Financial Restructuring Group

Client Alert

Milbank

The New German Restructuring Regime ("German Scheme") Will Enter Into Force on 1 January 2021

A groundbreaking, internationally competitive restructuring instrument

30 December 2020

Contact

Mathias Eisen
+49 69.71917.3447
meisen@milbank.com

Sebastian Heim
+49 89.25559.3628
sheim@milbank.com

Robert Kastl
+49 69.71914.3447
rkastl@milbank.com

1. "German Scheme" available from 1 January 2021 in (slightly) modified form

The German Federal Parliament finally adopted the long-awaited bill to introduce a new pre-insolvency business stabilization and restructuring regime into German law.[1] The new law was published in the German Federal Gazette on 29 December 2020 and will enter into force on 1 January 2021.

The availability of the ground-breaking new "**German Scheme**" from 1 January 2021 onwards will significantly change the German restructuring landscape and elevate it to an internationally competitive level. In particular, the German Scheme will close the gap between consensual out-of-court restructurings and in-court restructurings since, in the past, the latter could only be implemented in Germany by means of comprehensive insolvency proceedings.

When compared to the draft bill for the new German Scheme presented by the German Government in October 2020, the final bill adopted by the German Federal Parliament differs from the previous draft in the following key respects:

- <u>No shift of directors' duties upon the occurrence of imminent illiquidity</u>: While the draft bill proposed an early shift of the duties of the directors (and of the corporate bodies supervising them) towards the protection of the creditors' interests upon the occurrence of imminent illiquidity, the new law has not adopted such shift of directors' duties.
- <u>No termination of executory contracts</u>: The draft bill provided the possibility to terminate executory contracts, i.e. mutual contracts which have not yet been fully

[1] Unternehmensstabilisierungs- und restrukturierungsgesetz – StaRUG, which forms part of the bill to further develop the restructuring and insolvency law in Germany (*Sanierungsrechtsfortentwicklungsgesetz – SanInsFoG*).

performed by both sides, ahead of time. The new law does not provide for such early termination right.

- Creditors' committee as additional body: The new law provides for the establishment of a creditors' committee as an additional body to supervise the debtor.

- Restructuring of all group guarantees and security: The draft bill confined the possibility to restructure third-party guarantees and security for liabilities of the debtor to upstream guarantees and security granted by subsidiaries of the debtor. The new law now also provides for the restructuring of guarantees and security granted by other affiliates of the debtor, i.e. cross-stream and downstream guarantees and security.

2. Background

2.1. Historic gap between consensual out-of-court restructurings and insolvency proceedings

In the past, German law only provided for either out-of-court restructurings with the consent of all affected creditors and shareholders or in-court restructurings by means of an insolvency plan. Consequently, if the contemplated restructuring solution was not unanimously supported by the relevant creditors and/or shareholders, the required cram-down of dissenting creditors or shareholders was only possible within insolvency proceedings.[2]

An insolvency process, however, entails various significant drawbacks ranging from impediments for the debtor's trading and legal restrictions for its management affecting the creditors to loss of control of the shareholders of the debtor. In addition, and despite the significant improvement and acceptance of insolvency proceedings as a restructuring tool in the last years, an insolvency process may still unsettle employees, customers, suppliers, trade credit insurers and other stakeholders. In addition, German insolvency proceedings are, by definition, comprehensive bankruptcy proceedings over the entire estate of an insolvent debtor and are therefore not well-suited to restructure only certain elements of the capital structure of a debtor, e.g., financial liabilities of an over-leveraged company whose operating business should continue without any disruption.

To avoid such drawbacks of German insolvency proceedings, German debtors which (only) required a financial restructuring (i.e., without the necessity of a restructuring of their operative business) often turned to English law governed schemes of arrangement. This provided German debtors with the option to implement the required financial restructuring without being dependent on the consent of all affected creditors and shareholders. Sometimes, the availability of a scheme of arrangement and the willingness of the majority of the affected creditors and shareholders to implement it, had a disciplinary effect on all other stakeholders which ultimately resulted in the restructuring being implemented consensually.

2.2. Legislative process and last-minute changes

On 20 June 2019, the European Parliament and the Council adopted the EU directive on restructuring and insolvency (the "EU Directive")[3]. The EU Directive requires EU member states to implement effective national preventive restructuring frameworks which enable debtors in financial difficulties to continue operating, in whole or in part, by changing the composition, conditions or structure of their assets and/or liabilities or any other part of their capital structure.

The German government, while being required to implement the EU Directive, also recognized the necessity of a pre-insolvency restructuring instrument. Consequently, on 19 September 2020, the German Federal Ministry of Justice and Consumer Protection presented a draft bill for a comprehensive business stabilization and restructuring framework also including complementary adjustments of German insolvency and corporate law. Shortly thereafter, on 14 October 2020, the German

[2] Other than a possible cram-down of bond liabilities pursuant to the German Bond Act (*Schuldverschreibungsgesetz*) which is applicable to German law governed bonds.

