilization and restructuring framework for businesses** (*Gesetz über den Stabilisierungs und Restrukturierungsrahmen für Unternehmen*, **Unternehmensstabilisierungs- und –restrukturierungsgesetz – StaRUG**), implementing the EU Directive 2019/1023 on preventive restructuring frameworks. The StaRUG is the center-piece of the San-InsFoG. We had provided an initial overview of the draft bill in our newsletter of 23 September 2020 and will comment in this newsletter on the StaRUG as it has become effective.

Amendments to the German Insolvency Code (InsO) renovate regime of self-administration and protective shield proceedings

(2) **Renovation of the German insolvency law regimes of self-administration (*Eigenverwaltung*) and protective shield proceedings (*Schutzschirmverfahren*)** by way of amendment of the German Insolvency Code (**InsO**). We will provide further detail, and our view as to the practical implications to be expected from this reform, in a separate newsletter (to be published shortly).

Amendment to CovInsAG (the German COVID-19 emergency law of 27 March 2020) for new temporary relief measures

(3) **New short-term temporary relief measures for German debtors struggling to recover from the effects of the COVID-19 pandemic** (by way of amendment to the COVID-19 emergency legislation COVInsAG of 27 March 2020) and include suspension of duty to file for insolvency until 31 January 2021, easier access to protective shield and self-administration proceedings and a prognosis period for the over-indebtedness test abbreviated from 12 to 4 months – please **see our newsletter of 4 January 2021** for more detail.

1) **<u>StaRUG's key features.</u> How does the preventive restructuring framework work?**

StaRUG's key features

StaRUG introduces a new instrument to remedy a company's crisis early-stage and outside of formal insolvency proceedings:

1.1) Key instrument: restructuring plan majority-approved by creditors

Pre-insolvency debt-reduction by way of restructuring plan; similarity to insolvency plan

The key instrument of the EU-wide harmonization of restructuring regimes required by EU Directive 2019/1023 is **the reduction of the debtor's debt by way of a restructuring plan** (*Restrukturierungsplan*).

In its German version, the restructuring plan largely resembles the insolvency plan (*Insolvenzplan*) in formal insolvency proceedings. The following particularities are noteworthy:

(i) <u>Debtor selects creditor groups to participate in restructuring by way of restructuring plan</u>. To take account of its pre-insolvency nature, a restructuring plan does not have to (and for practical reasons should not) include all of the debtor's creditors; the debtor is largely free to select the creditors whose claims it intends to restructure in order to prevent its insolvency and secure its viability.

(ii) <u>Restructuring plan can include and restructure</u>
- claims of creditors (due, undue or contingent),
- security interests provided by the debtor,
- security interests provided by third party affiliates, i.e. creditors' claims against third parties affiliated with the debtor (e.g. under guarantees or assumptions of liability joint and several with the debtor) and creditors' security interests in assets provided by such affiliates, provided in each case that the secured parties receive adequate compensation for any reduction or concession regarding such intra-group third-party collateral,

Restructuring can include claims against third party security providers (if affiliated to debtor) and debtor's personally liable general partners

- shareholders' equity interests in the debtor and claims under shareholders' loans, which can be

Shareholders' interest in the debtor can be cancelled or transferred to creditors / investor

cancelled or transferred to the creditors or an investor.

(iii) Restructuring plan must not include employees' wages and pension benefits. Employees' claims for wages and rights to pension benefits are excluded from restructuring under StaRUG to account for its pre-insolvency nature.

Employees' wages and pension benefits cannot be restructured

(iv) Restructuring measures available. Creditors' claims can be subjected to deferral, reduction, waiver, debt-equity-swap (only with individual creditor's consent), amendments to ancillary terms of claims (e.g. financial covenants, events of default, ranking), in relation to syndicated financings this applies even to the terms of inter-creditor agreements. Creditors' security interests can be released or changed in their respective rank. In addition, the restructuring plan can provide for a decrease or increase of the debtor's registered capital and can approve the debtor entering into new loan and collateral arrangements to finance the restructuring.

Restructuring by means of deferral, reduction, debt-equity swap, amendment of terms of agreements (e.g. financial covenants) including inter-creditor arrangements, new financing and collateral arrangements

(v) Restructuring plan cannot terminate executory contracts. Executory contracts (*gegenseitige Verträge*) can only be restructured to the extent the creditor has fulfilled his part of the contracts and can require fulfilment from the debtor. Thus, the debtor cannot restructure the unfulfilled "future" part of an executory contract, such as the terms regarding the outstanding term of a lease-contract. Initially, the draft bill of StaRUG afforded the debtor with exactly this ability to terminate executory contracts when the other party refused to cooperate to amend the contract for the future. The aim was to allow the debtor to (threaten to) terminate long-term contracts such as leases, which could also be terminated in the alternative scenario of insolvency proceedings. This would have increased the debtor's bargaining power to request their amendment. The final draft of StaRUG deleted this termination of contracts tool in response to widespread criticism: The debtor should not be afforded an easy exit from cumbersome contracts before its insolvency and without assuring that the burden of

No termination of executory contracts (e.g. leases)

such a restructuring is born by all stakeholders concerned, as would be the case in subsequent insolvency proceedings.

(vi) Record-date concept allows debtor to restructure claims, which are likely to be traded during the StaRUG proceedings. According to StaRUG the claims, security interests and shares selected by the debtor will be subject to the restructuring plan as established and held by their respective creditors/shareholders at the point in time when the debtor submits the restructuring plan to the parties concerned (creditors and shareholders) or to the court, if the debtor opts to have the court organize a hearing for discussion and voting by the parties concerned. If a creditor or a shareholder disposes of his claims or shares after that point in time, the claims or shares he has disposed of will nevertheless continue to be subject to the restructuring plan and the plan will, if adopted by the creditors and approved by the court, be binding upon the acquirer of the claims or shares. This effective day-concept of the StaRUG proceeding allows the debtor to include also those claims (or shares) in the restructuring, which are likely to be traded during the process, such as bonds or *Schuldscheine*.

Debtor sets record-date for restructuring when submitting restructuring proposal to creditors, restructuring plan will be binding upon all successors-in-title

(vii) Restructuring plan requires approval by 75%-majority of creditors in each group of creditors (and shareholders, where shareholders are included). Creditors' vote is determined in accordance with their respective claim amounts and collateral values, absentees are deemed dissenting. Thus, to secure creditors' adoption of the plan the debtor is well advised to minimize absences by communicating with the creditors and motivating them to participate in the vote. The debtor determines whether voting takes place in creditors' meeting or outside of such a meeting. Each creditor can require a meeting in which the debtor explains and discusses the restructuring plan and potential amendment requests from creditors.

Restructuring plan requires approval of 75%-majority in each group of creditors (and shareholders, if included)

(viii) Cross-class cram-down. Restructuring plan becomes effective even against the rejection by individual voting-groups, if (i) it is approved by the majority of groups, (ii)

Cross-class cram-down

does not put the rejecting groups in a worse position than they would be in without the plan, and (iii) attributes the rejecting groups an appropriate share in the value that is created by the restructuring plan and distributed to those affected by it.

