INSOL Europe/LexisPSL joint project on the implementation analysis of the Directive (EU) 2019/1023 in the EU Member States

Germany

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Restructuring & Insolvency analysis: This article looks at how Austria has implemented Directive (EU) 2019/1023 as part of the Joint Project between INSOL Europe and LexisPSL to track implementation.

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INSOL Europe/LexisNexis research on implementation of the EU Directive

LexisPSL are working with INSOL Europe on a joint project to obtain articles from the INSOL Europe membership and Country Coordinators showing how EU Member States have implemented Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (the EU Directive).

A consolidated table appears at Practice Note: INSOL Europe/LexisPSL Joint Project on EU Harmonisation Directive 2019/1023: consolidated table.

As always, you should contact local lawyers in the relevant jurisdiction to check the current measures in force and the impact of any particular circumstances or nuances of your case.

Question 1: When did/will the new restructuring law come into force? What is/are the name of the new proceedings which comply with the EU Directive?

On 17 December†2020, the German Federal Parliament adopted a substantial reform bill, introducing far-reaching changes to the German insolvency regime (Bundesgesetzblatt/(BGBl) [2020] Part I p 3256 ff). The core piece of the reform bill was Germany's implementation law for the EU Directive, called the Corporate Stabilisation and Restructuring Act ('*Unternehmensstabilisierungs-und—restrukturierungsgesetz*', also referred to as 'StaRUG').

StaRUG came into force on 1 January 2021. Its objective is to enable a restructuring outside of, and avoiding, insolvency proceedings for viable debtors. At the heart of the new law lies the Restructuring Plan, a sophisticated rescue tool that enables debtors to cram down dissenting minority creditors and restructure by way of majority decision. Prior to StaRUG's introduction, out-of-court restructurings in Germany were unregulated and required unanimous consent of the debtor's (affected) creditors (see: Bundesgerichtshof (BGH) 12 December 1991, case number IX ZR 178/91, BGHZ 116, 319); the notable exception being the restructuring of German law-governed bonds under the Bonds Act (Schuldverschreibungsgesetz) of 31 July 2009 (BGBl. I page 2512).

StaRUG adopts a modular approach. The debtor may choose from a variety of options that are available to help with the successful implementation of a restructuring concept. This may include judicial supervision for the voting on, and confirmation of, a Restructuring Plan and cross-class cram-down or a court-confirmed moratorium. Overall, the new law is a long-awaited addition to the restructuring toolbox and it appears to be a versatile tool that is fit for purpose.

Question 2: Is court approval automatically required? Is court involvement possible during the course of the proceedings? (for eg to rule on short notice on conflicts regarding classes of creditors with voting rights, etc…)

As indicated in Question 1, StaRUG offers a variety of options which may or may not include the involvement of a court. The corporate debtor may discuss and negotiate its proposals for the implementation of a necessary restructuring with its (affected) stakeholders completely out of court under Section 17(1) and may propose and negotiate the terms of a Restructuring Plan and subsequently invite creditors to vote on it. For the statutory content of a Restructuring Plan, see sections 5 to 15 StaRUG and the annex to StaRUG).

The court's assistance may be sought in the following circumstances (detailed in section 29(1) and (2) StaRUG):

- to conduct a court-supervised vote on a Restructuring Plan (see sections 45 and 46 StaRUG)
- for a preliminary court examination of the Restructuring Plan and matters that are, or may be, significant and/or relevant for the confirmation of the Restructuring Plan (see section 47 StaRUG)
- to obtain an order prohibiting the enforcement of claims (stays of execution and realisation, referred to in the StaRUG as a 'stabilisation order' (see section 49 (1) no 2 StaRUG), and
- a confirmation of the Restructuring Plan (see section 60 et seqq StaRUG)

The prerequisite for any of the above is that the debtor has notified the court of its intention to implement a StaRUG-restructuring and submitted the necessary documentation, including but not limited to a draft of the Restructuring Plan (or an outline of its restructuring concept at the very least—see section 31 StaRUG) and a summary of the current status of the negotiations with the affected creditors, shareholders and/or investors (if any). With this notification the matter is legally pending (lis pendens) and the debtor gains access to the various instruments available under StaRUG for as long as the restructuring matter remains legally pending, which may be up to a maximum of six months or, following submission of a renewal notice/second notification, up to twelve months (see section 31(4) StaRUG).