[3] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

Government presented a revised draft bill which retained the general concept of the German Scheme and, to a vast extent, confined the amendments to technical adjustments, clarifications and cleanups.

Although the draft bill for the German Scheme had been well received by the majority of restructuring professionals, some of its proposed features had been subject to controversial discussions. On 15 December 2020, the Committee on Legal Affairs and Consumer Protection of the German Federal Parliament presented a recommended form of the new law which reflected several points of criticism and proposed substantial amendments to the previous draft bills. On 17 December 2020, the German Federal Parliament finally adopted the new law in the form recommended by the Committee on Legal Affairs and Consumer Protection of the German Federal Parliament.

The key last-minute changes introduced by the legislator in December 2020 to the bill can be summarized as follows:

- No shift of directors' duties:

  The previous draft bills proposed an early shift of the duties of the directors and of the corporate bodies supervising them. With a view to creating a counterweight to the extensive options the German Scheme provides for a debtor to curtail the rights of its creditors, the previous draft bills proposed a shift of the focus of directors' duties to the protection of the creditors' interests (already) upon the occurrence of imminent illiquidity.

  The new law has not adopted such shift of duties. The management continues to generally owe its duties to the company and its shareholders until either the occurrence of actual insolvency (i.e., illiquidity or over-indebtedness) which requires the management to file for insolvency or the initiation of German Scheme proceedings by the debtor which triggers a duty of the directors of the debtor to protect the interests of the creditors as a whole ((see below, section 4.6 (*Debtor-in-possession process with a shift in directors' duties towards protection of creditors' interests*)).

- No termination of executory contracts:

  The previous draft bills proposed the possibility to terminate executory contracts, i.e. mutual contracts which have not yet been fully performed by both sides, ahead of time. This would have provided an additional restructuring tool to implement the desired restructuring concept if the counterparty refused to agree to an adjustment or termination of the contract in question.

  The new law does not provide for such early termination right. Any termination of executory contracts is only possible within insolvency proceedings.

- Creditors' committee as additional body:

  The new law provides for the establishment of a creditors' committee as additional body to supervise the debtor ((see below, section 4.8 (*Constitution of creditors' committee in insolvency-like German Scheme proceedings*)).

- Restructuring of all group guarantees and security:

  The draft bills confined the possibility to restructure third-party guarantees and security for liabilities of the debtor to upstream guarantees and security, i.e. guarantees and security granted by subsidiaries of the debtor.

  In addition to the restructuring of such upstream guarantees and security, the new law now also provides for the restructuring of guarantees and security granted by other affiliates of the debtor, i.e. cross-stream and downstream guarantees and security.

3. At a glance – Key features of the proposed German Scheme

The key features of the proposed German Scheme are:

- Debtor-in-possession process
- Availability of the German Scheme upon imminent illiquidity prior to an insolvency (actual illiquidity or over-indebtedness)
- No comprehensive bankruptcy process, but selective pre-insolvency process which can be confined to certain liabilities (in particular, financial liabilities)
- Restructuring of the debtor's liabilities and the security interests securing such liabilities, including guarantees and security granted by affiliates of the debtor, and the related contractual provisions (e.g., financial covenants) as well as arrangements among the creditors (in particular, intercreditor agreements)
- No restructuring of employment-related rights, obligations, pension schemes or pension obligations
- Availability of measures relating to the share capital of the debtor, enabling debt-to-equity swaps, share transfers and the reduction and increase of share capital as well as accompanying measures
- Majority threshold of 75% of the votes in the respective class
- Votes are determined in each class by the amount of the respective liabilities, value of the security interests etc.; Headcount majority not required
- Availability of cross-class cram-down of dissenting creditors and shareholders
- Reduced claw-back and lender liability risks for turnaround financings
- Appointment of a restructuring officer under certain circumstances to supervise the debtor and the restructuring process
- Constitution of creditors' committee as additional body to supervise the debtor
- Safeguarding measures such as stay on foreclosure and enforcement measures and invalidity of *ipso facto* clauses

The German Scheme does not provide for a single holistic procedure, but rather a flexible framework providing a toolkit from which the debtor can choose to implement the desired restructuring. The new German Scheme combines well-established features of German insolvency plan proceedings with new tools providing for more flexibility and protection of the debtor in the pre-insolvency stage. The key element of the German Scheme is the restructuring plan. The restructuring plan implements and effects the desired restructuring with binding effect for the affected creditors and shareholders.