(ix) Restructuring plan becomes effective by court confirmation. Restructuring plan becomes effective upon confirmation by the court, also vis-à-vis dissenting creditors and – if the conditions of the cross-class cram-down are met - creditors of a dissenting group. Legal remedies filed against the plan's confirmation generally have no suspensive effect.

Limited protection of court-confirmed restructuring measures and their implementation in debtor's subsequent insolvency

(x) Court's confirmation of restructuring plan exempts restructuring measures (including new money loans) from claw-back until debtor is sustainably restructured. StaRUG exempts the measures of a restructuring plan and the acts taken for their implementation from claw-back (*Insolvenzanfechtung*), limited, however, to the period ending with the debtor's sustainable restructuring (*nachhaltiger Sanierung*), which should coincide with the full implementation of all measures provided by the restructuring plan. In practical terms, this means that the lender of a new money loan provided for under the restructuring plan will be exempted from claw-back regarding the granting of the collateral securing the new loan. On the other hand, the debtor's subsequent amortization payments on the loan will not be exempted from claw-back in a future insolvency. Thus, the lender will have to continuously monitor the debtor's solvency and viability just as any other lender would in relation to the debtor's debt service. Unfortunately, StaRUG does not expressly protect new financing from subsequently being held voidable under the German law concept of lender's liability (*Haftung wegen Beihilfe zur Insolvenzverschleppung*) for providing restructuring-financing without adequately ensuring the viability of the underlying restructuring concept. In this respect, StaRUG inadequately implements the EU Directive's task to adequately protect interim financing provided during the negotiation-phase of the plan and

new financing provided under the confirmed plan from subsequently being voided or held unenforceable. New lenders are, therefore, well advised to require that the debtor's restructuring concept complies with the requirements of the German Supreme Court in relation to lenders assisting a debtor in its out-of-court restructuring attempt by way of prolongations and new money loans. In practice, lenders should require the debtor to submit a fully-fledged restructuring concept supported by an expert's opinion that the restructuring plan is reasonably likely to result in a successful restructuring.

Lenders should require restructuring concept and opinion compliant with requirements of German Supreme Court / IDW S6 when prolonging existing loans or extending new loans under the plan

(xi) StaRUG does not afford priority to new financing. EU Directive 2019/1023 allows member states to afford new financings provided under a restructuring plan priority over existing unsecured financings in a future insolvency of the debtor. However, StaRUG does not adopt such protection for future financings (provided under a plan) nor for interim financings (provided in order to bridge the time to adopt the plan).

1.2) Requirement for access to StaRUG – impending illiquidity

Access to a restructuring plan under StaRUG requires that the debtor is not insolvent, but threatened by illiquidity (*drohende Zahlungsunfähigkeit*), and is able to restore its viability (*Bestandsfähigkeit*) by means of the restructuring plan. When the debtor submits the proposal of the restructuring plan to the creditors, it must also submit a reasoned statement on the prospect of preventing the debtor's insolvency and restore its viability. Should the debtor become insolvent during the StaRUG proceeding, it must inform the court and the proceeding will usually be converted into an insolvency proceeding, possibly in self-administration.

Access to restructuring plan tool requires debtor's impending illiquidity (*drohende Zahlungsunfähigkeit*)

1.3) Debtor's control of StaRUG proceeding

Another key element of the preventive restructuring framework is that it is only available upon the debtor's initiative. The debtor stays in possession and control of its business operations throughout the proceeding. StaRUG generally leaves the initiative for all procedural steps to the debtor. Thus, the debtor

Debtor stays in possession and controls proceeding

drafts and submits the restructuring plan and the debtor decides if and when to apply to the court for a stay of enforcement actions or collateral realization or the court's confirmation of a restructuring plan approved by the creditors. However, StaRUG affords the court discretion to restrict the debtor's control of the proceeding and its business, where (i) the restructuring plan or an enforcement stay concerns (also) SME or even consumers, or (ii) the approval of the restructuring plan requires a cross-class cram-down and the restructuring is not limited to creditors of the financial services sector or of capital markets instruments. In these cases, the court appoints a practitioner in the field of restructuring charged with supervising the debtor's financial status and business conduct (see below). Where the StaRUG proceeding extends to all debt suitable to be subject of a restructuring plan, the court can even establish a creditors' council (*Gläubigerbeirat*) charged with supervising the debtor in conducting its business operations, similar to a creditors' committee in formal insolvency proceedings.

Court appoints practitioner to supervise debtor, if restructuring extends to SMEs/consumers

Court also appoints creditors' council, if restructuring plan extends to all debt suitable for restructuring under StaRUG

1.4) Stay of creditors' actions for enforcement and realization of collateral

Upon the debtor's request, the court can stay – in relation to those claims and security interests which the debtor subjects to the restructuring plan - all creditors' actions to enforce such claims and realize such collateral (including enforcement of collateral provided by affiliates of the debtor) to afford the debtor up to three months' time to complete the restructuring proceedings. The court can extend the stay by one month in the event the debtor has submitted a restructuring plan to its creditors. Where the plan has been adopted by the creditors and is awaiting court-approval, the court can extend the stay until court-approval, provided the total stay-period does not exceed 8 months.

Debtor can request stay on creditors' enforcement actions and collateral realization

A secured party is entitled to interest on its claim and to compensation for depreciation in asset value, where such secured party has a security interest in an asset, which the court authorizes the debtor to continue using in its business operation.

1.5) Creditors prohibited from accelerating or terminating contracts

The debtor's initiation of restructuring proceedings or the court's stay of creditors' actions for enforcement or collateral realization enforcement does not *per se* entitle creditors to terminate contracts with, accelerate their claims against, or withhold deliveries or services due to be made to, the debtor. The creditor can only exercise these rights, if it demonstrates that the debtor does not require the creditor's services or deliveries to continue its business operations.

Creditors must not accelerate or terminate contracts due to initiation of StaRUG proceedings or stay of enforcement actions

However, where creditors have undertaken to make advances of deliveries, services or loans to the debtor, StaRUG protects their interests: Theses creditors may require the debtor to provide security or provide his consideration concurrently with the creditor's delivery or service; a lender may reject the debtor's drawing request under the lender's loan commitment and terminate his loan commitment where justified due to a deterioration of the debtor's financial status or of the value of the security granted for the loan commitment.

StaRUG protects creditors owing advances to the debtor

1.6) Practitioner in the field of restructuring (*Restrukturierungsbeauftragter*) coordinates plan proceeding and safeguards creditors' interests

While StaRUG entrusts the debtor with the initiative for the restructuring plan proceedings, for procedural steps and for a stay of creditors' actions, it provides checks and balances where the restructuring concerns creditors who typically lack the ability to protect their own interests: Consumers and SME.