Question 3: What are the entry criteria (ie must insolvency be proved)? Could you please define the entry criteria under your national legislation?

The EU Directive provided that the new restructuring tool was meant to be available where a debtor faces a 'likelihood of insolvency'; the difficulty being that 'likelihood of insolvency' is not a defined term in the EU Directive. The German legislator construed it as a reference to an immediate danger of being unable to pay one's debts as they fall due and, therefore, decided to make the tools of the StaRUG available only if the debtor:

- is 'imminently illiquid' (*drohend zahlungsunfähig*) pursuant to section 18 of the German Insolvency Code (*Insolvenzordnung*, hereinafter referred to as 'InsO'), ie it is more likely than not that the debtor will be unable to pay its debts within the next 24 months, and
- is not 'illiquid' (see section 17 InsO) or 'over-indebted' (ie failing either the insolvency cash-flow and/or balance-sheet test—see section 19 InsO)

This is, of course, very rigid and prescriptive and has already led to heated discussions in the restructuring profession and among academics. However, what little case law is available at this stage strongly supports the suggestion that a debtor needs to satisfy the above two-limbed test to be able to avail themselves of the options and instruments of StaRUG (see: County Court (*Amtsgericht*) Cologne, order dated 3 March 2021, court case number 83 RES 1/21).

Note that as long as a restructuring matter is legally pending, the management's statutory obligation to present a petition for the commencement of insolvency proceedings pursuant to Section 15a InsO is suspended. However, should the debtor become (technically) insolvent, it must immediately notify the court—sections 32(3) and 42 StaRUG. The court may, at its discretion, decide not to terminate the restructuring matter if that is in the best interest of the stakeholders.

Question 4: Can foreign companies use the process?

In general, all debtors except for financial institutions may use StaRUG, provided they have their centre of main interest (COMI) in Germany. Regrettably, the German legislator did not introduce specific provisions on international jurisdiction and, therefore, a ‘sufficient connection’, (as per the UK Scheme of Arrangement or Restructuring Plan or the Dutch *Wet Homologatie Onderhands Akkoord* (or WHOA)) will not suffice.

Question 5: Does the debtor (ie company’s management) remain in possession or is an insolvency practitioner (or any other professional, in that case could you please specify) automatically appointed?

Generally, the debtor (via its management) remains in full control of the debtor company and its business operations. Further, the debtor may make use of StaRUG’s instruments without the appointment of an insolvency practitioner or equivalent office holder. However, in certain circumstances the court may, and sometimes will have to, appoint an office holder, referred to in the StaRUG as a ‘Restructuring Officer’ (see section 73 et seqq. StaRUG).

For example, the appointment of a Restructuring Officer is mandatory if the debtor applies for a stabilisation order directed against substantially all its creditors (see section 73(1) no 2 StaRUG, and for the stabilisation order see Question 6). The court may, at its discretion and on a case-by-case basis, refrain from appointing a Restructuring Officer. Alternatively, it may decide to make such an appointment and instruct the Restructuring Officer to review and evaluate the prerequisites for the approval of the Restructuring Plan and the adequacy of the compensation payable to intragroup third-party security providers, if any, (see section 73(3) StaRUG; for the compensation payable to secured creditors see Question 10). A Restructuring Officer will always have to be appointed if it is foreseeable that the restructuring objectives can only be achieved by way of a cross-class cram down (see section 73(2) StaRUG in conjunction with section 26 StaRUG).