The debtor and its management will be the driving force in the new process. The German Scheme provides for a debtor-in-possession process with the debtor's management remaining in charge of the debtor's affairs. Only the debtor is entitled to propose the restructuring plan and to submit it for adoption by its affected creditors and/or shareholders. Creditors and shareholders are not entitled to initiate the restructuring process. A pre-packed solution is, however, possible. In certain circumstances, a restructuring officer is to be appointed and commissioned to supervise the debtor and the restructuring process (see below, section 4.7 (*Appointment of a restructuring officer*)). If German Scheme proceedings involve all eligible liabilities of the debtor, the restructuring court can also install a creditors' committee to support and supervise the debtor's management (see below, section 4.8. (*Constitution of creditors' committee in insolvency-like German Scheme proceedings*)).

From a corporate law perspective, the new law provides for a material change of directors' duties towards preserving the interest of the creditors as a whole once German Scheme proceedings are initiated by the debtor's management (see below, section 4.6 (*Debtor-in-possession process with a shift in directors' duties towards protection of creditors' interests*)).

The restructuring pursuant to the German Scheme can involve all types of secured and unsecured liabilities other than employment or pension-related obligations. A restructuring plan is also capable of restructuring guarantees and security granted by affiliates of the debtor (see below, section 4.2 (*Comprehensive restructuring of the capital structure*)). This is of particular relevance for the restructuring of LBO or other secured financing structures which regularly involve upstream, cross-stream and downstream guarantees and security granted by material group companies across various jurisdictions.

The restructuring plan is adopted by vote of creditor classes with creditors in a similar position forming a creditor class (see below, section 4.3 (*Creditor classes, voting and cram-down*)). The same applies to shareholders if the restructuring extends to the equity. The voting threshold in each class is a qualified majority of 75 per cent. of claims or, as regards shareholders, equity participation (see below, section 4.3 (*Creditor classes, voting and cram-down*)). Since out-of-court restructurings have in the past been frustrated by hold-outs of dissenting creditors or shareholders, the new bill provides not only for such majority decision in each class, but also for a cross-class cram-down (see below, section 4.3 (*Creditor classes, voting and cram-down*)) to overcome such hold-outs and facilitate pre-insolvency restructurings.

4. In detail - The new German Scheme

4.1. Availability for debtors with a COMI in Germany upon imminent illiquidity

The new German Scheme will be available to all debtors (other than financial institutions) which have their centre of main interest – COMI – in Germany. Linking the jurisdiction to the COMI follows the principle for determining the jurisdiction for insolvency proceedings.

Debtors with a COMI in Germany have access to the new restructuring process if they are threatened to become illiquid (imminent illiquidity) without yet being insolvent. A debtor is imminently illiquid if it is more likely than not (>50%) that the debtor will be unable to honor all of its payment obligations which are due from time to time within the applicable forecast period. The bill clarifies that the applicable forecast period will generally be 24 months (see below, section 4.10 (*Accompanying changes to the insolvency regime*)).

Should a debtor become insolvent in the course of the restructuring process, the restructuring efforts will not necessarily be frustrated due to the occurrence of actual insolvency (illiquidity or over-indebtedness). The restructuring court is authorized to deviate from the general rule that German Scheme proceedings are to be terminated by the restructuring court upon the occurrence of insolvency if either (i) the commencement of insolvency proceedings would, in light of the progress achieved in the German Scheme proceedings, obviously not be in the interest of the creditors as a whole, or (ii) the insolvency was caused by an acceleration of a claim which was contemplated to be rearranged by means of the restructuring plan, provided that the achievement of the restructuring objective is predominantly likely.

4.2. Comprehensive restructuring of the capital structure

The restructuring plan allows for a comprehensive restructuring and recapitalization of the debtor. It can compromise and rearrange all of the debtor's secured and unsecured liabilities, including security interests, but can also be confined to certain liabilities of the debtor, in particular financial liabilities.

The German Scheme has been tailored to also provide a suitable restructuring option for typical financing structures involving various layers of debt and guarantees and security provided by affiliates of the debtor. On the one hand, the restructuring plan can also extend to intercreditor agreements and rearrange the ranking and enforcement rights of the various creditor classes. On the other hand, it can restructure guarantees or security granted by affiliates of the debtor and thereby restructure not only the debtor but also those of its affiliates which granted such group guarantees or security.

The restructuring plan can also restructure shareholder rights, allowing for all types of equity measures such as debt-to-equity swaps, share transfers, capital reductions and capital increases with an exclusion of the subscription rights of existing shareholders. Shareholders can be diluted or squeezed-out entirely. As in insolvency plan proceedings, any change of control rights of third parties triggered by a debt-to-equity swap or other changes in the shareholding structure resulting from the restructuring plan are deemed invalid. Similarly, a debt-to-equity swap requires the consent of the affected creditors and cannot be forced onto them pursuant to the German Scheme.