Practitioner in the field of restructuring (*Restrukturierungsbeauftragter*)

(i) Mandatory appointment of practitioner where restructuring includes SMEs or where cross-class cram down is likely. Where the debtor includes the claims of consumers or SME in the restructuring plan or applies for an enforcement stay (also) in relation to such creditors' actions, the court will usually appoint a practitioner in the field of restructuring (*Restrukturierungsbeauftragter*). The court will also appoint a practitioner in the field of restructuring, where the creditors' approval of the plan will likely require a cross-class cram-down; however, no such practitioner will be appointed if the debtor exclusively includes claims of creditors from the financial services sector (or their successors-in-title) or claims under instruments traded in the capital markets and money markets (such as bonds). StaRUG requires the court to select the practitioner among

Mandatory appointment of practitioner where

- **restructuring includes SMEs, or**
- **cross-class cram down is likely**

No practitioner required if restructuring plan exclusively restructures bank debt or bonds

those experienced restructuring and insolvency professionals who have generally offered to the court to assume such instructions. Individual courts have already indicated that they would start their list of candidates by including those practitioners already listed as candidates for the office of insolvency administrator. Since the courts have abundant working-experience with those listed on the administrators' lists, the court can be expected to select the practitioner among those persons listed as insolvency administrators in its precinct.

Court has discretion to transfer debtor's cash management to mandatory practitioner

Where the appointment of a practitioner is mandatory, the court may instruct the practitioner to supervise the debtor's financial status and business conduct and to manage all of its payment transactions.

(ii) Debtor's proposal for practitioner-candidate is binding where debtor is well-prepared. The court is bound to appoint a practitioner proposed by the debtor (unless the candidate is obviously unsuitable), where the debtor has submitted the confirmation by an experienced restructuring expert confirming that the restructuring plan submitted by the debtor is consistent and complete and that the debtor has no substantial arrears under employment contracts, pension commitments, tax liabilities, or vis-à-vis suppliers or the social security system. Where the court is not bound by a proposal from the debtor, a group of creditors combining 25% or more of the votes in each voting group of the restructuring plan can submit a joint proposal, which will then be binding upon the court.

(iii) Court can appoint second practitioner to substitute practitioner appointed upon debtor's binding proposal. In order to assure the independence of the practitioner from the debtor, the debtor's shareholder and the creditors, the court can appoint – in its own discretion – a second practitioner and can transfer to such second practitioner most of the tasks of the first practitioner. The first practitioner will retain, however, authority to decide that the creditors vote in writing or in a private meeting (instead of in a court hearing) and may preside the voting outside a court hearing.

Where the appointment of a practitioner is not mandatory, the debtor or a group of creditors combining at least 25% of the

votes in one class can request the appointment of a practitioner (the voluntary practitioner). Where the creditors' group requests the appointment, the appointment is subject to the creditors' group assuming joint and several liability for the costs incurred in relation to the appointment. The creditors can also request the court to instruct the practitioner to supervise the debtor's financial status and business conduct and to manage all of its payment transactions (subject to creditors' group assuming the respective costs). However, any such instruction would seriously reduce the debtor's control, which is an essential element of the StaRUG proceedings. Therefore, the court can be expected to hear the debtor prior to taking its decision. It remains to be seen, how the courts will respond to applications of a 25%-plus-one-vote creditors' group. While StaRUG formally does not afford the court any discretion, courts can be expected to also take into account the debtor's interest to maintain control over its business conduct.

1.7) StaRUG proceedings may be conducted confidentially or publicly

StaRUG allows the debtor to conduct the proceedings either confidential to those creditors concerned, i.e. underneath the radar of other creditors and the general public, or in a public fashion with a similar degree of publicity regarding the appointment of a practitioner in the field of restructuring and all decisions the court takes in the course of the proceedings as in an insolvency proceeding. Since recognition of the court's decision in the restructuring proceedings in other EU-jurisdictions under the European Insolvency Regulation EU 2015/848 (EIR) EUInsVO will require "public" proceedings, debtors are well advised to conduct StaRUG proceedings involving claims subject to the laws of other EU jurisdictions as "public" proceedings. Please note, however, that the formal recognition of publicly conducted StaRUG proceedings as "insolvency proceedings" in the meaning of Annex A to the EUR is anticipated to occur only about mid-2022.

European Insolvency Regulation expected to afford recognition of court-confirmed restructuring plan (if resulting from a publicly conducted StaRUG proceeding) in other member states from about mid-2022

In relation to the UK, StaRUG proceedings will likely have to comply with local English law requirements for recognition in the UK. Since the end of the transition period on 31 December 2020 the EIR and the (Recast) Brussels Regulation 1215/2012

re jurisdiction and recognition of judgments have ceased to apply in relation to the UK.

2) <u>StaRUG's strengths</u>. How will StaRUG help resolve restructurings? What is the sweet-spot for StaRUG?

StaRUG's strengths:

StaRUG closes the gap between consensual out-of-court restructurings, which lack the means to force individual hold-out creditors to consent, and insolvency plan proceedings, which allow a simple majority of creditors voting in each group to impose the plan upon all dissenting creditors, at the price of subjecting the debtor and all its assets, debts and contractual relationships to fully collective formal insolvency proceedings. In a nutshell, we expect the following improvements for the German restructuring practice:

2.1 Hold-outs of creditors against debt restructurings can now be resolved outside of insolvency proceedings

StaRUG allows to impose restructuring plan on creditor hold-outs without recurring to insolvency proceedings

In the past, German debtors struggling to convince dissenting minority-creditors of their restructuring concept had to go through fully-fledged insolvency proceedings, unless they were able and willing to make use of a scheme or arrangement under English law. StaRUG now allows the debtor to initiate restructuring plan proceedings concerning only the financing creditors (e.g. bank lenders and holders of *Schuldscheine* and bonds), while keeping all trade-creditors out of the proceedings and sparing its business from being disrupted like in insolvency proceedings.

2.2 StaRUG's sweet spot is the restructuring of financial debt

StaRUG's sweet-spot is a restructuring limited to bank-debt, bonds and *Schuldscheine*

If the debtor only restructures its financial debt (bank loans, *Schuldscheine*, bonds), it retains a maximum of control over the proceeding. The court cannot appoint a practitioner in the field of restructuring (or even a creditors' council) to supervise and control the debtor in managing its business, unless creditors with combined voting rights of 25% plus one vote require it to do so and assume all costs incurred in relation to such appointment. The debtor can even apply the cross-class cram-down tool if its restructuring plan does not receive a

75%-majority in all classes. The debtor can streamline proceedings by organizing the voting on the restructuring plan by way of an out-of-court process. However, the court may, prior to confirming the plan, invite all participants to a court-hearing for information purposes. If required to secure the restructuring proceeding against dissenting creditors' enforcement actions, the court will, upon debtor's request, stay such actions for up to three months (extendable up to a total of eight months). StaRUG also allows the debtor to restructure any debt assumed by the debtor's affiliates for purposes of collateralizing the debtor's financial debt and to request the court to stay all enforcement actions against the debtor's affiliates under such collateral.

2.3 StaRUG proceedings can remain non-public

StaRUG proceedings may be non-public, but future recognition in other EU-member states (under EIR) will require proceedings conducted in public fashion

The debtor may choose to keep proceedings confidential to those creditors concerned by it and prevent publication of all court hearings and court decisions, including the appointment of a practitioner in the field of restructuring. However, where the debtor wishes to render the restructuring plan immediately enforceable in other EU jurisdictions, e.g. because individual creditors are domiciled in such EU jurisdictions, the proceedings will likely have to be conducted in a public fashion. Reason: A StaRUG proceeding fulfils all criteria of an insolvency proceeding under the EIR, if it is conducted in a public fashion. The StaRUG proceeding can therefore be expected to be listed as a national procedure in Annex A to the EIR and will, therefore, (from about mid-2022) most likely be recognized without any further examination by the courts in the EU-jurisdictions of the creditors concerned.