In the absence of any mandatory reason for the appointment of a Restructuring Officer, the court will only make such an appointment at the request of the debtor. Furthermore, a Restructuring Officer may also be appointed upon the request of a group of creditors representing at least 25% of the voting rights of their class (see section 77 StaRUG).

The debtor may propose a Restructuring Officer (section 74(2) StaRUG). The individual to be appointed as Restructuring Officer will have to show a qualification similar to that of an insolvency office holder (section 56 InsO). Any tax advisor, auditor or lawyer experienced in restructuring and insolvency matters and independent from the creditors and the debtor is eligible in principle to be appointed as Restructuring Officer (see section 74(1) StaRUG).

Question 6: Is there any moratorium on claims to protect the debtor during the process? What is the minimum and maximum length of the stay?

To support the restructuring efforts and increase the chances of success, the debtor may apply to the court for a moratorium, ie a temporary stay of any foreclosure and enforcement action (referred to in StaRUG as a ‘stabilisation order’—section 49(1) StaRUG). Any such application has to be supported by a liquidity plan, showing that the debtor is fully financed for the following six months (see section 50(2) no 2 StaRUG).

The application may initially be granted for a maximum period of up to three months (section 53 StaRUG), however, the debtor may request an extension by another month if (i) the debtor has submitted its Restructuring Plan to the creditors and (ii) provided there are no reasons as to why the Restructuring Plan may not be accepted by the creditors within one month (see section 53(2) no 2 StaRUG).

A stabilisation order may subsequently be extended for up to eight months, if the debtor has requested a court confirmation of a Restructuring Plan that is approved by the creditors (see section 53(3) StaRUG).

A stabilisation order can apply to individual creditors (namely those affected by the Restructuring Plan) or, alternatively, all creditors, with the marked exception of those creditors generally excluded from the application of a Restructuring Plan; the debtor’s employees and their pension schemes and creditors whose claims arise from tort, for example. It may also apply to any third-party security granted by the debtor's subsidiaries or affiliated companies (see section 49 StaRUG).

Question 7: Are creditors placed into classes for voting purposes? How are 'affected creditors' defined under your legislation?

As aforementioned, at the heart of StaRUG lies the Restructuring Plan. It is the tool that implements the actual restructuring by way of modifying the debtor's liabilities. Loosely described, it is an arrangement between the debtor and its stakeholders which can be imposed on dissenting creditors if the relevant criteria are satisfied, and it is approved by the court. Creditor claims or shareholder rights addressed in the Restructuring Plan (referred to as 'restructuring claims' (section 2 StaRUG)) can be amended, and the debtor's unsustainable debt reduced to the level necessary to allow it to continue, provided only if stakeholders vote in favour of the Restructuring Plan. The same applies to financing arrangements with a large number of creditors, such as promissory note creditors or bonds. It is also possible to amend securities granted by affiliated companies, eg joint and several liability of subsidiaries for financial liabilities of the parent company.

When it comes to adopting the Restructuring Plan, it is put to a vote. For that purpose, the stakeholders affected by the Plan are divided into separate classes (see section 9(1) StaRUG).

The debtor may choose, at their discretion, which (groups of) stakeholders it wishes to include in the Restructuring Plan; however, as far as class composition is concerned, the choice must be reasonable and appropriate and, furthermore, within each group, all creditors must receive the same rights. Any class composition must namely take into account the various legal positions and commercial interests of its members—for instance secured creditors (see section 9(1) no 1 StaRUG), non-subordinated unsecured creditors (see section 9(1) no 2 StaRUG), and subordinated creditors (see section 9(1) no 3 StaRUG).

Shareholder or holders of membership rights form a separate class (see section 9(1) no 4 StaRUG).

Question 8: What is the voting threshold to approve the restructuring?

To adopt a Restructuring Plan, each class voting on the Restructuring Plan proposal must consent with a majority of at least 75% of the respective voting rights.

To clarify, the requirement is 75% of all voting rights, not merely 75% of the votes cast (see section 25(1) StaRUG). The German legislator did not make use of the option provided by Art 9(6) subparagraph 1 sentence 2 of the EU Directive to demand an additional requirement of a per capita majority.

