DRAFT BILL FOR THE REFORM OF GERMAN RESTRUCTURING LAW - A GREAT LEAP TOWARDS A MORE EFFICIENT RESTRUCTURING CULTURE

The draft bill for the implementation of the European Directive on preventive restructuring frameworks (Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019) has been a hotly anticipated piece of legislation in the German restructuring community for quite some time. However, the wait is now over. The German Ministry of Justice and Consumer Protection recently published its draft bill, which has the potential to open a new chapter for the German market by allowing for the implementation of innovative and efficient pre-insolvency restructuring measures in Germany.

The draft bill for the development of restructuring and insolvency law (*Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts - SanInsFoG*) includes a new policy for the stabilisation and restructuring of businesses (*Unternehmensstabilisierungs- und Restrukturierungsgesetz – StaRUG*), which will bring about a new era for pre-insolvency restructurings in Germany by reshaping the fundamentals of the German investment landscape and considerably improving framework conditions for creditors.

THE LONG AWAITED INTRODUCTION OF THE GERMAN RESTRUCTURING SCHEME

The focus of the new law is very much on the introduction of a German restructuring scheme, i.e. a new pre-insolvency restructuring regime in accordance with the EU Directive. The new law will introduce the possibility of proposing a restructuring plan to cram down dissenting creditors and shareholders in a way that combines the English scheme of arrangement with US Chapter 11 proceedings. The German restructuring scheme includes a mechanism for a pre-insolvency moratorium to facilitate negotiations for a restructuring plan and allows for compromises or special arrangements for financially distressed debtors which avoid the need for unanimity, prevent "hold outs", allow for "cram-downs" of a dissenting class, and binds the

Key features of the draft bill:

- The reform of the German restructuring & insolvency landscape has been 'in the making' for a number of years.
- The main focus of the draft bill is the creation of a German restructuring scheme as an important tool for the effective implementation of restructurings.
- The focus of the new law is very much on the development of a new pre-insolvency and restructuring regime in accordance with the European Directive on preventive restructuring frameworks.
- The proposed law will introduce the possibility of proposing a restructuring plan to cram down dissenting creditors and shareholders by combining elements of the English Scheme of Arrangement and US Chapter 11 proceedings.
- New restructuring framework includes a mechanism for a pre-insolvency moratorium to facilitate negotiations for a restructuring plan and allows for compromises or special arrangements for financially distressed debtors which (i) avoid the need for unanimity, (ii) prevent "hold outs", (iii) allow for "cram-downs" of a dissenting class, which subsequently bind the shareholders if the requisite majorities are met, and (iv) protect new financing and managing directors throughout the process.
- Implementation expected in Q1/2021

shareholders if the requisite majorities are met, as well as protection for new money and managing directors throughout the process. The scheme extends to financial claims, guarantees and other security rights granted by group companies as well as operational contracts including the possibility to terminate contracts not yet fully performed, which will allow for financial and operational restructurings.

CHANGES TO INSOLVENCY FILING OBLIGATIONS FACILITATING THE ACCESS TO THE GERMAN SCHEME

Managing directors seeking to access the German restructuring scheme will need legal certainty that they will be able to do so without being at risk of violating the strict German insolvency filing obligations. It is suggested in the new law that that the new scheme will be available to debtors in financial distress and companies with impending illiquidity (*drohende Zahlungsunfähigkeit*) on the basis of a 24-month prognosis. The scheme may be terminated if insolvency filing obligations (including illiquidity and over-indebtedness) are triggered during the process, unless the restructuring scheme has progressed and is more promising than a subsequent insolvency process. A newly introduced 12-month forecast period will facilitate the going concern prognosis for the over-indebtedness test which is expected to reduce the number of insolvencies where the issues appear at a longer time horizon.

AMENDMENTS TO THE GERMAN COVID-19 EMERGENCY LEGISLATION

Many businesses have suffered from the impact of the Covid-19 pandemic and experienced massive shortfalls in turnover and profits. Whilst most of these businesses have been able to secure additional liquidity from state loans and other state aid measures, they have accrued substantial additional debt as a result, thus bringing the continuation of the business into question. In order to prevent premature and extensive insolvency filings, the new law aims to improve the restructuring conditions for businesses which have suffered due to Covid-19. Businesses which had a successful result in 2019 but a shortfall in turnover of more than 40% in 2020 will not be subject to an immediate obligation to file for insolvency on the basis of over-indebtedness, insofar as they have sufficient prospects of recovering within the next four months (instead of applying the newly introduced 12month forecast period outlined above).

CHANGES TO THE EXISTING REGIME FOR IN-COURT DEBTOR IN POSSESSION PROCEEDINGS (*EIGENVERWALTUNGSVERFAHREN*)

A recent evaluation of the existing in-court restructuring tools (ESUG) has emphasised the need to adapt the process by which an entity can access German debtor in possession proceedings (*Eigenverwaltungsverfahren*) in order to prevent malpractice and abuse. Going forward, there will be a greater focus on the financial position and financial planning of the debtor within self-administration proceedings, a stronger emphasis on the protection of creditor interest and more specific provisions governing the termination of self-administration proceedings, if they are being used to the detriment of creditors.

OUTLOOK

The draft bill is without a doubt a vital step towards the successful creation of an out-of-insolvency restructuring regime in Germany and it provides an efficient tool for the implementation of restructurings with the support of a creditor majority – despite an opposing minority. It represents, therefore, a fundamental change in German law, which complements the existing insolvency regime with an array of tools for crisis-shaken companies seeking flexible solutions to stabilise operations (with creditor support) but without the negative impact typical of insolvency proceedings. With a view to the most recent changes to the insolvency filing obligations of managing directors on the basis of over-indebtedness (*Überschuldung*), namely a partial suspension until the end of December 2020 to avoid a wave of insolvency filings, the expedited implementation of the draft bill and its coming into force, as planned, at the beginning of January appears to be the right way of dealing with the economic impact of Covid-19.

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