2.4 StaRUG allows to restructure claims of creditors against the debtor's affiliates and general partners (where debtor is a limited partnership) under intra-group collateral

Where the debtor is part of a group of companies, the debtor can also include in the restructuring plan claims creditors have against affiliates of the debtor under collateral agreements and – where the debtor is organised as a limited partnership - against the debtor's general partner. While these

claims can also be restructured by the plan, their creditors need to be compensated adequately.

2.5 StaRUG also addresses the need for new financing

New financing needs are typical for debtors in crisis. StaRUG ensures that the debtor informs court and creditors about the new financing and its impact on the restructuring concept and the prospects of restoring the debtor's viability: The restructuring plan must explain why new financing is required and how it ties into the underlying restructuring concept. The court can refuse confirmation of the plan, if the underlying restructuring concept is inconsistent or if it is apparent that the restructuring concept does not rely on the actual facts or does not have reasonable chances of success. However, StaRUG has not perfectly implemented the EU Directive's task to ensure that interim financing granted in the plan-negotiation-phase and new financing granted under the court-confirmed plan is protected from being voided in a potential subsequent insolvency of the debtor. The remaining risk is discussed below in item *3) StaRUG's weaknesses*.

2.6 StaRUG allows debtor to establish a common forum for the restructuring of all other members of the group (*Gruppengerichtsstand*)

StaRUG allows debtor to establish group forum for StaRUG proceedings of all other group entities with COMI in Germany

Upon the debtor's request, the court creates a group *forum* for future StaRUG proceedings of any other members of the debtor's group of companies affiliated to the debtor with COMI in Germany. Upon the debtor's request, the court can extend the group *forum* also to potential future insolvency proceedings of the group-members. The debtor may file these requests, if it evidences that it is not just of secondary importance for the group as such, e.g. because its share in the group's employees is at least 15% and its balance sheet total or total sales are at least 15% of the group's combined figures.

3) <u>StaRUG's weaknesses</u>. Which are the situations, in which StaRUG is less helpful?

StaRUG's weaknesses:

3.1) StaRUG proceedings cannot restructure employment relationships, pension liabilities

No restructuring of employees' salary claims and pension entitlements

The German legislator decided to exclude employees' claims and pension entitlements from StaRUG's restructuring ambit. The rationale is that StaRUG aims at restructuring the debtor to continue its operating business. However, where the debtor is unable to pay all salaries, its crisis is obviously more advanced and will requires a more comprehensive restructuring including all creditors, which is only available under formal insolvency procedings.

Debtor's employees are not eligible for insolvency money (*Insolvenzausfallgeld*) as they would in insolvency proceedings

For this reason, employees of debtors in StaRUG proceedings are not eligible to receive insolvency money (*Insolvenzausfallgeld*) from the German employment agency (*Bundesagentur für Arbeit*), as they would in insolvency proceedings.

3.2) StaRUG proceedings cannot restructure executory contracts, such as lease-contracts

No restructuring of long-term executory agreements, e.g. lease agreements

While existing claims established by creditors under executory contracts can be restructured, the terms of the contracts cannot be modified for the future. Initially, the StaRUG draft bill allowed the debtor to terminate contracts, where the respective creditor did not agree to a proposed amendment of the contract and allowed the debtor to restructure the creditor's resulting damages claim in the restructuring plan. This termination-tool sparked widespread criticism for releasing the debtor from its undertakings under long-term agreements prior to its insolvency to the benefit of all other creditors without assuring – as insolvency proceedings would - that all creditors share in the economic burden of such termination. It was, therefore, deleted in the final version of StaRUG.

StaRUG not suitable to restructure businesses operating a branch-network requiring down-sizing

As a result, StaRUG proceedings are not suitable where the debtor's restructuring requires – besides a restructuring of its financial debt – also a significant re-sizing of its workforce and / or lease-portfolio, e.g. in the crisis of debtors operating stationary retail businesses relying on a network of leased branch-stores spread across the geographies. In the absence of a termination-tool, the debtor will usually not be able to broker the required lease-amendments with all landlords concerned.

3.3) StaRUG does not adequately protect financing obtained by the debtor in StaRUG proceedings

New financing under restructuring plan – limited protection from claw-back re collateral and risk remains re lender's liability

(i) Neither interim-financing, which the debtor may obtain during the plan-negotiation-phase, nor new financing, which the debtor may obtain under the court-confirmed restructuring plan are expressly protected by the StaRUG from being held unenforceable or voided in a subsequent insolvency proceeding. The risk to which the financing creditor is exposed, is the following: It is well-established German case-law that the loan granted to assist a debtor in its out-of-court restructuring attempt is an immoral (*sittenwidrig*) loan and as such voidable, unless the creditor shows that his loan was part of a comprehensive and consistent restructuring concept complying with the guidelines developed by the German Supreme Court and adopted by the German auditors' association under standard IDW S6. In practice, this requires a restructuring concept wih a fully-fledged integrated business-planning approved by an independent expert's opinion. StaRUG does not require the debtor to submit a restructuring plan that meets this standard. Therefore, the courts could – at least in theory - invalidate interim financing provided during the preparation of the plan or even new financing provided under a court-confirmed plan if the restructuring concept underlying the plan subsequently proves inadequate and not compliant with the jurisprudence of the German Supreme Court.

StaRUG does not comprehensively exempt interim financing and new financing from risk of claw-back and lenders' liability

(ii) StaRUG's response to this threat is not convincing, although the EU Directive expressly requires member states to protect financing from subsequently being "voided":

- StaRUG only addresses lender's liability in relation to actions performed during the preparation and negotiation of the plan. Even in this regard, the wording does not clearly exempt assistance in the preparation of a restructuring plan from lenders' liability.
- New financing provided under the restructuring plan, is only protected under the general provision exempting the plan's provisions and the

measures to implement them from claw-back risk and is limited to the time when the debtor is sustainably restructured. This exemption exempts collateral obtained to secure the new loan from claw-back, but it does not address the lenders' liability, which the creditor risks to assume by providing financing under a plan relying on an inadequate restructuring concept.

(iii) It remains to be seen whether German insolvency administrator's and courts will challenge financings provided under restructuring plans. In light of the EU Directive's express request for comprehensive protection of new financing and the German legislator's view (expressed in the reasoning for StaRUG's draft-bill) that "*the participants shall generally rely on the stability of the plan and the measures taken for its implementation*", the courts may be inclined to interpret the relevant sections in StaRUG widely and exempt new financings from lender's liability even though the court-approved plan is subsequently found to be inadequate to restore the debtors' viability. To increase their comfort-level in this regard, lenders are well-advised to require the debtor to deliver a restructuring concept compliant with the rules established by the German Supreme Court for restructuring concepts in out-of-court consensual restructurings (or with the even more comprehensive auditor's standard IDW S6) and approved by an independent expert's opinion.

