KNOW-HOW

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RESTRUCTURING

A PREVENTIVE RESTRUCTURING FRAMEWORK AND ADAPTED REGIME OF MANAGEMENT DUTIES, WITH REGARD TO INSOLVENCY FILING AND COVID-19 CRISIS-COMPLIANCE, ENTERED INTO FORCE ON 1 JANUARY 2021

- **New rules for obligations to file for insolvency and to observe payment restrictions for managing director and board members**: Since 1 January 2021, the same obligations to file for insolvency as before the pandemic began now to apply for most companies again.
- **New restructuring framework**: Facilitation of preventive restructuring by means of a restructuring plan with a majority decision of the affected parties.

On 17 December 2020, the Federal Parliament enacted the Act on the Further Development of Restructuring and Insolvency Law (*Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts, "**SanInsFoG**"*), which makes far-reaching changes to insolvency law and creates a new legal situation for preventive restructuring. The Act, which also serves to implement the EU Directive on preventive restructuring frameworks, entered into force on 1 January 2021, while substantive COVID-19-related special rules expired on that same day. Certain special rules continued to apply until the end of January and have since been extended to 30 April 2021.

A. OVERVIEW

The entry into force of the **SanInsFoG** on 1 January 2021, and pandemic-related additions which have applied since 1 February 2021, will result in a large number of **fundamental changes to the restructuring** of companies:

- Since 1 January 2021, the following now once again applies in principle: If signs of crisis emerge, managing directors and board members will be obliged to examine without undue delay and on an ongoing basis whether grounds for insolvency are present – possibly with the involvement of external advisors. If the company is illiquid (*zahlungsunfähig*) or overindebted (*überschuldet*), a **petition to open insolvency proceedings is mandatory** (exceptions involving further temporary COVID-19-related facilitation measures are discussed below). A violation of the obligation to file will expose the managing directors and board members to liability and criminal prosecution. In cases of imminent illiquidity (*drohende Zahlungsunfähigkeit*), filing for insolvency remains optional.
  - Since 1 January 2021, the relevant **forecast periods** for the presence of imminent illiquidity have been 24 months, and only 12 months for the going concern forecast (*insolvenzrechtliche Fortführungsprognose*) in case of overindebtedness.
  - Payments made in violation of the prohibition of payments, as a result of the company being illiquid or overindebted, give rise to the personal **liability** of the management.
  - The temporary **suspension of obligations to file for insolvency**, as well as the facilitation measures with regard to the prohibition of payment in the course of the COVID-19 pandemic, **largely expired** on 31 December 2020 (exceptions to the further temporary COVID-19-related facilitation measures are discussed below).
  - Since 1 January 2021, companies have been obliged to set up a "**crisis early warning system**".

- COVID-19-related facilitation measures now only apply in narrowly defined **exceptional cases**:
  - Up to 30 April 2021, the **obligation to file for insolvency** will be suspended for companies which, in the period from 1 November 2020 to 28 February 2021, filed applications for the granting of financial aid within the framework of the national aid programmes, to enable them to avert insolvency.
  - The time period for the going concern forecast is limited to four months if the company's **overindebtedness** is **due to the pandemic**. However, this will (only) be presumed if the company (cumulatively) (i) was not illiquid on 31 December 2019, (ii) had generated a positive result in the last financial year prior to 1 January 2020 (iii) suffered a **drop in turnover of more than 30%** in the 2020 calendar year in comparison to the previous year.