The dissenting creditors in any one class (if any) are bound by that majority decision (they are 'crammed down').

Question 9: Can shareholders be bound?

As with an insolvency plan under the operation of the German Insolvency Code, a Restructuring Plan, too, may compromise the rights of the debtor's shareholders. To that end, all tools and procedures available under German corporate law are also available in a Restructuring Plan procedure. This expressly incudes the option of converting creditor claims into shareholder or membership rights ('debt-to-equity swap'—see sections 2(3) and 7(4) StaRUG). Technically, the shareholder's existing shares are cancelled by operation of the Restructuring Plan (if approved with the requisite majority) and the debtor's equity is reduced by the nominal value of those cancelled shares. Subsequently, new shares are issued to creditors in conversion of their claims and to the exclusion of the previous shareholders, who are thus being disenfranchised.

Question 10: How are secured creditors treated?

The StaRUG Restructuring Plan may amend and/or modify certain claims and rights, including the rights of (certain) secured creditors (see section 2 StaRUG). In essence, a Restructuring Plan may modify the rights owed to creditors who hold or own restructuring claims under any liability assumed by a subsidiary or affiliated company of the debtor (*verbundenes Unternehmen*— see section 15 of the German Stock Corporation Act (*Aktiengesetz*)).

This option is available for all kinds of intra-group securities, whether corporate guarantees, joint debt instruments or any other right a creditor may hold in the assets of an affiliate. That said, the ability to modify such rights comes with strings attached: if a Restructuring Plan interferes with intra-group securities, the creditors holding such rights must be compensated adequately in return (section 2(4) StaRUG).

StaRUG does not prescribe how such compensation may be calculated. However, section 64(1) StaRUG, sets out the principal rule that creditors must not be worse off if compared with their position without the Restructuring Plan. It follows that the compensation will have to amount to at least the level of enforcement proceeds the affected creditor would have been able to realise but for the Restructuring Plan.

Question 11: How are employees treated?

A Restructuring Plan cannot modify the claims of employees (salaries and/or pension claims). These remain unaffected. It is helpful to note that the EU Directive contains a carve-out specifically for the claims of employees. If, therefore, a necessary restructuring cannot be implemented without a considerable contribution from the debtor's employees (for instance by way of a reduction in the workforce or an agreement that their salaries be kept static at a certain level) and should a consensual restructuring prove impossible, the debtor will have no option but to fall back upon an insolvency process.

Question 12: Can certain (holdout) creditors be crammed down? Is the absolute priority rule applied?

As stated in Question 8, to adopt a Restructuring Plan, a majority of 75% by value of claims within each group is required (see section 25(1) StaRUG). The dissenting creditors in any one class (if any) are bound by the majority decision (they are 'crammed down').

Should a whole group vote against the Restructuring Plan (or the where the requisite majority is not achieved), the dissenting group may also be 'crammed down', if:

- the majority of classes vote in favour of the Restructuring Plan (in each case with the required majority)
- members of the dissenting class can be expected to be in a position that is not worse than without the Restructuring Plan; and members of the dissenting class receive an adequate share in value created by the Restructuring Plan (see section 26(1) no 1–3 StaRUG)

A class will be deemed to participate adequately in the value of the Restructuring Plan, if:

- no other stakeholder receives any value in excess of the amount of their claim
- no equal ranking creditor is better off than the creditors of the class concerned, and
- claims of a dissenting class of creditors are paid in full before any class of creditors junior to such dissenting class receives or retains any property in satisfaction of their claims (see the absolute priority rule at section 27(1) no 1 to 3 StaRUG)

With respect to the absolute priority rule, the EU Directive allowed for some wriggle room and in its implementation law, Germany has certainly made use of it.