New money lenders can reduce risk of claw-back and lenders' liability by requiring restructuring concept compliant with standards of German Supreme Court / IDW S6

(iv) As regards collateral newly provided to secure new financing, it is captured by the StaRUG-provision generally exempting all provisions of a court-confirmed restructuring plan and the actions for their implementation from claw-back in a subsequent insolvency. Unfortunately, StaRUG generally limits this exemption to the time-period ending with the debtor's sustainable restructuring. This should coincide with the day when the restructuring plan is fully implemented. We think that the wording of this time-limitation is too wide and that it was not StaRUG's intention to completely lift the protection from claw-back on the day the debtor is sustainably restructured. The EU Directive clearly requires

to ensure that "*in the event of any subsequent insolvency of the debtor*" transactions implementing the court-confirmed restructuring plan are not declared void or unenforceable "*on the ground that such transactions are detrimental to the general body of creditors, unless other additional grounds laid down by national law are present.*" Thus, no new financing should be held voidable and no collateral should be clawed-back on the ground that the restructuring plan and the new loan did not rely on a viable restructuring concept.

(v) It should be noted that amortization payments made by the debtor on new financing obtained under the plan are not captured by the StaRUG-provision protecting the plan provisions and the measures taken for its implementation. Thus, the creditor is subject to the same rules as all other creditors and may be subject to claw-backs, i.e. where the creditor is aware of the debtor's insolvency when receiving payments.

Amortization payments on new money loans are not privileged and remain subject to the same general claw-back risk as all other payments which a distressed debtor makes to its creditors

3.4) Insufficient flexibility for court to uphold StaRUG proceedings, when debtor becomes illiquid during procedure.

Only non-insolvent debtors have access to StaRUG. If a debtor becomes insolvent during the course of a StaRUG proceeding, the debtor must inform the court and the court terminates the proceeding while the debtor prepares an insolvency filing. This concept is consistent with the nature of StaRUG proceedings as partially-collective proceedings, which are as such not suitable to remedy the debtor's insolvency. Therefore, StaRUG allows the court to continue the StaRUG proceedings only in case the restructuring plan, if adopted and confirmed by the court, would remedy the insolvency incurred by the debtor, and the achievement of the restructuring is sufficiently likely, because (i) the plan has already been adopted by the creditors and is awaiting the court's confirmation, or (ii) a plan submitted to the creditors or not yet submitted, but prepared in sufficient detail, has sufficient prospects of being adopted by the creditors and confirmed by the court.

The requirements of this exemption will prove to be too tight where the debtor becomes illiquid during StaRUG proceedings and such illiquidity results from the failure to agree on the extension of a stand-still- or waiver- period regarding claims subjected to the restructuring plan. While these creditors are prohibited from accelerating their claims upon the initiation of StaRUG proceedings, the lapse of a waiver- or stand-still- period agreed with the debtor prior to the initiation of the proceedings may still render their claims due and payable and cause the debtor's illiquidity. Unless the creditors have already adopted the restructuring plan or will do so within a short time-frame, the court has no choice other than terminating the StaRUG proceedings and forcing the debtor to file for insolvency proceedings. This result is particularly deplorable, where the debtor's illiquidity only results from the debtor's failure to find an agreement on the extension of a stand-still or a waiver with creditors whose claims are subject to the restructuring plan and will either be subject to a majority-vote in their class or be subject to a cross-class cram-down.

Where creditors' refusal to extend maturity or stand-still period causes debtor's illiquidity, the court may be forced to terminate StaRUG proceeding and cause debtor to file for insolvency

4) Caveats. What are the caveats for shareholders, creditors and investors in a StaRUG proceeding?

4.1) Caveats for shareholders

Caveats for shareholders re StaRUG proceedings

(i) Debtor requires shareholders' approval to initiate StaRUG proceedings. The StaRUG proceeding is at the sole initiative of the debtor. It is accessible to any debtor, which is not insolvent, but can demonstrate its impending illiquidity (*drohende Zahlungsunfähigkeit*, i.e. occurrence of illiquidity likely within the next 24 months). Since initiating a StaRUG proceeding requires that the debtor is not insolvent (but threatened by illiquidity), the debtor's management has to obtain the shareholders' prior approval.

Given that StaRUG allows to impose upon the shareholders, by way of cross-class cram-down (without the shareholders' consent), the complete or partial loss of all their equity interests and shareholder loan claims, approval by the shareholders' meeting will usually require a qualified majority under the respective debtor's corporate governance and constitutional documents,. Due to StaRUG empowering the debtor and the creditors to completely deprive shareholders of their equity

Debtor requires approval of shareholders' meeting by qualified majority (as would be required for amendments to constitutional documents)

intererests, the shareholders' approval to allow or instruct the debtor to initiate a StaRUG proceeding should be subject to the same majority and formal requirements as an amendment to the debtor's constitutional documents.

Shareholders are well-advised to make diligent use of their power to approve of, or stop the debtor from, entering into StaRUG proceedings. At this early stage of the proceeding (only), shareholders can exercise a significant influence on the restructuring concept and on the draft of the restructuring plan submitted to the creditors for approval.

Shareholders should weigh the opportunity of an early restructuring attempt against the risks of being deprived of their equity interests

When the debtor turns to its shareholders with the proposal to restructure part of its debt (e.g. its debt under bank loans and bonds) by means of a StaRUG proceeding, the shareholders should – on the one hand - appreciate the advantages of this pre-insolvency restructuring as opposed to a fully-fledged insolvency proceeding in self-administration:

(a) StaRUG allows to restructure financial debt at a time when the debtor is only threatened by illiquidity and not insolvent and leaving aside trade creditors and not disturbing the debtor's business operations.

(b) Consequently, at this pre-insolvency stage, StaRUG requires the debtor to provide, as part of his plan proposal a computation comparing the creditors' prospects to receive payments on their claims under the restructuring plan with the creditors' prospects to receive satisfaction without the plan; in relation to this no-plan scenario StaRUG requires the debtor to assume the continuation of the debtor's business, unless a sale of the business or an alternative form of continuation is without prospect. Pursuant to the governmental explanation of the draft StaRUG bill, deviating from the continuation of business assumption and computing the no-plan scenario on the basis of the debtor's liquidation requires thorough reasoning.

Key question: does debtor's business have positive equity value when assuming its continuation, but also discounting the threat of future illiquidity?

(c) Before this background, the key question for shareholders is: Will the no-plan scenario, based on the continuation of the debtor's business, result in a positive equity value and thereby allow shareholders to stay in the equity? The answer will depend on how the valuing expert will discount the enterprise value by the impact of the debtor's threatened illiquidity, i.e. the prospect that – during the upcoming 24 months - the debtor will likely not be

able to service all its liabilities when due. The answer will require a prognosis and may result in a range of values with similar degrees of probability.

