Restructuring PROKON: A case study

Dietmar Penzlin & Niklas Marwedel write on a dual-track restructuring process, resulting in a combined debt-to-equity swap of 37,000 creditors and a debt-to-debt swap of €500m

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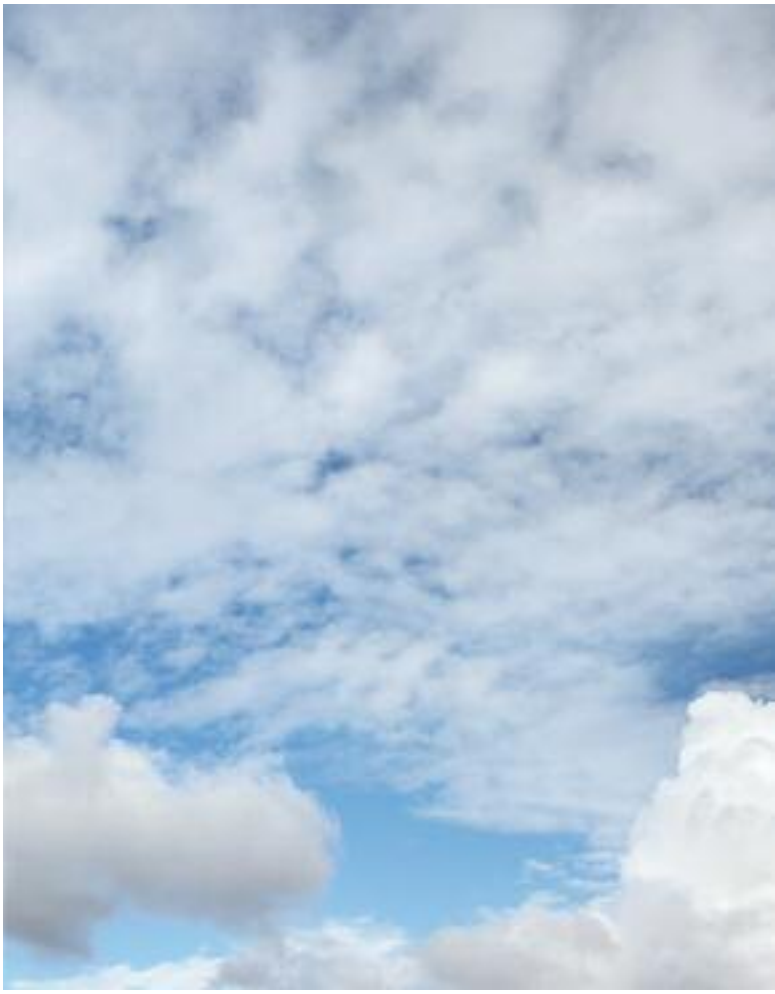
PROKON filed for insolvency in January 2014 and was restructured as a cooperative (*Genossenschaft*) controlled by its former creditors in July 2015 by means of a complex restructuring plan (*Insolvenzplan*). This article outlines the restructuring process of the renewable energy firm based in Itzehoe in northern Germany.

The set-up

At its core, PROKON was planning, building and operating on-shore wind parks in Germany. But the scope of its operations had grown far beyond this nucleus, fuelled by a steady influx of jouissance capital (*Genussrechtskapital*) which could not be invested in wind parks as quickly as it could be canvassed. Most notable amongst the non-core assets acquired with this capital were a German company operating a canola oil mill and loans to a German producer of standard pallets used in transportation and to a Romanian forest holding company.

PROKON was remarkably successful in attracting private investors: By January 2014 some 75,000 had entrusted their savings (in total about €1.4bn) to the firm in exchange for jouissance share rights. This permanent debt obligation *sui generis* established no membership rights under company law, but a proprietary interest to participate in the company's profits. The investors had flocked to the firm, following promises of high interest rates (6-8% p.a.), short holding periods (six months), safe returns (from subsidies to renewables) and an ethically impeccable business case. However, these promises proved to be unsustainable. When PROKON finally had to admit its failure by filing for insolvency, the sheer numbers involved were shocking to the public. Due to PROKON's aggressive advertising and success on the grey capital market, legislators were prompted to issue the Retail Investor Protection Act in 2015, more commonly known as "Lex Prokon," introducing new obligations for providers of capital investments.

