Gravenbrucher Kreis

Gravenbruch Theses

"Pre-insolvency restructuring procedure in Germany?"

of 14 January 2017

SPOKESMAN:

Attorney-at-Law Prof. Dr. Lucas F. Flöther
Franzosenweg 20
D-06112 Halle
Tel +49 (0)345 21222-0
Fax +49 (0)345 21222-395

www.gravenbrucher-kreis.de
kontakt@gravenbrucher-kreis.de

At the invitation of the Gravenbruch Circle, 16 specialists drawn from

the Federal German Ministry of Justice and of Consumer Protection,
Commerzbank AG,
Deutsche Bank AG,
Deutscher Anwaltverein e.V.,
Euler Hermes Deutschland AG,
Gesellschaft für Restrukturierung TMA Deutschland e.V.,
the Gravenbruch Circle,
the judiciary,
Pensions-Sicherungs-Verein aG,
UniCredit Bank AG,
VID Verband Insolvenzverwalter Deutschlands e.V., as well as
senior academics

took part in the Gravenbruch Discussion in Berlin in mid-January 2017 - a panel discussion - on the topic of "Pre-insolvency restructuring procedure in Germany?". Within the context of this discussion, which followed on from previous Gravenbruch Discussions held in November 2015 and May 2016 on the same topic, the participants discussed whether Germany needed a procedural framework of this nature, and how this might then be implemented. In this conjunction, the Gravenbruch Circle updated its views of 23 May 2016, positioning itself in the current specialist debate:

Preliminary remarks

Germany has one of the world's best insolvency laws. According to a study prepared by the World Bank "Doing Business 2017 - Equal Opportunity for All" of 25 October 2016, it ranks 3rd out of 190 states in the field of corporate insolvencies.[1] National insolvency law contains in particular rules that function very well, and in overall terms represents a good standard when it comes to restructuring companies. Existing German rules make it possible to restructure companies effectively and efficiently at an early stage in the process. Restructuring procedures

[1] World Bank study "Doing Business 2017 - Equal Opportunity for All" of 25 October 2016, p. 208, available under: http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf (retrieval date: 14 January 2017); also see: http://www.doingbusiness.org/rankings (retrieval date: 14 January 2017).

conducted in accordance with applicable national law can be planned and are transparent; the costs thereby incurred are calculable and can be appealed. Minimum German standards for out-of-court and court restructuring extend far beyond the intention of the European Commission[2].

In view of the assessment and appraisal of the World Bank, as well as within the context of the recommendation[3] and current directive proposal of the European Commission[4], a supplementary amendment of the toolbox of German restructuring law may be required, and not a total paradigm shift - away from creditor satisfaction, and towards discharge procedures: a new tool that dovetails with out-of-court financial restructuring efforts, and supports these when these threaten to be thwarted by individual objectors. This means restructuring will not have to draw upon instruments of foreign law in order to be successful.

The decision that needs to be taken in response to every corporate crisis (liquidation or restructuring) needs to be taken at an early stage in order to minimise further damage for creditors. Companies should have access to the restructuring framework only if they are solvent and moreover remain solvent for twelve months.

Views:

1. The objective of a new restructuring framework is to safeguard or to restore the economic viability of the company in question, outside insolvency proceedings, by restructuring the liabilities side of the balance sheet. Restructuring measures that extend further (such as mandatory interventions in employee rights, rights to reject legal agreements and special termination rights) should not be available through pre-insolvency restructuring procedures. Only those persons should be involved in the procedures (as well as in the restructuring negotiations) who are required to make a contribution pursuant to the restructuring plan (no comprehensive procedure). In accordance with the debt discharge

[2] Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU of 22 November 2016, COM(2016) 723 final, available under: http://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=CELEX:52016PC0723&qid=1483620686500&from=EN (retrieval date: 14 January 2017).
[3] Recommendation of the Commission of 12 March 2014 for a new approach to corporate failures and corporate insolvencies, C(2014) 1500 final, available under: http://ec.europa.eu/justice/civil/files/c_2014_1500_de.pdf (retrieval date: 14 January 2017).
[4] see footnote 2.

objective of the preventive restructuring framework, planned interventions should be limited to outstanding loans. German lawmakers need to implement a possible directive with this objective in mind. In addition, during the current European legislative process, German lawmakers also need to encourage the European Commission, the European Parliament and the Council of the European Union to clarify the wording of the directive accordingly, for example in the form of a flexibility clause in the directive that enables member states to exempt certain groups of creditors from the scope of application of the restructuring plan.