On the other hand, shareholders should be aware that StaRUG does not afford the shareholders effective legal remedies against the court's confirmation of a restructuring plan, which completely or partially cancels their equity interests and shareholder loans, even before the debtor is insolvent:

(ii) Creditors will require restructuring plan to also curtail shareholders' interests in debtor's equity and shareholder loans

As a general assumption, creditors will expect any restructuring plan, which aims at curtailing selected creditors' claims, to also (and with priority) curtail the shareholders' equity interests in the debtor as well as all shareholder loans. However, StaRUG requires application of this principle, referred to as the "absolute priority rule", only to protect a dissenting class of creditors when the restructuring plan is crammed down on them: A restructuring plan can be crammed-down on a dissenting creditor class (i.e. a class, in which the 75% approval is not achieved) only if the plan ensures that other creditors and shareholders, which would rank junior to the dissenting class in an insolvency proceeding, receive no value under the restructuring plan except where such value is fully compensated by a performance of the respective beneficiary into the debtor's assets.

(iii) Situations, in which shareholders may retain equity interests in the debtor

This does, however, not mean that the debtor's shareholders will always need to be (fully or partially) deprived of their shareholdings and shareholder loans:

(d) The absolute priority rule only applies where a cross-class cram-down is needed. This is only the case, if one or more creditors classes do not approve the plan by 75%-majority.
(e) Even where the absolute priority rule applies (due to cram-down), StaRUG provides by way of narrow exemptions that shareholders may retain (all or part of) their equity interests under the restructuring plan, if
    - the plan only "insignificantly" affects creditors' rights, which StaRUG assumes to be the case, if creditors'

rights are not curtailed or abbreviated and their respective maturities are not extended by more than18 months, or

- circumstances personal to such shareholders require that such shareholders continue to participate in the operation of the debtor's business and the shareholders assume respective undertakings under the plan also allowing the debtor to require transfer of the participation should the shareholders not comply with their undertakings during a period of five years.

It should be noted that these narrow exemptions do not allow the shareholders to retain claims under shareholders' loans. Thus, claims under shareholder loans must be completely waived/contributed if a cram-down is needed.

It should further be noted that if the court confirms a plan, which required a cross-class cram-down for the creditors' approval, any dissenting creditor can file an appeal (*sofortige Beschwerde*) against such confirmation, requiring the court to review, and potentially revise, its decision on the application of, or exemption from, the absolute priority rule.

(f) The absolute priority rule does not apply in the event the restructuring plan is approved with 75%-majority in all classes and does not need to be crammed-down on any class. In this case, it is completely up to the creditors asked to vote on the plan to determine whether the proposal the plan makes as to a retention by the shareholders of all or part of their equity interests and shareholder loans is acceptable to them in light of the contributions the plan requires from the creditors. If the creditors approve the plan without a cram-down, the court will not review whether the plan adequately balances the contributions of the creditors and the shareholders to the restructuring. Even a dissenting creditor's appeal (*sofortige Beschwerde*) against such court confirmation will not result in the court conducting such review.

(g) If the court has to appoint a practitioner in the field of restructuring (e.g. in cases where the plan also includes SMEs or the plan will need to be crammed-down on one

or more class of non-financial creditors), the mandatory practitioner may also exercise pressure towards a fair contribution of the shareholders to the restructuring: The mandatory practitioner is generally required to diligently and impartially fulfil its duties vis-à-vis the court and the creditors. StaRUG does not require the mandatory practitioner to comment on, or advise the creditors in relation to, the content of the restructuring plan proposed by the debtor. StaRUG does, however, require the practitioner to review and comment on the reasoned explanation, which the debtor needs to provide on the chances that the restructuring plan will remedy the debtor's impending illiquidity and restore its viability. The debtor and its shareholders can, however, ensure that the court is not entitled to appoint a mandatory practitioner, by

- excluding claims of SMEs or consumers from the restructuring,
- abstaining from requesting an enforcement stay that extends to claims of all or virtually all creditors, and
- preventing as much as possible that a cram-down is required in any class, unless the restructuring only concerns creditors of bank loans, *Schuldscheine* and bonds.

Creditors holding 25% plus one vote in a single class may (at their own cost) be able to subject the debtor to supervision and control of a practitioner

(h) However, debtor and shareholders should be aware that StaRUG seems to allow one or more creditors representing more than 25% of the voting rights in one class to request (and thereby cause) the court, at any time, to appoint a voluntary practitioner and instruct him to supervise the debtor's financial status and business conduct and to manage all of its payment transactions, provided the creditors' group assumes all resulting costs. The creditors' group may even achieve such an instruction where a voluntary practitioner has already been appointed upon request of the debtor. While the wording of StaRUG does not afford the court any discretion in this decision, it can be argued that the court should not be allowed to subject the debtor (who is not insolvent) to such restrictions merely upon the request of a minority of creditors, unless justified by the debtor's behavior or the apparent deterioration of its financial situation.

Shareholders have no efficient legal remedy to prevent plan from (partially) deleting their equity interest, where debtor makes monetary compensation available

(iv) No efficient legal remedy for shareholders against a plan cancelling all or part of their equity interests.

(a) StaRUG generally affords each party concerned by the restructuring plan (whether creditor or shareholder) the right to request the court to refuse to confirm a restructuring plan, provided such party voted against the approval of the plan and demonstrates that the plan puts it in a worse position than it would be without the plan.

(b) However, this remedy will, in practice, not effectively protect the shareholder:

- The debtor can exclude the exercise of this remedy by reserving a certain amount in the plan to compensate any party evidencing being damaged by the plan. In this case, the court will reject the remedy and direct the party concerned to seek compensation outside of the StaRUG proceedings, without even checking whether the funds reserved for this purpose under the plan will be sufficient.
- The shareholder can only seek compensation for the deletion of his shares.

(c) The shareholder can file (within a two weeks' period) an appeal (*sofortige Beschwerde*) against the court's confirmation of the plan. But this remedy will it practice not allow the shareholder to defend retaining its equity interest:

- The appeal will only be successful, if the shareholder evidences that the plan puts it in a "substantially" worse position than it would be without the plan and that this substantial disadvantage cannot be compensated by the monetary funds reserved under the plan.
- The appeal will not uphold the plan from becoming effective. Causing the court to suspend the plan's effectiveness until it has taken its decision requires the shareholder to demonstrate that it would suffer irrevocable damages, which would be out of proportion to the advantages of a swift implementation of the plan.
- In any event, the debtor can request the court to reject the appeal, if the disadvantages resulting from the plan being upheld until the court's decision on the appeal "seem to" outweigh the disadvantages caused to the plaintiff by the plan becoming effective.

The shareholder then would have to seek compensation from the debtor for any damages incurred by him as a result of the implementation of the plan in separate litigation outside of the StaRUG proceedings.

4.2) Caveats for creditors

Caveats for creditors when faced with StaRUG proceedings

Creditors should be aware that the debtor remains in the driver's-seat during most of the StaRUG proceeding, while the court has limited supervisory competencies, owing to StaRUG's pre-insolvency nature. Thus, from the very beginning of a StaRUG proceeding creditors should prepare to more actively pursue their rights than they may do in an insolvency proceeding.

(i) No general prohibition to terminate contracts or accelerate claims.

