西村あさひ法律事務所
NISHIMURA & ASAHI

Europe Newsletter

Recent Changes in German Insolvency Law

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I. Overview and Background

Effective January 1, 2021, after only a few weeks of parliamentary deliberation, the so-called "Act on the Further Development of the Restructuring and Insolvency Law (*SanInsFoG*)" has introduced significant changes to German Insolvency Law. In addition to entirely new pre-insolvency restructuring measures ("Law on Stabilization and Restructuring Framework for Enterprises (*StaRUG*)") mandated by Directive (EU) 2019/1023 of June 20, 2019, the German lawmakers have fine-tuned and amended some of the regulations introduced in early 2020 that were intended to ease the pressure on companies affected by the COVID-19 pandemic.

II. New Restructuring Procedure

With the goal of preventing the insolvency of viable companies in financial difficulties, not least due to the current pandemic, the new measures offer companies a toolbox of flexible pre-insolvency restructuring options, including Debt-Equity-Swaps as well as certain other corporate measures, utilizing concepts and ideas of US Chapter 11 proceedings, the English Scheme of Arrangement, and the existing German insolvency plan proceedings.

Highlights of the newly established pre-insolvency restructuring measures include:

- Under certain circumstances, companies may choose to conduct the restructuring in private without involvement of the courts. Notable and practically relevant exceptions are cases in which the moratorium (see below) is applied, or cases in which a dissenting minority of creditors objects to the restructuring measures.
- Access is granted only for companies in an early stage of crisis, i.e. "impending illiquidity". Section 18 of the German Insolvency Act (*InsO*) defines impending illiquidity (*drohende Zahlungsunfähigkeit*) as a large possibility that a debtor becomes illiquid within 24 months.
- Claims by almost all sorts of creditors and shareholders may be subject to the restructuring. Important exceptions are

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claims by employees, claims based on tort and intentional acts, as well as calls for sanctions by states (*staatliche Sanktionsforderungen*). Creditors can be organized in various classes. It is also possible to limit the restructuring to only a certain group of creditors such as creditors of financial liabilities.

- Decisions regarding the restructuring are made within the relevant classes of creditors with a majority (75%) vote. It is also possible to outvote dissenting classes by way of a 'Cross-Class Cram-Down', i.e. a majority of classes vote in favor of the restructuring, after which the court may impose the restructuring plan on dissenting classes of creditors. A Cross-Class Cram-Down is also possible if only two classes of creditors have been formed.
- Agreements between the company and concerned creditors might be amended (e.g. claims may be reduced or deferred) but may not be terminated extraordinarily.
- A moratorium for execution measures might be ordered by the restructuring court for a maximum period of three to four months; this period can be prolonged to up to eight months depending on the circumstances of the case.
- In general, securities provided for new financing of the company are exempted from the risk of being voided (*Insolvenzanfechtung*). This preferential treatment does not cover the repayment of financing, as the repayment itself is not a part of the restructuring plan's execution. Shareholder loans and similar claims and securities are not eligible for preferential treatment.
- A restructuring officer can be appointed by the court, if (i) consumers, small- or mid-sized companies are affected; (ii) a moratorium is issued; or (iii) the restructuring can only be implemented against a certain group of creditors. The restructuring officer acts as an independent intermediary for control and mediation purposes.
- A creditor committee may be appointed, if claims by all creditors (except the creditors whose claims are exempted by law, e.g. employees) are affected and if the restructuring covers a variety of creditors with diverse interests. Under certain circumstances the creditor committee may nominate the restructuring officer and, generally, the court is required to appoint such nominated person. In addition, the creditor committee may include creditors who are not included in the restructuring proceeding, e.g. employees.
- On July 17, 2022, additional rules regarding the publication of the restructuring will enter into force in order to facilitate the recognition of a restructuring in Germany in other EU-member states according to the European Insolvency Regulation (right now the new restructuring measures are outside the scope of the European Insolvency Legislation).

III. Changes to Insolvency Act

Apart from the introduction of the StaRUG, the SanInsFoG also brings along some changes to the debtor in possession proceedings (*Eigenverwaltung*) and other existing regulations under the German Insolvency Act. The most important changes are as follows:

- In order to nudge companies towards taking advantage of the new pre-insolvency restructuring options (see above), the bar for companies to conduct debtor in possession insolvency proceedings (*Eigenverwaltung*) has been raised, now requiring court approval of a detailed plan by the applying company with a six-month planning horizon.
- The deadline for the management of insolvent companies to make insolvency filings on behalf of the company is prolonged from three weeks to six weeks.
- Rules on wrongful payments (*verbotene Zahlungen*), which so far have been scattered throughout various statutes, are consolidated in one sub-section.
- A company's over-indebtedness (*Überschuldung*) now has to be determined on a 12 months forward looking basis (not 24 months as before). This time period is further reduced to 4 months in cases in which the over-indebtedness is related to the COVID-19 crisis.
- Until the end of January 2021, certain companies remain exempted from the obligation to file for insolvency if they have previously applied for financial support from the government, but (i) have not received it yet and (ii) are therefore in a situation of over-indebtedness. This suspension of the obligation to file for insolvency may be prolonged until end of April as a result of ongoing COVID-19 relief measures currently being discussed by the German federal

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and state governments.

IV. Outlook

Overall, the new restructuring scheme is a meaningful step towards bringing the German Insolvency Law framework up to international standards by providing companies in distress with more options to keep the business running and bring a stop to the recent trend of evading foreign law regimes during German restructurings. In combination with the various changes to existing regulations, some of which were less than one year old, German lawmakers have also shown that they are not only well aware of and concerned about the severe effects that the COVID-19 pandemic has and will continue to have on companies, but also that they are able and determined to adjust the law to (business) reality on short notice.

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