

Client Alert

Update – Revised draft bill for the new German business stabilization and restructuring regime ("German Scheme")

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Contact

Mathias Eisen
+49 69.71917.3447
meisen@milbank.com

Sebastian Heim
+49 89.25559.3628
sheim@milbank.com

Robert Kastl
+49 69.71914.3437
rkastl@milbank.com

1. Background and Overview

As described in our Client Alert "The new German business stabilization and restructuring regime ("German Scheme")" dated 12 October 2020, the German Federal Ministry of Justice and Consumer Protection had presented a draft bill (the "**Original Bill**") to introduce a new business stabilization and restructuring framework - the new "**German Scheme**" - into German law.

The German Federal Government has now presented a revised draft bill for the German Scheme (the "**Revised Bill**"). The Revised Bill retains the general concept of the German Scheme proposed in the Original Bill and the majority of amendments constitute technical adjustments, clarifications and clean-ups. The substantive changes made in the Revised Bill can be summarized as follows:

- Business judgment rule for the duty to protect creditors' interests
- Discretion of the court to terminate the restructuring proceedings upon the occurrence of insolvency
- Modifications to the absolute priority rule
- Privilege on claw-back only for new money financings
- Fewer instances in which the appointment of a restructuring officer is mandatory

2. Summary of key amendments in the Revised Bill

2.1 Business judgment rule for the duty to protect creditors' interests

Regarding the shift in duties of the directors of a company, and the corporate bodies supervising such directors, towards the protection of the interests of the creditors of that company following the occurrence of imminent illiquidity (see page 7, paragraph 4.6 (*Debtor-in possession process with a shift in corporate bodies' duties towards protection of creditors' interests*) of the Client Alert), the Revised Bill introduces a business judgment rule to mitigate the liability risks of directors and members of the corporate bodies supervising such directors. Pursuant to the proposed business judgment rule, a

director is deemed not to have breached his duty to protect the creditors' interests if, on the basis of adequate information, he could have been of the reasonable opinion to protect the interests of creditors.

Further, the Revised Bill provides for an additional duty of the relevant corporate bodies to restore the debtor's management if the debtor is imminently illiquid and its directors have resigned or otherwise ceased to be directors. If the debtor has no incumbent director(s) and is threatened to become illiquid, the competent corporate body, i.e. the shareholders' meeting or, as applicable, the supervisory board, has to appoint the required number of directors to reestablish the debtor's ability to act.

2.2 Discretion of the court to terminate the restructuring proceedings upon the occurrence of insolvency

If illiquidity or over-indebtedness occurs during the restructuring process, the Original Bill provided for a continuation of the restructuring process without the necessity of initiating an insolvency process if, and for as long as, the restructuring efforts were promising (see page 3, paragraph 4.1 (*Availability for debtor with a COMI in Germany upon imminent illiquidity*) of the Client Alert). The Original Bill deemed this to be the case if (i) there were sufficient prospects that the proposed restructuring plan would be accepted by the affected stakeholders, and (ii) the tests of illiquidity and over-indebtedness would not be met had the debtor's liabilities – which were supposed to be rearranged by the restructuring plan – already the amount, maturity and other terms envisaged by the proposed restructuring plan.

The Revised Bill modifies this concept insofar as it no longer provides for an automatic continuation of the restructuring process in such a scenario. Instead, the restructuring court is authorized not to terminate the restructuring proceedings despite the occurrence of insolvency if (i) such insolvency was caused by the acceleration of a claim which was contemplated to be rearranged by the restructuring plan, and (ii) the implementation of the restructuring plan is predominantly likely.

2.3 Further modifications to the absolute priority rule

The Original Bill already provided for a cross-class cram-down, subject to a modified absolute priority rule (see page 4, paragraph 4.3 (*Creditor classes, voting and cram-down*) of the Client Alert). The Revised Bill retains this concept but introduces a further modification to the absolute priority rule.

The Revised Bill sets out that an appropriate participation of the creditors in the economic value provided by a restructuring plan is also possible in the event that a creditor ranking equal with the creditors of a particular class is awarded a preferential treatment by the restructuring plan, provided that such deviation from the absolute priority rule is appropriate in view of the nature of the economic difficulties to be resolved by the restructuring plan and the individual circumstances of the case.

The Original Bill already provided another exception from the absolute priority rule, i.e. the possibility to award economic value to the debtor or any of its shareholders, if the involvement of the debtor or its shareholders was required for the continuation of the debtor's business. The Revised Bill provides for additional requirements in this context insofar as it is now also required that the debtor and/or, as applicable, its shareholders commit to (re-)transferring the economic values received if their involvement ceases for reasons attributable to the debtor and/or, as applicable, its shareholders within five years. In addition, the Revised Bill now deems an extension of the maturity by up to 18 months (as opposed to twelve months under the Original Bill) as non-material for creditors, thereby introducing a further modification to the absolute priority rule.