2. The preventive restructuring framework is easy to initiate, but entails a relatively low level of interventions, and this needs to be reflected in its procedural types. For this reason, neither plan confirmation proceedings for the purpose of safeguarding or restoring the economic equilibrium of the company outside insolvency proceedings, nor optional preliminary proceedings for a stay of enforcement actions are available as restructuring tools of more strongly regulated and supervised proceedings (e.g. insolvency appeal, insolvency money, rights to reject legal agreements and special termination rights, general moratorium) ("easy entry, light consequences"). On this point the restructuring framework that, according to the European Commission, should be applied ahead of an insolvency needs to be clearly distinguished from proceedings that are intended for insolvent companies that require these tools. In the current European legislative process, it is important to ensure vis-à-vis the European Commission, the European Parliament and the Council of the European Union that the Directive provides those member states with implementation flexibility where effective restructuring-friendly proceedings already exist with the aforementioned tools.

3. The restructuring negotiations themselves, as well as a possible agreement on the restructuring plan, should take place outside of judicial proceedings (minimal court involvement). The mandatory binding of dissenting creditors, as well as an individual short-term stay of enforcement, may be established only after recourse to a court of law and following an individual assessment by the court. In this conjunction, preconditions for an individual stay of enforcement need to adhere to the principles of proportionality and the prohibition of discrimination, and for this reason may be ordered only insofar and to the extent that it is necessary to support the negotiations on the restructuring plan, the affected creditors are not unreasonably disadvantaged, and the debtor is not otherwise threatened by insolvency; solvency must be maintained for

a period of twelve months. The activities of the court will then not be publicly announced. A restructuring framework cannot make provision for a comprehensive moratorium to be imposed upon all creditors. This is available within the framework of the already-existing rules of restructuring-friendly insolvency proceedings. Companies that require far-reaching enforcement protection (and not just protection from individual objectors) are ripe for insolvency and cannot be given access to a restructuring framework.

4. A judicial plan confirmation for the purpose of binding a dissenting creditor should be arranged only if the court takes the view that the implementation of the restructuring plan is supported by a large majority of the affected creditors (at least 75 % of the sum of the claims in question), and also takes the view that these have been properly selected, including the proper establishment of groups, and that they have been comprehensively informed about the plan concept and the plan approval (Art. 103 Para. 1 GG). Sample restructuring plans[5] are wholly unsuitable for the restructuring of companies. If a creditor is to be bound by the plan with or without his consent, then the court must grant him minority protection at his request, by refusing to confirm the plan if the applicant voted against the plan and if he is able to argue credibly that the plan is likely to leave him in a worse position than he would have been without a plan. The benchmark comparison for a worse position is not necessarily the residual value, but instead the continuation value in the event of a possible corporate sale; in the event of secured creditors, the anticipated proceeds in the hypothetical case of the earliest possible access to the collateral.

5. At the request of the debtor or of a creditor, the court may appoint a practitioner in the field of restructuring to help the debtor or creditors prepare or negotiate a restructuring plan (mediation). Any suitable natural person may be appointed as the practitioner in the field of restructuring who is suitable for the particular case, is in particular an expert in the field of business and is independent of the creditors and the debtor.

[5] Art. 8 Para. 2, 3 of the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU of 22 November 2016, COM(2016) 723 final.

