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Latham & Watkins Restructuring & Special Situations Practice 18 December 2020 | Number 2838

German Bundestag Passes Comprehensive Reform in Restructuring and Insolvency Law

Through implementing the EU Restructuring Directive, German restructuring and insolvency law will be modernized, more effective, and enriched by new instruments.

On 17 December 2020, the German Bundestag passed the Act on the Further Development of the Restructuring and Insolvency Law (SanInsFoG). The SanInsFoG specifically provides for the implementation of Directive (EU) 2019/1023 on Preventive Restructuring Frameworks (Restructuring Directive) into German law. In addition to the adoption of a Law on the Stabilization and Restructuring Framework for Enterprises (StaRUG), which serves to implement the Restructuring Directive, the Act contains several other reforms of German insolvency and restructuring law. In particular, the Insolvency Code shall be adjusted in those areas where the Federal Government saw need for improvement following the evaluation of the Law to Further Facilitate the Restructuring of Enterprises (ESUG) passed in 2011. As a reaction to the increased infection rate in late autumn, the Law to Mitigate the Consequences of the COVID-19 Pandemic in Civil, Insolvency, and Criminal Procedure Law shall be adjusted again, *inter alia*, to provide a suspension on the obligation to file for insolvency during January 2021 for companies that expect November and December aid programs. The SanInsFoG shall already become effective in substantial parts on 1 January 2021.

Law on the Stabilization and Restructuring Framework for Enterprises (StaRUG)

The heart of the SanInsFoG is the StaRUG, though which the Restructuring Directive will be implemented: The StaRUG's wide catalog of new restructuring instruments offers debtors the opportunity to implement a restructuring concept with the support of a majority of creditors against obstructing creditors, but also involves considerable challenges for the affected stakeholders and the debtor's directors. In any case, the impact of the StaRUG on German restructuring and insolvency practice will be significant. This will be bolstered by the fact that some Member States have already presented new implementation laws that are also fairly progressive, and differ in details from the German approach.

Core: Restructuring Plan

A core element of the StaRUG is the option of a pre-insolvency restructuring by way of a restructuring plan. The debtor has the opportunity to submit a restructuring plan to its creditors to provide for the restructuring measures as well as restructuring contributions of the affected creditors. In principal, a majority of the creditor groups defined in the restructuring plan with 75% of the claims in each creditor group is sufficient for the adoption of the plan. If the required majority is not achieved in one class, its approval may be replaced under certain conditions by a so-called “cross-class cram-down”. In this respect, the StaRUG uses concepts and elements that are partly known from the US Chapter 11 proceedings, the English Scheme of Arrangement, and the German insolvency plan proceedings, but overall creates its own, new approach.

The debtor (in agreement with the stakeholders who support the plan) is granted flexibility to adapt the structure of the proceedings to the actual circumstances. Unlike insolvency proceedings, no consolidated overall proceedings are required. For example, a debtor could restructure only the financial liabilities and could keep the involvement of the courts to a minimum to conduct the proceedings largely privately. The StaRUG thus introduces a selective and generally silent restructuring instrument.

The use of this restructuring framework will, however, only have the desired effect for all participants if it is professionally prepared and conducted *lege artis*. The law contains instruments against unfair use of the framework as well as numerous legal protection options, which means that there are also options for safeguarding and asserting interests on the side of the stakeholders who reject the plan.

Framework for the Restructuring Plan

In particular: Moratorium, Restructuring Officer, Creditors’ Committee, and Increased Liability

In order for a debtor to be able to prepare and negotiate the restructuring plan, the StaRUG offers the possibility of imposing a moratorium (the draft law calls it a “stabilization order”), whereby measures of individual enforcement of creditors' rights may be restricted. The moratorium may initially be imposed for a maximum period of up to three months, although under certain circumstances follow-up orders to extend the moratorium to a maximum of eight months are permissible.

In certain cases, a restructuring officer shall be appointed and will generally be responsible for monitoring the propriety of the proceedings, and, if necessary, mediating between the parties. The debtor and creditors have certain rights of influence regarding the person and the appointment of the restructuring officer. Before the law was passed by the German Bundestag, a new option was added that a creditors’ committee may be appointed if the restructuring matter has the character of collective proceedings. The creditors’ committee would also have a right of nomination with respect to the restructuring officer.

Other last-minute changes to the SanInsFoG being passed include the following three major amendments (which are compared to the government draft):

- The government draft of the StaRUG allowed, under certain conditions, an interference with existing contractual relationships through a respective court order to terminate certain contracts (e.g., long-term lease agreements). This option was certainly the most controversial topic within the legislative process, and has now been removed from the final law. The enforcement of contract terminations shall (as in past cases) only be available within insolvency proceedings.

- The government draft contained an explicit provision that with the occurrence of imminent illiquidity, the directors’ primary duty shifts to serving the interests of the creditors. Such provision has now been deleted against the background of the “unclear relation to the general restructuring duties under corporate law”. The German Legal Committee, however, is of the opinion that this deletion does not lead to any liability gaps as this shall be covered by the general liability provisions under German corporate law, which will, in future, have to be more specified. Simultaneously, the initially anticipated external liability of directors from the time of the notification of the restructuring plan at court has now been amended to a purely internal liability towards the company for compensation of damages, which all creditors will suffer in the event of a director's breach of duty.

- The option to anticipate changes to any security granted by subsidiaries of the debtor in the restructuring plan has now been expanded to any security granted by parent and other affiliated companies. The secured creditors that are affected by such interference in their security rights will need to be adequately compensated.

Further Assistance for Companies Economically Affected by COVID-19

Under the Law to Mitigate the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law, the obligation to file for insolvency is currently suspended until 31 December 2020 for those companies that are over-indebted in the sense of insolvency law as a result of the pandemic, but not cash-flow insolvent. Due to the increase of infections and the new administrative restriction orders, the SanInsFoG also provides certain conveniences for companies that have fallen into insolvency due to the economic implications of the pandemic. This includes the following measures:

- The forecast period for the assessment of over-indebtedness in the sense of insolvency law will be reduced from twelve to four months from 1 January to 31 December 2021, provided that the over-indebtedness of the debtor was a result of the COVID-19 pandemic (for which the law sets out certain criteria).

- Until 31 January 2021, the obligation to file for insolvency is suspended for debtors that applied for state aid to mitigate the consequences of the COVID-19 pandemic between 1 November 2020 and 31 December 2020 (or were prevented from applying for legal or technical reasons), provided that such application is not obviously lacking the prospect of success, or is not sufficient to overcome insolvency.

- Additionally, companies affected by the COVID-19 pandemic will have easier access to protective shield proceedings.

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