- The new Corporate Stabilisation and Restructuring Act (*Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen – "**StaRUG**"*) creates the legal framework for the preventive restructuring of companies. Its objective is to enable a restructuring outside of, and avoiding, insolvency proceedings with the consent of the majority of the affected parties. Under the StaRUG, the affected parties can resolve a **restructuring plan** with a **majority of 75% in each group of them**, which is binding for all of the parties included in the plan and their claims and rights.
  - The stabilisation and restructuring framework created by the StaRUG additionally enables judicial stabilisation orders, such as stays of enforcement and realisation measures, in order to secure the restructuring plan.
  - Not only the claims and securities of the creditors involved in the plan can be **amended in the restructuring plan**, but also rights and interests of the shareholders and multilateral legal relationships (in particular syndicated loan agreements).
  - A **restructuring practitioner** (*Restrukturierungsbeauftragter*) may be appointed by court order to support, and possibly monitor, the management of a company in crisis.
  - The instruments of the StaRUG are only available if the company faces **imminent illiquidity**.

- The prerequisites for entering into insolvency in **self-administration** (*Eigenverwaltung*) are increased for companies, which are not affected by the pandemic in order to prevent abuses and adjust the statutory rules to a market standard that has been established in practice for well-prepared proceedings. Additionally, companies affected by the pandemic in 2021 will have access to **protective shield proceedings** (*Schutzschirmverfahren*) even if they are illiquid.

B. KEY ASPECTS OF THE NEW LAW

I. Suspension of obligation to file for insolvency ended for most companies on 31 December 2020

Under the COVID-19 Insolvency Suspension Act (*COVID-19-Insolvenzaussetzungsgesetz*) of 27 March 2020, the obligation to file for insolvency was generally suspended as of 1 March 2020. This obligation only continued to apply to companies whose illiquidity or overindebtedness was not due to the consequences of the coronavirus pandemic or which had no prospect of being able to remedy an existing illiquidity in the future. Moreover, the prohibition of payments for managing directors, subject to liability, was temporarily restricted, and payments made in the ordinary course of business were permitted.

These rules were originally limited to 30 September 2020 and then extended, to a reduced extent, to 31 December 2020. The SanInsFoG did not provide for any further extension of this period, meaning that in principle, the management's material obligations prior to the pandemic period again became applicable on 1 January 2021:

- The managing directors are obliged to file a **petition to open insolvency proceedings** in the case of the company's illiquidity or overindebtedness, but not in case of imminent illiquidity. The going concern forecast for ascertaining overindebtedness relates to the next twelve months (for COVID-19-related exceptions, see II. below).
- In the case of illiquidity, an insolvency petition must be filed within no more than **three weeks** after it arises. In the case of overindebtedness, an insolvency petition must now be filed within no more than **six weeks** (former time period: three weeks).
- If **signs of a crisis** are present, the managing directors are obliged to examine and monitor without delay whether the company is insolvent, i.e. illiquid or overindebted. If the managing directors do not themselves have the expertise necessary to perform this examination (which is normally the case), they must obtain advice from experts.
- These examination and filing obligations are incumbent on **every single managing director**, regardless of representation rules or the internal allocation of responsibilities. Any instructions by the shareholders or a (majority) resolution of the managing directors with the intention of restricting, delaying or avoiding the examination or the filing of the petition are irrelevant. In case of a violation of the obligation to file, the managing directors will be subject to liability and criminal prosecution.
- The relevant signs of crisis which trigger an obligation to examine include in particular the entry of a **deficit that is not covered by equity capital** in a balance sheet according to commercial law, the entry of losses in an amount threatening the viability of the company or an existing or imminent liquidity shortfall.
- The managing directors are **liable** without limitation for payments (including those which reduce the assets) that are made in violation of the **prohibition of payments** after illiquidity has arisen or overindebtedness has been determined. Payments are only permissible as an exception if they are consistent with the due care of a prudent manager in this particular situation.