Unfortunately, PROKON's success in attracting private investors was not paralleled by a growth of the firm's management structures and capabilities. Up until January 2014, the firm was practically managed by the sole shareholder and director Carsten Rodbertus alone. Managerial



accounting was strikingly neglected; for instance, no reliable forecast of the firm's payable obligations could be presented.

The private investors' patience and trust were lost at the turn of the year 2013/2014. An ever increasing amount of the jouissance share capital was called in by the investors and PROKON was unable to meet all demands. The company pleaded its creditors to defer payment and was able to sway some of the investors, but by far not enough to pay out the rest.

Even then, from the director's perspective, filing for insolvency was only a measure of the utmost precaution. The general terms and conditions for the issued jouissance share capital stated – customary for jouissance share capital – that all other creditors' claims were more senior than those of the investors and the jouissance share capital should share the losses (as well as the profits) of the company. With regard to these clauses, the director argued that the investors' claims should neither be weighed as a liability against the assets of the company, nor should the inability to repay the investors constitute bankruptcy. The legal argument presented by the director concerning the seniority clause relied on an obscure ruling of the German Federal Court of Justice. However, the legal merits of this argument were not to be fathomed fully. Rather the general terms and conditions for the issued jouissance share capital proved to be too opaque for the inexperienced private investors. The seniority clause and the loss-sharing clause were therefore considered to be void by the Local Court in charge of the insolvency proceedings (*Insolvenzgericht*). On 1 May 2014 the Local Court opened the insolvency proceedings with regard to both the overindebtedness as well as the illiquidity of the company.

Struggle for the rudder

In a fierce struggle to regain control of the restructuring process from the appointed insolvency administrator, the director launched a mailing campaign to acquire powers of attorney from as many creditors as possible for the upcoming first creditors' assembly. Several injunctions were necessary to suppress the most blatant public infringements during this campaign. However, an independent group of creditors formed an alliance of their own: These self-styled Friends of Prokon stood in opposition to the director, who had thoroughly disappointed their trust previously.

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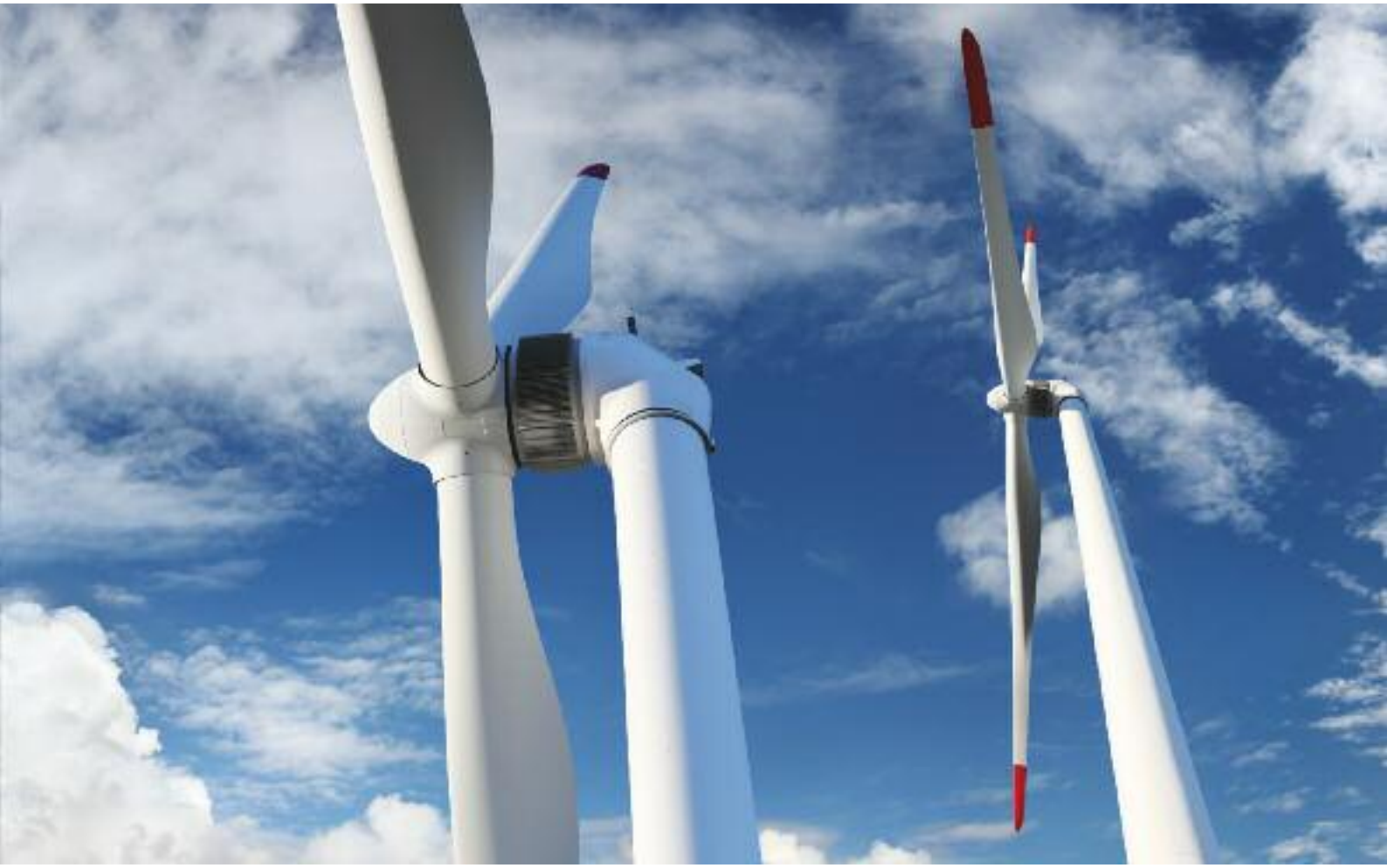

