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Draft Law for a New German Restructuring Framework

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Restructuring and Bankruptcy

So far, restructurings in Germany have been implemented either by way of consensual pre-insolvency solutions or formal and comprehensive insolvency proceedings with court oversight. The EU Restructuring Directive (EU) 2019/1023 of 20 June 2019 paved the way for the implementation of pre-insolvency restructuring proceedings in all EU member states that allow debtors to restructure effectively at an early stage.

On 14 October 2020, the German Government published a draft law implementing the EU Restructuring Directive in a new national law which is planned to come into force on 1 January 2021. The reason for the very rapid legislative procedure is to address the needs of the many German companies which are currently facing financial difficulties due to the COVID-19 pandemic.

The new law allows comprehensive pre-insolvency restructurings even in the face of objections from individual parties. It provides a new and modern and internationally competitive tool set for corporate restructurings in Germany.

Availability of the New Law to Debtors

The new restructuring framework with its respective restructuring instruments will be available to debtors as soon as they face imminent illiquidity and have made a respective notification to the restructuring court. The debtor remains in full control and can conduct the restructuring procedure as a debtor-in-possession with minimum court supervision. If the debtor does become illiquid or over-indebted, the debtor has to notify the restructuring court. After such a notification, the court can still abstain from initiating insolvency proceedings if (i) in light of the advanced status of the restructuring a termination would not be in the interest of the creditors, or (ii) there is a sufficient likelihood that the restructuring will be successful nevertheless. The new law presents an overall lean and flexible procedure. In particular, it can be tailored to only affect certain groups of creditors – such as financing creditors – and the rights of shareholders. Court involvement can be limited to a minimum, enabling non-disruptive and silent restructuring efforts.

The Restructuring Plan

The framework follows the concept of the UK Scheme of Arrangement, the U.S. Chapter 11 procedure, and the German insolvency plan. Debtors may propose a restructuring plan to amend the rights of unsecured and secured creditors as well as shareholders by a variety of possible restructuring measures, such as deferrals, haircuts, debt-equity-swaps or even a sale of the enterprise in parts or as a going concern.

Stay of Individual Enforcement Actions

In order to allow a successful restructuring, the debtor can apply for a general stay of individual enforcement actions, to be granted by the restructuring court. A stay can be granted for an initial period of up to 3 months with the option of an extension of up to 8 months in total under certain conditions.

Duties of Directors – Protecting Creditors' Interests

In case the debtor enters the stage of imminent illiquidity, the management owes its duties primarily towards the creditors rather than towards the company and its shareholders. The closer the debtor approaches imminent illiquidity, the more the management decisions are to be focused on protecting creditors' interests.

Directors who breach such duties face personal liability for damages towards the company, i.e. constituting an internal liability. A breach of duty is excluded if the directors could, on the basis of adequate information, reasonably assume that they were protecting the interests of the creditors. After the debtor has notified the competent court of the restructuring, the creditors may, in case of a breach of the directors' duties, directly assert damage claims against the directors. This means that the new law introduces a new concept of external liability of the management vis-à-vis creditors to German law.

Voting Procedure

The vote on the restructuring plan is taken by the creditors in separate voting classes. Each class comprises a group of persons with sufficiently aligned rights and interests. The confirmation of the restructuring plan requires the approval by a majority of 75% of the voting rights in each respective voting class.

In case not all voting classes vote for the restructuring plan with the required majority, a key feature of the new framework comes into play – the court approved 'cross-class cram-down'. This tool allows the court to confirm a plan and bind dissenting voting classes, if (i) the plan is supported by the majority of voting classes, (ii) no dissenting creditor would be disadvantaged under the plan compared to liquidation, and (iii) the members of the dissenting class appropriately participate in the economic value of the plan.

The latter criterion requires a distribution of the plan value following the principle of absolute priority, which means, that more senior classes have to be satisfied in full before a junior class is to receive any payment or keep any interest under the restructuring plan. Exceptions are possible for the benefit (inter alia) of shareholders which are important for a restructuring of the debtor as a going concern or in case of minor impairments of the creditor rights only, such as a 12-month deferral of due dates of their claims.

Under German restructuring law, so far the 'cross-class cram-down' was only available in formal insolvency proceedings. The new law allows stakeholders to overcome obstructive behaviour by individual parties and fosters efficient and comprehensive restructuring concepts.

Termination of Contracts

Beyond what the EU Restructuring Directive requires (but does not prohibit), the new draft law will allow the restructuring court to terminate, at the debtor's request, mutual contracts. Employee claims are exempted from this and cannot be subject to a restructuring plan. The other party of the terminated contract is entitled to damages for non-performance. Such claims can be included in and impaired by the restructuring plan. The newly introduced tool can be of particular value not just for financial restructurings, but can be used to improve operating performance (e.g. by getting rid of burdening long-term lease liabilities).

Restructuring Officer

The debtor's management remains in full control of the company and its business operations when making use of the new restructuring framework. However, in certain situations, the restructuring court will appoint a so-called restructuring officer. This applies, inter alia (i) when the rights of consumers or SMEs are to be amended under the plan, (ii) the debtor applies for a stay of enforcement actions, or (iii) the court confirms the restructuring plan in the way of a 'cross-class cram-down'. Any individual with adequate experience in insolvency and restructuring matters, such as tax advisors, auditors or attorneys can qualify as restructuring officer. The court has, in general, to follow a proposal by the debtor or creditors who account for more than 25% of the voting rights in each class, for the person of the restructuring officer, unless such person is evidently not suitable.

Extended Suspension of the Obligation to File for Insolvency

Beside the new preventive restructuring framework, the German legislator has announced further changes in insolvency law in view of the ongoing COVID-19 pandemic.

To mitigate the consequences of the COVID-19 pandemic in civil, insolvency and criminal procedure law, a suspension of the obligation to file for insolvency was initially planned until 30 September 2020. However, by amendment on 25 September 2020, the German Parliament extended this suspension of the obligation to file for insolvency until 31 December 2020 for companies that are over-indebted in the sense of insolvency law but not illiquid.

The new draft law now further mitigates the impact of the COVID-19 pandemic by reducing the forecast period for the assessment of over-indebtedness from 12 months (as to be implemented in the German insolvency code as part of the draft bill) to 4 months until 31 December 2021. A debtor can benefit from this relief measure, if (i) it was not illiquid as of 31 December 2019, (ii) its ordinary business has generated a positive result in the last fiscal year completed before 1 January 2020 and (iii) revenues generated from its ordinary business in the calendar year 2020 have dropped by more than 40% compared to the prior year.

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