II. Only very restricted special COVID-19 rules left since 1 January 2021

COVID-19-related special rules only still apply in the following situations:

- **Between 1 January 2021 and 30 April 2021**, the obligation to file for insolvency will still be suspended for companies which filed, an **application for the granting of national aid** within the framework of COVID-19 aid programmes in the period from 1 November 2020 to 28 February 2021. This does not apply if there is no prospect of obtaining the aid or if the aid would not be sufficient to eliminate the reasons for insolvency

- **The following applies from 1 January 2021 to the end of 2021**: In the case of a **COVID-19-related overindebtedness**, the period for the going concern forecast is reduced from twelve to four months. Thus, it is sufficient for a determination that there is no overindebtedness, and thus no obligation to file for insolvency, if the company will more likely than not be able to continue for the next four months. This is meant to prevent companies from needing to file for insolvency due solely to forecast uncertainties during the pandemic. However, a COVID-19-related overindebtedness will **only be presumed** if the company
  - was not illiquid at the end of 2019,
  - generated a positive operative result in the last completed financial year prior to 2020 and
  - suffered a drop in turnover from the normal business operation of more than 30% in the 2020 calendar year.

Moreover, for such companies affected by the pandemic, the illiquidity of the debtor will not stand in opposition to an application for **protective shield proceedings** in 2021. The "corona protective shield proceedings" are intended to take into account the fact that an illiquidity during the pandemic is not an indication of improper crisis management.

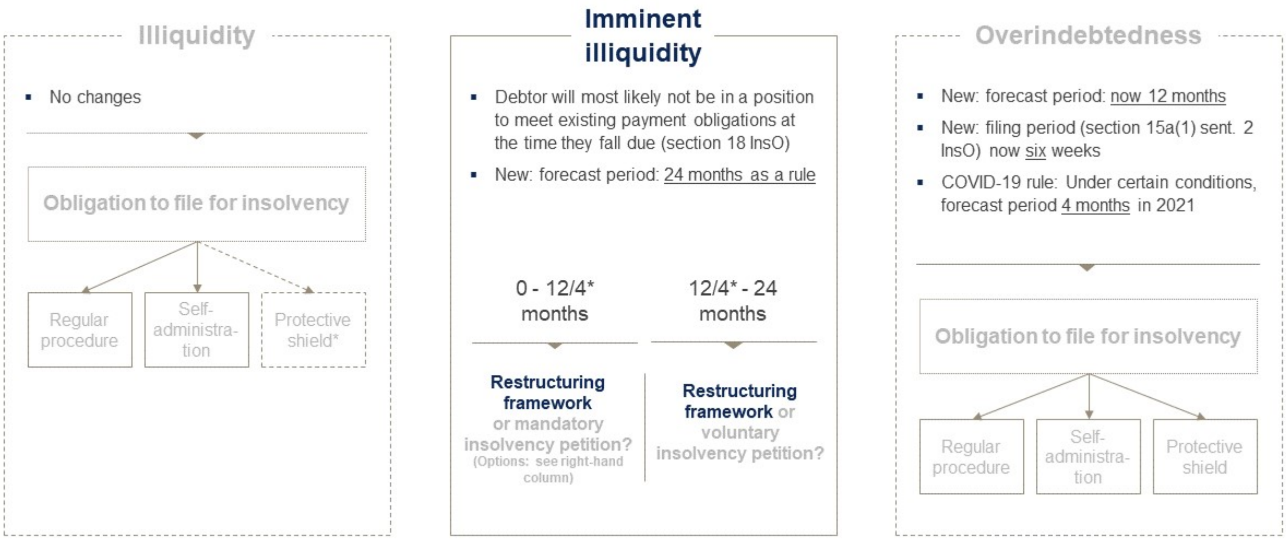
III. Extensive new possibilities for restructuring companies within the stabilisation and restructuring framework

The Corporate Stabilisation and Restructuring Act ("***StaRUG***") is based on Directive (EU) 2019/1023 on preventive restructuring frameworks and regulates in a separate law the prerequisites and instruments for the new, very far-reaching possibilities for restructuring a company outside of and avoiding insolvency proceedings.

1. Prerequisites

One prerequisite for utilising the instruments provided by the stabilisation and restructuring framework is **imminent illiquidity** (*drohende Zahlungsunfähigkeit*).