> THE INVESTORS WERE TO BE INVITED TO A PARTIAL DEBT-TO-EQUITY SWAP TO ACQUIRE FULL CONTROL OF THE COMPANY

They were able to gather even more of the creditors' votes behind their ranks and employed them to set the course for restructuring the company and its debts. The director's campaign was finally thwarted by the Local Court, which ruled that the director's cypher who held the acquired power of attorney could not exercise this power during the first creditors' assembly. Later, all remaining financial issues of the shareholder and director with the insolvency administrators were settled amicably.

Setting the course

With the votes of the Friends of PROKON, the first creditors' assembly commissioned the insolvency administrator in July 2014 to draft a restructuring plan with certain guidelines proposed by the insolvency administrator: the enterprise was to be reformed. Its core business (wind energy) was to be preserved and all non-core assets were to be sold off in order to repay some of the company's debt. The creditors would be asked to accept a considerable haircut. The jouissance share capital was to be fully restructured. The investors were to be invited to a partial debt-to-equity swap to acquire full control of the company. The remaining fraction of the jouissance share capital (unable or unwilling to swap to equity) was to be restructured in bonds with a more sustainable coupon (3.5 % p.a.) and collateralised with all operating wind parks (debt-to-debt swap).

Running dual track

In July 2014, it was incalculable whether the restructuring concept with the given guidelines could be implemented at all. In Germany, debt-to-equity swaps had only recently been added to the legal instruments for restructuring a company by means of an insolvency plan. The legislators' rationale behind the introduction of this instrument to the restructuring toolbox available during insolvency proceedings was to allow the creditors full access to the going concern values and to overcome a possible shareholder obstruction, when the going concern values are inseparably tied to the insolvent company while the shares are otherwise without worth or value. This consideration was quite fitting to PROKON's operating wind parks but even more so to its wind park projects. However, debt-to-equity swaps had not been fully tried and tested in Germany, much less in a set-up with several thousand likely participants.

Moreover, the outlined restructuring concept was not the only potentially viable option to restructure PROKON. As an alternative to the envisioned debt-to-equity swap (and the accompanying debt-to-debt swap), an investor could take over the shares of the company and pay out the former private investors. And indeed the assembled wind parks and the advanced project pipeline of the company were well in demand. Therefore, a classical M&A solution might eventually have turned out to be more advantageous. Time was of the essence, since the value of the wind park projects would crumble during the insolvency proceedings; there was but one shot at restructuring the company.

