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New German Preventive Restructuring Landscape Imminent

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In the course of implementing EU directive 2019/1023 of 20 June 2019 on preventive restructuring frameworks, the German legislator intends¹, among other things, to provide for (i) a Preventive Restructuring Plan as flexible restructuring tool, (ii) further relief in connection with the COVID-19 pandemic, and to make small but important changes to the general provisions of German insolvency code. The changes are envisaged to come into force and effect as of 1 January 2021.

The Preventive Restructuring Plan is suitable to have an enormous impact on the German restructuring landscape and would allow restructurings outside formal insolvency proceedings with very high flexibility, especially in financial restructurings. The new legislation will presumably also change the balance of power between shareholders and creditors.

I. Preventive Restructuring Plan

The key element of the new legislation is the Preventive Restructuring Plan .It combines various elements from the insolvency plan proceeding (the German equivalent of U.S. chapter 11 proceedings) in order to provide for a flexible restructuring tool outside (or prior to) formal insolvency proceedings.

1. Key Prerequisites

- The Preventive Restructuring Plan is generally available to all debtors (other than financial institutions in the sense of § 1 para. 9 KWG) with their center of main interest (COMI) in Germany.
- The relevant debtor must not yet be obliged to file for insolvency due to illiquidity or over-indebtedness. Therefore, the relevant debtor must be in a state of impending illiquidity (cash flow insolvency in the next 24 months) in order to be eligible for the Preventive Restructuring Plan.

2. Major goal of Preventive Restructuring Plan

- The main goal of the Preventive Restructuring Plan is to enable a flexible financial restructuring (i.e., no operative restructuring) by implementing, amongst other things, the following actions/measures:
 - a waiver of deferment on existing debt (with the exception of pension obligations and obligations vis-a-vis the workforce and claims based on willful misconduct) or changes to existing covenants/termination rights;
 - a release or amendment of existing third-party security;

- a release or amendment of upstream security (in consideration for a fair compensation); and
- debt to equity swaps/transfer of shares/corporate changes.
- The law provides for a modular system of possible restructuring elements to be used in the sole discretion of the debtor ("**Measures**"), which includes the following:
 - judicial plan coordination;
 - judicial preliminary examination;
 - termination of contracts;
 - stabilization measures (e.g., enforcement protection); and
 - judicial plan confirmation.

3. Plan structure

- The Preventive Restructuring Plan is prepared by the debtor.
- The debtor has a wide discretion of which claims shall form part of the plan. Therefore, the debtor can limit the scope of the Preventive Restructuring Plan to certain creditors/claims (i.e., selective approach possible).
- Moreover, the debtor can compose different creditor groups based on appropriate criteria if such groups are subject to the plan (e.g., secured creditors, unsecured creditors, subordinated creditors, and shareholders).
- The acceptance of the plan principally requires (i) 75% of consenting voting rights within the respective group and (ii) the consent of all groups. A Cross-Class Cram-Down is possible under certain prerequisites, which enables an acceptance of the Preventive Restructuring Plan irrespective of a dissenting class of creditors.

4. Court Involvement

- A court involvement is in generally not mandatory. As a result, the Preventive Restructuring Plan is not officially announced by the restructuring court.
- However, the Measures (as defined above) require court involvement. The confirmation of voting result/the plan in connection with the Cross-Class Cram Down and the termination of contracts will presumably be in very high demand in future restructuring practice.
- While the application for the Measures is pending, the debtor is not obliged to file for insolvency due to illiquidity or over-indebtedness (to the extent such reasons to file for insolvency occur after the plan proceeding was started) but must notify the restructuring court accordingly.
- During stabilization measures (e.g., enforcement protection), the creditors' right to file for insolvency is suspended. This period may last up to eight months.

5. Restructuring Officer

- As a general principle of the Preventive Restructuring Plan, the debtor remains in control of the restructuring plan process itself and retains control over its company.

- However, if key decisions (e.g., a majority decision against minorities or stabilization measures) are to be implemented, the involvement of a restructuring officer as an independent control and mediation body by the restructuring court becomes mandatory. The scope of the powers of control and cooperation conferred on the restructuring officer is at the discretion of the restructuring court (which may include monitoring and supervisory powers as well as the assessment of the viability of the debtor in the course of the restructuring).
- It is also possible to appoint a restructuring officer on a voluntary basis (either by the debtor or by creditors with more than 25% voting rights in a creditor group).

II. Other important changes to the German Insolvency Code

1. Monitoring Obligation

In the future, the management will be subject to an ongoing monitoring obligation with respect to effects that could threaten the going concern of the company. If the management becomes aware of any such threat, it has to take appropriate measures and inform supervisory bodies (e.g., supervisory board/shareholders) without undue delay.

2. Stakeholder Interest

In case of an impending illiquidity, the management will be obliged to observe the interest of all creditors. Instructions of the shareholders/supervisory bodies which are not in line with the creditors' interest will not be binding upon the management.

3. Changes with respect to Duty to file for insolvency

- The maximum period in which the management is obliged to file for insolvency is extended in case of over-indebtedness up to six months. In case of illiquidity, the period of up to three weeks remains in place.
- Moreover, the German legislator distinguishes between the required positive going-concern prognosis with respect to impending illiquidity and over-indebtedness: The relevant period for the forecast period will now be explicitly determined to be 24 months in case of impending illiquidity and (only) 12 months in case of over-indebtedness.
- In addition to these general provisions, special COVID-19 legislation reduces the forecast period in connection with over-indebtedness to four months if the debtor can demonstrate that (i) it was not illiquid on 31 December 2019, (ii) generated profits in the business year 2019, and (iii) faced a decline in revenues in excess of 40% in 2020 in comparison to the previous year.

4. Changes to debtor-in-possession proceedings

- In the future, the prerequisites for debtor-in-possession proceedings will be stricter. Under the new legislation, the debtor must enclose a self-administration plan with its application for self-administration, which, in particular, contains (i) a financial plan for the period of six months, (ii) a concrete restructuring concept, (iii) a presentation of the status of restructuring negotiations with the creditors, (iv) a presentation of the precautions to be taken to ensure that all obligations of the debtor under insolvency law are met, and (v) a presentation of the expected additional or reduced costs of self-administration compared to regular insolvency proceedings. Before initiating self-administration proceedings, the insolvency court must review the self-administration plan to ensure that it is complete and coherent.

- However, due to COVID-19, it is possible to access DIP proceedings under simplified criteria for a limited period of time.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Frankfurt lawyers:

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¹ The following summary is based on the proposal of the German Government dated 14 October 2020 (*SanInsFoG-E*). As a consequence, further changes may be implemented in the course of the legislative process.