2.4 Mitigation of claw-back risks only for new money financings

The Original Bill provided for a mitigation of claw-back risks in relation to financings which form part of a restructuring plan (see page 6, paragraph 4.4 (*Mitigation of claw-back and lender liability risks for turnaround financings*) of the Client Alert). The relevant provisions were supposed to apply not only to new money financings but also to extensions and deferrals of existing financings. The Revised Bill now

limits the scope of application to new money financings and does not privilege extensions or deferrals anymore.

In addition, the Revised Bill clarifies that such claw-back privilege does not apply to shareholder loans and economically comparable transactions which, by operation of German insolvency law, are subordinated in any German insolvency process.

In relation to third-party new money financings, such claw-back privilege expires if and once a sustainable rehabilitation of the debtor has been achieved.

2.5 Mandatory appointment of a restructuring officer

The Original Bill provided for a mandatory appointment of a restructuring officer in certain scenarios (see page 7, paragraph 4.7 (*Appointment of a restructuring officer*) of the Client Alert). This general concept has been retained in the Revised Bill, although the Revised Bill no longer provides for a mandatory appointment of a restructuring officer if the debtor applies for a termination of executory contracts or a restructuring of upstream guarantees or security.

As the Revised Bill does not provide for any additional events or circumstances triggering a mandatory appointment of a restructuring officer, the appointment of a restructuring officer should not be mandatory for restructurings confined to financial liabilities.

3. Outlook and conclusion

The concept for the German Scheme proposed in the Original Bill has been fully retained in the Revised Bill. Despite ongoing discussions about the options proposed in the Original Bill allowing the debtor to curtail creditors and shareholder rights, the German Federal Government has not limited these options in the Revised Bill. The changes in the Revised Bill are largely confined to technical adjustments, clarifications, clean-ups and certain additions in detail.

Insofar, it is fair to assume that the German Scheme will be introduced substantially in the form as proposed in the Revised Bill. The German legislator intends to complete the legislative process by the end of 2020 to ensure that the German Scheme will become available on and from 1 January 2021.

Global Financial Restructuring Contacts

Frankfurt | Neue Mainzer Straße 74, 60311 Frankfurt am Main

Mathias Eisen	meisen@milbank.com	+49 69.71914.3447
Thomas Ingenhoven	tingenhoven@milbank.com	+49 69.71914.3437
Robert Kastl	rkastl@milbank.com	+49 69.71914.3447

Munich | Maximilianstraße 15, 80539 Munich

Martin Erhardt	merhardt@milbank.com	+49 89.25559.3666
Sebastian Heim	sheim@milbank.com	+49 89.25559.3628

London | 10 Gresham Street, London EC2V 7JD

Nicholas Angel	nangel@milbank.com	+44 20.7615.3008
Jacqueline Ingram	jingram@milbank.com	+44 20.7615.3251
Karen McMaster	kmcmaster@milbank.com	+44 20.7615.3266
Yushan Ng	yng@milbank.com	+44 20.7615.3341
Sinjini Saha	ssaha@milbank.com	+44 20.7615.3814

New York | 55 Hudson Yards, New York, NY 10001-2163

Dennis F. Dunne <i>Practice Group Leader</i>	ddunne@milbank.com	+1 212.530.5770
Nelly C. Almeida	nalmeida@milbank.com	+1 212.530.5271
Matthew Brod	mbrod@milbank.com	+1 212.530.5460
Lauren C. Doyle	ldoyle@milbank.com	+1 212.530.5053
Evan R. Fleck	efleck@milbank.com	+1 212.530.5567
Samuel A. Khalil	skhalil@milbank.com	+1 212.530.5015
Tyson Lomazow	tlomazow@milbank.com	+1 212.530.5367
Michael Price	mprice@milbank.com	+1 212.530.5577
Abhilash M. Raval	araval@milbank.com	+1 212.530.5123
Eric K. Stodola	estodola@milbank.com	+1 212.530.5663
Gerard Uzzi	guzzi@milbank.com	+1 212.530.5670

Los Angeles | 2029 Century Park East, 33rd Floor Los Angeles, CA 90067-3019

Gregory A. Bray	gbray@milbank.com	+1 424.386.4470
Thomas R. Kreller	tkreller@milbank.com	+1 424.386.4463
Mark Shinderman	mshinderman@milbank.com	+1 424.386.4411

Financial Restructuring Group

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