With these considerations in mind, the insolvency administration prepared both restructuring alternatives (the swap solution and the M&A solution) starting in fall 2014. Ideally, at the end of the dual track, the creditors were to be given the choice between the full-fledged swap solution, the M&A solution and the liquidation of the company's assets.

This goal was achieved. On the track towards the swap solution, the change of legal form of the company into a cooperative was prepared and the documentation for a debt-to-debt swap was drafted. On the track towards the M&A solution a broad bidding process was initiated. It resulted in the German energy trust EnBW offering to pay €550m in exchange for the shares of the company which would then run only its remaining core business (wind energy). The progress made on both tracks was regularly reported to the creditors. In May 2015 the insolvency administrator eventually filed two restructuring plans (the swap plan and the M&A plan) with the Local Court and submitted them to the creditors for selection.

The creditors' choice

The second creditors' assembly was scheduled for 2 July 2015. This left only very few precious weeks for the creditors to choose between the very different scenarios. The swap plan offered an insolvency quota of 57.8%, the M&A plan offered a quota of 52.2% and the default option, i.e., the liquidation of all assets, offered an estimated quota of 47.8%. Both EnBW as the now publicly designated investor with regard to the M&A plan and the tireless Friends of Prokon campaigned amongst the creditors for their preferred restructuring model.

Each private investor who wanted to take part in the debt-to-equity swap needed to file his individual agreement with the insolvency administrator before the beginning of the assembly. To balance the scales between the swapping creditors and the non-swapping creditors it was necessary for certain number of the creditors (representing at the least about €600m of the jouissance share capital) to take part in the debt-to-equity swap with a fixed amount of their respective claims. But the debt-to-equity ratio required for the approval of the future cooperative demanded an even higher number of swapping creditors (representing about €660m). Falling short of this number would have made it impossible to implement the swap plan. This would have left only the M&A plan or the liquidation of all assets for the eventual creditors' vote at the upcoming second creditors' assembly. However, when all individual agreements were tallied, they amounted to about €865m and the necessary amount to implement the swap plan was thus surpassed by far.

Due to the vast number of creditors, both creditors' assemblies were arranged in a mass hall and voting was held with electronic devices. The second creditors' assembly was first asked to vote on the swap plan. The M&A plan would only have stood to vote if the swap plan had been declined. A total of seven different groups of creditors and the shareholders were asked to vote separately. Again, the Friends of Prokon held an overwhelming majority of the assembled votes in favour of the swap plan. Within each of the eight voting groups, the respective majority agreed on the swap plan for a final score of 8:0.

The plan in effect

The Local Court confirmed the swap plan on 3 July 2015 and this decision became final on 20 July 2015. Within days, the change of legal form of the company into a cooperative was then publicly registered. The insolvency proceedings were lifted on 29 July 2015 with effect to the end of the month.

Since 1 August 2015, the newly instated board has been managing PROKON's sole remaining core business (wind energy) instead of the insolvency administrator. PROKON now has 37,000 members, namely its former creditors, and has a comparatively high debt-to-equity ratio for its sector. PROKON has already assigned the designated collateral to the trustee of its future bondholders. In summer 2016, the cooperative will emit bonds at a nominal value of €500m to its creditors in exchange for the former jouissance share capital.

The office of the insolvency administrator is now reduced to managing and monitoring other aspects of the fulfilment of the swap plan, e.g., the insolvency administrator will pay out the liquid funds of the insolvency estate. But even more importantly, he will monitor the sale of PROKON's remaining non-core assets (i.e., loans invested in pallets and forests), which have been assigned to a special purpose vehicle (SPV) commissioned with liquidating the assets. This SPV will then partly pay out the creditors who did not participate in the debt-to-equity swap. ■

“THE INSOLVENCY ADMINISTRATOR EVENTUALLY FILED TWO RESTRUCTURING PLANS AND SUBMITTED THEM TO THE CREDITORS FOR SELECTION”

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