If imminent illiquidity exists, the debtor can therefore choose between an insolvency proceeding and a pre-insolvency restructuring pursuant to StaRUG:



* Only 2021 and subject to additional prerequisites (COVID-19 Insolvency Suspension Act)

The introduction of the stabilisation and restructuring framework is accompanied by the statutory (new) regulation of the relevant forecast periods for the presence of grounds for insolvency (see I. above).

2. Instruments of the stabilisation and restructuring framework

a) Restructuring plan

The key instrument of the StaRUG is the restructuring plan, which largely **replicates the insolvency plan**. The restructuring plan can be put to a vote and accepted in a voting meeting either in or out of court.

b) Regulation of claims and legal relationships

Claims and securities of the **creditors** involved in the plan, **rights and interests of shareholders** and **multilateral legal relationships** can be amended in the restructuring plan.

Multilateral legal relationships are, for example, **syndicated loan agreements** and agreements between the creditors on the rank and distribution of the proceeds (intercreditor agreements). Other financing arrangements with a large number of creditors, such as promissory note creditors or bonds, also fall under this regulation. It is also possible to incorporate into a restructuring plan securities which are granted by affiliated companies, e.g. joint and several liability of subsidiaries for financial liabilities of the parent company. A release from such **third-**

party collateral internal to the group is possible in the restructuring plan as long as the parties receiving the collateral are appropriately compensated. The same will also apply in the insolvency plan in the future.

Claims of employees, including pension commitments, are not eligible for regulation in the restructuring plan.

c) Stabilisation orders

In order to restrict individual enforcement measures and thus stabilise the company involved, the competent court can order a (temporary) **stay of enforcement** and **realisation measures**.

d) Restructuring practitioner (*Restrukturierungsbeauftrater*) or restructuring moderator (*Sanierungsmoderator*)

The competent court must **ex officio** appoint a restructuring practitioner to support, and possibly monitor, the company and its management in the handling of the crisis if, among other things, rights of consumers or small to medium-sized companies are affected by the restructuring, a stabilisation order essentially pertains to all of the receivables against the debtor, or it is apparent that the restructuring plan can only be adopted by way of cross-class cramdown. The restructuring practitioner is subject to the supervision of the court and has certain notification and reporting obligations vis-à-vis the court. Apart from purely financial restructurings which involve companies in the financial sector, the appointment of a restructuring practitioner will most likely be the **general rule**.

Upon application of the debtor – or, under certain circumstances, of affected parties – an **(optional) restructuring practitioner** can be appointed, in particular to further the negotiations with the affected parties. Instead of the restructuring practitioner, a restructuring moderator (with restricted tasks, but likewise with reporting obligations) can also be appointed at an earlier point in time to mediate between the debtor and the affected parties.

IV. Changes in insolvency law – increased requirements for access to self-administered insolvency

The following changes to insolvency law for **protective shield proceedings** and other **self-administration proceedings** entered into force on 1 January 2021:

- In order to be able to engage in a self-administered insolvency, it is now necessary to present a plan for the **self-administration** showing the concept of the restructuring in self-administration. A separate certification or concept by an expert third party with experience in insolvency matters is not necessary for this purpose, but is often to be recommended.
- The company is obliged to present a **financial plan** for the proceeding which meets the requirements under insolvency law and covers a period of at least six months. The additional or reduced costs of the self-administration in comparison to normal administration must be disclosed.
- The company must prove that it has taken precautions to meet its **duties under insolvency law**. As a rule, it will still be necessary for the management to be supported by an insolvency practitioner with experience in self-administration.
- During the (temporary) self-administration, the managers will be liable toward the creditors as an insolvency administrator pursuant to sections 60–62 German Insolvency Code (InsO).
- In 2021, companies affected by the pandemic will be able, as an exception, to apply for a temporary self-administration in the form of **protective shield proceedings** even if they are already insolvent

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