StaRUG provides for, what is referred to in Germany as, a 'relaxed absolute priority rule'. It means that in certain cases, some exceptions to the absolute priority rule are permitted, for example in situations where the debtor or its shareholders retain an interest in the corporate debtor's assets, always provided that:

- their participation is necessary for the continuation of the debtor in order to achieve the added value of the Restructuring Plan, or
- the impairment of the rights of creditors is marginal (for example, the Restructuring Plan does not compromise the creditors' claims and merely defers the maturity—see section 28(2) no 1 and 2 StaRUG)

It is interesting to note that Articlen11(1)(c) of the EU Directive permits confirmation of a plan against the votes of a dissenting class, provided it is ensured 'that dissenting voting classes of affected creditors are treated at least as favourably as any other class of the same rank and more favourably than any junior class' (the so-called 'relative priority rule').

Question 13: Can onerous contracts be disclaimed? Are there any restrictions on ipso facto clauses?

The German Government's initial draft of StaRUG provided that, upon the application of the corporate debtor, the court was given the power to disclaim certain kinds of onerous contracts (namely onerous executory agreements). However, the German legislator ultimately decided that this power to disclaim was too far-reaching for a pre-insolvency tool and therefore removed this option from StaRUG, much to the regret of many in the restructuring profession. Consequently, the power to disclaim onerous contracts is only available in Germany insolvency proceedings.

However, a Restructuring Plan may still provide for the modification of individual contract terms in long-term or continuing agreements that have been (partly) performed, and provided such modification is required to ensure the debtor's performance/compliance with its contractual obligations following completion of the restructuring. This applies namely to finance/facility agreements and loans made available and paid out to the debtor. In contrast, it is not within the scope of a Restructuring Plan to modify an agreement to allow a debtor to receive continued services on improved or more favourable conditions, for instance under a commercial lease agreement.

Irrespective of the above, StaRUG imposes some restrictions on creditors seeking to exercise their rights following an event of default (referred to as 'ipso facto clauses'). The mere fact that a court is notified of restructuring matter or that its modules or tools are being employed by debtor does not 'in itself' give rise to a right of termination or acceleration (section 44(1) no 1 and 2 StaRUG).

Further, a creditor being a party to a contract with the debtor may also not refuse performance of the contract or demand an amendment of the contract on the mere grounds that a restructuring matter is pending (see section 44(1) no 3 StaRUG). Any contract terms suggesting otherwise are invalid (see section 44(2) StaRUG).

In the above context, the words 'in itself' are of critical significance. As is the case within German insolvency proceedings, any contract clauses giving rise to a termination or acceleration right (or similar) specifically on the grounds of a party's insolvency are deemed invalid (see section 119 InsO).

However, this does not prejudice a party's rights stemming from an event of default that is not insolvency related (see BGH, judgment dated 15 November 2011, case number IX ZR 169/11, ZIP 2013, 274). The same principle applies to StaRUG's ban of ipso facto clauses and, consequently, creditors may exercise their rights stemming from a contractually agreed event of default as long as it does not deem the debtor's restructuring efforts an event of default. A lender, for instance, may therefore still exercise a contractual termination right under section†490 Civil Code for any loan not drawn at the time of the restructuring on the grounds of the debtor's significantly deteriorated financial affairs (see section 55(3) StaRUG and section 490(1) of the German Civil Code ((*Bürgerliches Gesetzbuch* or 'BGB'). The rationale here is that a lender may not be forced to increase their level of exposure as is the case already.

Furthermore, if the debtor has sought and obtained a stabilisation order (see Question 6 for more detail) a creditor may not refuse performance of, or terminate, an underlying contract exclusively on the grounds that the debtor's own performance remains due and outstanding for the duration of the stabilisation order (see section 55(1) StaRUG), provided that the performance of the contract is necessary to enable the debtor to continue its business (see section 55(2) StaRUG).

Question 14: Will the new procedure be listed in Annex A of the EU Recast Regulation on Insolvency 2015/848? If not, how will it be recognised in other countries?