6. The principal criterion for the legitimacy of the restructuring plan is the actual support shown for the planned measure by the overwhelming majority of the affected parties. Against this backdrop, the necessary quorum needs to be significantly higher than a simple majority. It may not amount to less than 75 % of the sum of the respective claims. At the same time, any possible intervention (requiring judicial legitimacy) in creditor rights during the negotiation phase, i.e. before a quorum of this nature has been reached, should be possible only on an exceptional basis to protect ongoing restructuring negotiations vis-à-vis individual objectors, and the content of this should adhere closely to this protective purpose. A general moratorium is disproportionate here, and would not be compatible with the balanced enforcement regime established under German law. A stay of enforcement that is directed merely towards individual creditors who are threatening compulsory enforcement should be possible during this phase, only for the specified purpose and only for a very short period of time, and this should not trigger publication obligations or suspend any possible insolvency petition obligations. Experience in Germany shows that even within the context of judicial restructuring, deadlines amounting to up to three months are generally sufficient, and these can be extended to up to six months in exceptional cases. As banks record outstanding loans as "impaired" if the debtor fails to serve these for a period of three months, lengthy stay periods have the effect of unnecessarily generating non-performing loans, which is certainly the reverse of what such proceedings are intended to achieve. For this reason, current European legislative proceedings need to ensure vis-à-vis the European Commission, the European Parliament and the Council of the European Union that the directive will enable member states to waive a comprehensive moratorium within the context of restructuring measures, and consequently to waive the comprehensive suspension of filing for insolvency obligations.

7. Under German law, it is already possible to grant restructuring and bridging loans that cannot be contested and are not exposed to liability obligations. German lawmakers need to adopt the relevant established jurisprudence and to rectify any possible unclear aspects. Protection for implementation measures and other transactions in conjunction with restructuring that extends beyond this is neither necessary nor reasonable. For this reason, current European legislative procedures need to ensure vis-à-vis the European Commission, the European Parliament and the Council of the European Union that such transactions are not universally privileged, and that at least an effective revocatory action of wilful intent remains possible in the follow-up insolvency.

8. Procedures are to be standardised in a new statutory act entitled "Restructuring Ordinance [Restrukturierungsordnung – ("RO"). Recognition of all procedures within the restructuring framework must be ensured within the European Union.

9. Specialist district courts should be exclusively responsible as restructuring courts for legal proceedings conducted in a restructuring framework defined in this manner. In this conjunction, a corresponding court needs to be designated for each higher regional judicial district (Oberlandesgerichtsbezirk). Restructuring procedures need to be handled by a separate department within the court.

Concluding remarks

The ESUG evaluation and the thoughts on the creation of a preventive restructuring framework are closely linked. § 270a/b proceedings need to be professionalised in line with the proposals put forward by the Gravenbruch Circle on the reform of the ESUG of 12 October 2015[6], in order to ensure that their value is not undermined.

[6] Gravenbruch Circle, ESUG: Erfahrungen, Probleme, Änderungsnotwendigkeiten - Thesenpapier, version: October 2015, ZIP 2015, 2159 ff.; also available under: http://www.gravenbrucher-kreis.de/app/download/12749944835/ReformESUG_12Okt2015_01.pdf?t=1454529535 (retrieval date: 14 January 2017).

About the Gravenbruch Circle

Since 1986, the Gravenbruch Circle has brought together representatives of Germany's leading insolvency law firms that are characterised by trans-regional restructuring expertise as well as comprehensive expertise in this field. Members undertake to ensure that they and their organisations exercise the highest quality and performance standards, documented by the exclusive certificate *InsO Excellence* that is verified by independent auditors. The Circle currently has 20 active members. Prof. Dr. Lucas F. Flöther has been the Spokesman of the Gravenbruch Circle since March 2015.

Since its inception, the Gravenbruch Circle has dedicated itself as a centre of expertise to the development and promotion of insolvency law and associated legal fields from a practical perspective. In addition, the Gravenbruch Circle contributes its experience of cross-border group insolvencies, and takes part in the continued development of international standards and rules in the restructuring field.

The interdisciplinary exchange of know-how and joint discussions within the Gravenbruch Circle facilitate detailed assessments and expert opinions. These are widely recognised by national and international specialists in the field of insolvency and restructuring law, and the views of Circle members are consulted during the course of legislative procedures.

www.gravenbrucher-kreis.de

Halle, 14 January 2017