Creditors may still terminate contracts or accelerating claims unless it is merely based on the debtor's initiation of StaRUG proceedings

StaRUG does not generally prevent prohibit creditors from terminating contracts with the debtor or from accelerating granted loans to the debtor. StaRUG only prohibits a termination or acceleration by the creditor based on the mere initiation by the debtor of StaRUG proceedings or a stay on actions of claims' enforcement or collateral realization.

Thus, when faced with a debtor initiating StaRUG proceedings, creditors should check for other reasons to terminate their contracts or accelerate their claims and carefully evaluate the impact and benefit of taking such action.

(ii) Creditors' claims and security-interests may become subject to court staying individual enforcement and collateral realization actions (*Vollstreckungs- und Verwertungssperre*)

Debtor may cause court to stay enforcement of creditors' claims and realization of collateral

Upon request of the debtor and to the extent required to secure the prospect of achieving the restructuring, the court can

- grant the debtor a stay of individual enforcement actions by creditors concerned by the plan, and
- grant the debtor a stay of individual collateral realization actions by secured parties and authorize the debtor to use assets, in which creditors have security interests, for the continuation of its business, provided the relevant assets are material for such business continuation.

Such stays can be aimed at individual claims or more generally at a group of claims and can include third party collateral granted by the debtor's affiliates. StaRUG only provides the debtor access to such stay measures if it provides the court with a number of documents and declarations aimed at ensuring that the debtor "deserves" this protective measure, e.g. updated restructuring concept and a six months' financial planning explaining how the debtor plans to continue its business.

The court can grant the stay for up to three months, which may be extended up to a total of eight months, where required to secure the completion of restructuring proceedings in an advanced stage.

Where a secured party's security interest is subject to a stay regarding the realization of its collateral, the secured party is protected as follows:

- Debtor must pay interest and compensation for the depreciation of any asset used by the debtor in the continuation of its business operations, in which the secured party has a security interest.
- Debtor must transfer all proceeds realized by collecting receivables security-assigned to the secured party or by disposing of movables security-transferred to the secured party.

(iii) StaRUG protects creditors from undertakings to make advances to the debtor.

A creditor obliged to make advance delivery or payment to the debtor can require security prior to making such delivery or payments

Under StaRUG, the debtor's initiation of proceedings is not *per se* a reason for the creditor to terminate a contract or accelerate loan claims. However, creditors are entitled to request security from the debtor, if they have undertaken, prior to the StaRUG proceedings, to make an advance delivery, service or loan payment to the debtor.

In addition, where the debtor's initiation of StaRUG proceedings uncovers (or triggers) a material deterioration of the debtor's financial status or of the value of the security granted for the loan commitment of a lender, the lender is entitled to reject any drawing request from the debtor under the lender's loan commitment and terminate his loan commitment.

(iv) StaRUG expressly allows shareholders to keep (part of their) equity interests where creditors rights' are only modestly restructured.

Plan can be crammed-down on creditors even though shareholders retain (part of) their equity interests, e.g. where plan only extends maturities by up to 18 months.

The creditors are free to refuse the approval of any restructuring plan, which allows creditors to keep all or part of their equity interests, whether or not the plan requires shareholders to make an adequate contribution to the restructuring.

Creditors should note, however, that where the plan is approved by a number of voting-classes sufficient to cram it down on the dissenting voting-classes, the court can approve the plan based on such cram-down, even though the plan provides for shareholders retaining all or part of their equity interests without requiring them to adequately contribute to the restructuring. Cramming the plan down on a class of creditors generally requires that the creditors concerned adequately participate in the benefit generated by the restructuring plan. In this respect, the concept of "absolute priority" generally protects the dissenting creditors against any other creditor or shareholder, who would rank junior to them in the debtor's insolvency proceedings, receiving any value under the plan that the respective recipient has not compensated by providing adequate consideration.

However, StaRUG allows the court to confirm the plan by derogating from the absolute priority rule, where

- the plan only "insignificantly" affects creditors' rights, which StaRUG assumes to be the case, if creditors' rights are not curtailed or abbreviated and their respective maturities are not extended by more than18 months, or
- circumstances personal to such shareholders require that such shareholders continue to participate in the operation of the debtor's business, provided the shareholders assume respective undertakings under the plan also allowing the debtor to require transfer of the participation should the shareholders not comply with their undertakings during a period of five years

(v) Creditors' right to meet, discuss and propose to amend restructuring plan

When a debtor initiates StaRUG proceedings, he may inform the creditors, which he selects to include in the restructuring plan, early-stage by inviting them to meet to introduce his restructuring concept before he finalizes the restructuring plan.

Alternatively, the debtor may prefer to "surprise" its creditors and directly forward to them the proposed restructuring plan together with either the request for written approval with no voting meeting or the invitation to a voting meeting of all creditors concerned, which the debtor organizes and presides.

If the debtor holds no meeting to introduce the creditors to the plan, any creditor can request that the debtor invites all creditors to such a meeting and allows them to discuss. Each creditor can propose changes to the debtor's plan, provided his proposal is submitted to the debtor not later than one day prior to the meeting.

Creditors can require debtor to organize a meeting to introduce and discuss the restructuring plan

<u>Creditors cannot require the debtor to organize the voting on the plan in a debtor-organized meeting or even in a court-hearing</u>. However, should creditors become aware of irregularities prior to or in the voting process, they can address their concerns to the court in the consultation court-hearing, which is mandatory where the debtor organizes the voting on the plan outside of a court-hearing.

Debtor has unfettered discretion to organize voting in writing, in a meeting or in a court-hearing

In order to facilitate communication among the stakeholders concerned (creditors and shareholders) by a restructuring plan, the legislator has instructed the German Federal Ministry of Justice and Consumer Protection to establish, within the German Federal Gazette (*Bundesanzeiger*), a restructuring forum (*Restrukturierungsforum*), which shall serve as communication platform for stakeholders concerned by the restructuring plan to publicly inform and encourage other stakeholders to exercise their voting right in a particular way and solicit voting proxies.

Creditors and other stakeholders concerned by the restructuring plan can communicate their voting intentions and solicit voting proxies in a new "restructuring forum" to be established within the German Federal Gazette

(vi) <u>Absentees are deemed rejecting the plan</u>

Creditors abstaining from the vote are deemed rejecting the restructuring plan under StaRUG. Thus, if creditors are interested in the adoption of the restructuring plan, they should participate in the vote and motivate their fellow creditors to also do so.

(vii) <u>No creditors' committee</u>

The court cannot (and the creditors cannot request the court to) establish a creditors' committee (*Gläubigerbeirat*). Only

were the debtor includes all eligible creditors in the restructuring proceedings (i.e. except for employees or pensioneers) and the creditors and their respective interests are as diverse as they typically are in insolvency proceeding, the court has discretion to establish a creditors' committee.

(viii) Practitioner in the field of restructuring can be instructed to protect creditors' interests

Where StaRUG requires the court to appoint a practitioner. This mandatory practitioner (in lieu of the debtor) will decide as to how the creditors shall vote upon the plan, presides voting meetings and documents them, examines the rights and claims of the various creditors and helps to clarify creditors voting rights. In addition, the court can (and the creditors can encourage the court to) instruct such practitioner to supervise the debtor's financial status and business conduct and to manage all of its payment transactions. In any event, it is the practitioner 's duty to inform the court of any circumstances that would justify the termination of the restructuring proceeding.