On 15 December 2021, publicly heard StaRUG schemes (‘*die öffentliche Restrukturierungssache*’) were included in Annex A of the EU Recast Regulation on Insolvency 2015/848. However, the option to have a case listed and heard in court publicly will only be available in Germany as of 17 July 2022, once the respective rules for publication have come into effect. The delayed implementation allows sufficient time to establish the technical prerequisites for public notices. Notices in the context of the proceedings include court dates, court decisions and the appointment or dismissal of a restructuring practitioner.

When it becomes available, the court will issue public announcements regarding the restructuring at the request of the debtor (see section 84(1) StaRUG) which qualifies the restructuring matter for recognition as ‘proceedings’ within the meaning of Annex A of the EU Recast Regulation on Insolvency 2015/848. This means that the (now public) restructuring matter and all of the StaRUG modules/instruments employed will be recognised automatically in EU Member States. However, if the debtor opts against a ‘public proceeding’, jurisdiction and international recognition are determined either by Brussels (I) Recast or the private international laws of the respective foreign jurisdiction.

Question 15: Are new money or other arrangements granted any protection/priority (eg DIP finance)?

The concept of DIP-financing as understood and operated in the United States is alien to the German legal system and, therefore, the German legislator decided not to enact the option available under the EU Directive to afford new financing priority over other creditors in any (hypothetical) subsequent insolvency of the debtor (see Article 17(4) of the EU Directive). However, fresh money injected or made available after the restructuring matter becomes *lis pendens* or, in conjunction with/performance of a restructuring plan that has entered into legal effect, and does enjoy some privilege in the sense that such fresh money may not be clawed-back by operation of insolvency avoidance laws within a subsequent insolvency of the debtor.

The fact that a stakeholder makes new money available knowing of the pending restructuring matter or that its modules or instruments have been employed by the debtor does not amount to bad faith on the part of the contributing stakeholder (see section 89(1) StaRUG) and will, therefore, not expose them to insolvency claw-back actions (see section 133 InsO (*Gläubigerbenachteiligung*) Actions to the Detriment of Creditors) or claims for damage (see section 826 *BGB*). Furthermore, all actions outlined in a court confirmed and legally binding Restructuring Plan, and all actions in the performance of such a plan are also protected from exposure to claw-back actions. In essence, insolvency avoidance is only available if the Restructuring Plan has not been confirmed/ or incorrect or incomplete information is submitted by the debtor, and only if the counterparty had knowledge of it (see section 90(1) StaRUG). This applies to new financing provided for in the plan as well as to interim and bridge financing.

There are notable exceptions: shareholder loans and equivalent claims (as well as any security provided for such loans) which do not enjoy protection from claw-back actions/insolvency avoidance actions (see section 90(1) StaRUG). The second exception to the rule applies if the Restructuring Plan provides for the transfer of all or substantially all of the debtor’s assets. In that case, any transactions or legal actions are protected from insolvency claw-back actions only if those creditors not affected by the Restructuring Plan are still able to recover their claims and enjoy priority with respect to the funds the debtor receives as consideration for the transfer of its assets vis-a-vis those parties affected by/addressed in the Restructuring Plan (see section 90(2) StaRUG).

Question 16: How long should the process take (roughly)?

This is very much case specific. As stated in Question 2, a StaRUG restructuring matter may remain pending up to a maximum of six months or, following submission of a renewal notice/second notification, up to twelve months. StaRUG is a very complex tool and certainly requires a fair amount of preparation, specifically if a cram-down has to be employed. However, the availability of relief for dissenting stakeholders (minority protection) is very limited and statutory deadlines for any court hearings and the confirmation of a Restructuring Plan very tight. In the circumstances, six months seems a good guess.

Question 17: How much is the process likely to cost (roughly)?

Again, due to the complexity of the procedure, the costs for restructuring advisors will be substantial. The StaRUG procedure in its current format will therefore unlikely be employed in smaller cases and be limited to more substantial restructurings with significant stakeholder/creditor exposure.