These powers delegated to the practitioner substantially restrict the debtor's room to shape the proceedings. Therefore, the debtor will want to prevent the appointment of a mandatory practitioner, e.g. by avoiding to include SMEs or consumers in the restructuring, avoiding cram-downs where the restructuring is not just restricted to financial creditors /bondholders, and not applying for enforcement stays regarding virtually all creditors.

Where the appointment of a practitioner is not mandatory, one or more creditors representing more than 25% of the voting rights in one class may be able to request (and cause) the court to appoint a voluntary practitioner and instruct him to supervise the debtor's financial status and business conduct and to manage all of its payment transactions, provided the creditors' group assumes all resulting costs. While the wording of StaRUG does not afford the court any discretion in this decision, it can be argued that the court should not be allowed to subject the debtor (who is not insolvent) to such restrictions

merely upon the request of a minority of creditors, unless justified by the debtor's behavior or the apparent deterioration of its financial situation.

(ix) To what extent will the court examine a restructuring plan when asked to confirm or reject the plan?

StaRUG aims at assisting the debtor and its creditors to restructure the relevant claims by way of a negotiated solution. Therefore, when the restructuring plan has received the creditors' approval, the court's authority to refuse the confirmation of the plan is limited to the breach of provisions regarding the plan procedure and approval process and its content in respect of an *essential point*.

There is good arguments, in particular with a view to the letter and the spirit of the EU Directive 2019/1023, that StaRUG does not intend to instruct the court with a full examination of the plan's compliance with StaRUG's "content"- provisions, but that the court's examination should be limited to ensuring that the restructuring plan "*has a reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business.*" In addition, the court itself will usually not be able to review the "content" of the plan for compliance with the relevant StaRUG provisions as the court lacks the required expertise.

On the other hand, StaRUG grants the court unlimited authority (discretion) to appoint a practitioner and instruct it to provide an expert's review on any relevant issue. Even where the restructuring plan has been adopted by the creditors without the help of a practitioner, the court may, when requested to confirm the restructuring plan, appoint a practitioner for the sole purpose of conducting an expert's review of issues to be defined by the court.

Before this background, we expect courts to apply the same (high) degree of scrutiny when examining whether the restructuring plan complies with the legal requirements regarding procedure and content as they apply under established practice when asked to confirm an insolvency plan under the German Insolvency Act.

Courts expected to apply same degree of scrutiny as practiced in insolvency plan proceedings:

- **complete review of restructuring plan re legal requirements**
- **review limited to consistency in relation to economic aspects and prospects**

In practical terms, and unless StaRUG expressly provides otherwise, this means:

- complete review regarding compliance with the legal requirements as to content and procedure,
- review limited to checking "consistency" regarding the prospects of the debtor's return to viability and other economic aspects.

A creditor (or shareholder) who has voted against the plan and demonstrates that he is treated worse under the plan than he would be without the plan can request the court to refuse confirmation of the plan. The court rejects such request if the plan provides for financial means to compensate creditors or shareholders who can evidence that they are damaged by the plan.

(x) Exposure to lenders' liability when prolonging maturities and amending terms of financing agreements?

StaRUG does not expressly exempt participating creditors from potential lenders' liability in a subsequent insolvency of the debtor

Lenders assisting the borrower to restructure by means of prolongations / extensions of maturities and other amendments to the terms of their financing instruments are well-advised to require the debtor to submit a restructuring concept (and an expert's opinion) complying with the tight requirements of the German Supreme Court or the auditors' standard IDW S6 regarding restructuring concepts:

While StaRUG does not expressly require the restructuring concept underlying the restructuring plan to comply with this high standard, lenders are well-advised to require the debtor to submit such documentation prior to approving the restructuring plan. If they fail to receive assurance that the restructuring plan meets the requirements of the German Supreme Court regarding restructuring concepts for restructuring loans, there is a certain risk that they may be exposed to lenders' liability towards other creditors not subjected to the restructuring plan for assisting the debtor in delaying its insolvency filing. They may also see their financing agreements (and collateral interests) avoided in a future insolvency proceeding over the assets of the debtor for fraudulent trading (*Gläubigerbenachteiligung*).

It is, however, an open question, whether the courts will apply the strict requirements, which they have defined in relation to restructuring concepts in consensual out-of-court restructuring attempts also to restructuring concepts underlying restructuring plans under StaRUG-proceedings, which are court-supervised and partially-collective procedures:

We would think that a court-confirmed StaRUG-restructuring plan provides sufficient assurance to third parties, which are not involved in the restructuring process, that the underlying restructuring concept has sufficient prospects to restore the viability of the debtor's business and to demonstrate that the parties involved do not primarily pursue their own individual interests. Also, how would the courts justify holding those creditors liable in a failed restructuring attempt who voted against the restructuring plan or upon whom the plan was crammed-down by application of the cross-class cram-down?

Therefore, as regards the quality of the documentation of the restructuring concept, the courts should not impose the same requirements on the debtor and the creditors participating in a StaRUG proceeding as they would in an out-of-court consensual restructuring attempt.

Creditors subjected to a restructuring plan who want to increase their comfort-level in relation to a remaining exposure to lenders' liability and claw-back should require the debtor to provide a restructuring concept (and expert's opinion) complying with the requirements of the German Supreme Court (or of the auditors' standard IDW S6).

4.3 Caveats for new money lenders

Caveats for new money lenders invited to provide new money restructuring loans in a StaRUG proceeding

Before lending new money to a debtor who is threatened by illiquidity lenders are well-advised to require the debtor to produce a comprehensive restructuring concept (and an independent expert's opinion) complying with the tight requirements of the German Supreme Court or the German auditors' standard IDW S6 regarding restructuring concepts. A lender who does not require the debtor to submit a restructuring concept which meets these standards risks being exposed to assuming lenders' liability towards other creditors for assisting in

delaying the debtor's insolvency filing and seeing its financing agreements and collateral interests avoided.

StaRUG requires the debtor to provide the lenders with a restructuring plan and a "restructuring concept" when asking them for their approval. Yet, the requirements as to the content of this concept do not match the criteria elaborated by the German Supreme Court (or the IDW) for restructuring concepts underlying restructuring loans in out-of-court restructuring attempts.

However, StaRUG requires the court to refuse its confirmation of the restructuring plan where the plan provides for new financing and the restructuring concept is not consistent or does not have a reasonable prospect to successfully restore the debtor's solvency and viability; StaRUG expressly provides that the court can, for the purpose of conducting this examination, appoint a practitioner and instruct him to review and provide his view on this issue. The question will then be: Which standards should the court and the expert apply when assessing the "consistency" or the "reasonable prospect to successfully restore the debtor's solvency and viability"?

In practical terms, we would expect that a debtor, who includes new financing in its restructuring plan, will provide a restructuring concept, which meets the standards of the German Supreme Court and the IDW S6, simply to ensure that the court confirms the plan. Therefore, the lender should also require the debtor to meet these standards before providing the new loan.

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