Claims resulting from intentional tort liability and monetary fines cannot be compromised or rearranged by way of a restructuring plan. The same applies to employment and pension obligations. Consequently, a restructuring plan is not capable of facilitating any lay-offs, adjustments of pension schemes or reduction of pension obligations. Such claims are expressly carved-out from the EU Directive. Since many German companies, in particular in the industrial sector, have significant pension liabilities which are not always fully funded or otherwise covered, the exclusion of such liabilities constitutes a drawback of the new restructuring regime. Insofar, it remains the case that pension liabilities can only be restructured as part of a comprehensive in-court insolvency process.

4.3. Creditor classes, voting and cram-down

The adoption of the restructuring plan follows to a significant extent the tried and tested procedure for the adoption of an insolvency plan in an in-court insolvency process. The restructuring plan needs to be voted on by the affected creditors and, if shareholder rights are to be impaired by the restructuring plan, the affected shareholders. The relevant stakeholders are separated into classes. Stakeholders which hold different legal positions have to form different classes. A further separation based on economic interests is possible.

Typically, separate classes will have to be formed at least for secured creditors, unsecured pari passu creditors, subordinated creditors, small claims creditors and shareholders. The same applies to beneficiaries of guarantees and security provided by affiliates of the debtor (see above, section 4.2 (*Comprehensive restructuring of the capital structure*)).

The legislator expressly states that the fact that certain claims originate from state-backed financing schemes introduced to mitigate the consequences of the COVID-19 pandemic as such does not justify a differing treatment, i.e. an allocation in a separate class. Any potential special treatment such claims must be based on the aforementioned criteria.

Subject to a possible cross-class cram-down, the restructuring plan needs to be accepted by each class. The acceptance by a class requires a majority of 75 per cent. of the voting rights. For unsecured creditors, the voting rights are determined in accordance with the nominal amount of such creditors' claims. For secured creditors and beneficiaries of guarantees and security provided by affiliates of the debtor, the voting rights are determined by the value of such security interests or guarantees. The voting rights of shareholders are determined by their respective participation in the equity. The wording of the new law suggests that all voting rights of the relevant class are counted for determining the majority and not only the voting rights of stakeholders which participate in the voting.

The German Scheme allows for a cross-class cram-down to overrule hold-outs combined with a modified "**absolute priority rule**". For this purpose, the restructuring plan is deemed to be accepted by a class despite a negative vote of that class if:

- the members of that class are likely not to be placed at a disadvantage by the restructuring plan compared to their situation in the absence of such restructuring plan;
- the majority of classes have accepted the plan, provided that if there are only two classes, the acceptance by the other class is sufficient and provided further that accepting classes must not exclusively be constituted by classes of shareholders and/or subordinated creditors; and
- the members of that class participate appropriately in the economic value the restructuring plan provides for the affected stakeholders.

As regards the latter requirement,

- a class of creditors is deemed to participate appropriately in the in the economic value if:
  - no other creditor receives economic value in excess of the full (nominal) amount of its claim;
  - neither any subordinated creditor nor the debtor or any of its shareholders receives any economic value (other than any economic value compensating a corresponding contribution into the debtor's estate) – so-called **absolute priority rule**; and
  - no creditor ranking equal with the creditors of that class is awarded any preferential treatment by the restructuring plan,

whereas

- a class of shareholders is deemed to participate appropriately in the economic value if:
  - no creditor receives any economic benefits exceeding the full (nominal) amount of its claim; and
  - no shareholder ranking equal with the shareholder of that class is awarded any preferential treatment by the restructuring plan.

As a deviation from the absolute priority rule set out above, an appropriate participation of creditors in the economic value is also possible if:

- such deviation is appropriate in view of the nature of the economic difficulties to be overcome and the relevant circumstances, whereas any deviation is deemed inappropriate and thus outside the scope of this deviation from the absolute priority rule if the crammed-down class represents more than half of the voting rights of the creditors of the affected rank;
- economic value is provided to the debtor or any of its shareholders, if the involvement of the debtor or its shareholders is required for the continuation of the debtor's business to achieve the added value of the restructuring plan, provided that the debtor and/or its shareholders have committed to such continuation and have committed to transferring the economic values received in the event that their involvement ceases for reasons attributable to them before the expiry of five years or any shorter period stipulated by the restructuring plan; or
- the claims of such creditors are only affected in a non-material manner, in particular if neither the nominal amount is compromised, nor the maturity of such claims is extended by more than 18 months.

Beneficiaries of guarantees and security provided by affiliates of the debtor must always receive appropriate compensation for any compromise of their rights against the relevant guarantors or security grantors. Otherwise, no cram-down of the class of beneficiaries of affiliate guarantees and security may occur.

4.4. Mitigation of claw-back and lender liability risks for turnaround financings

Commitments of new financings and the granting of security for such new financings may form part of the restructuring plan. The provisions of a German Scheme finally sanctioned by the competent restructuring court and any legal actions implementing such a confirmed German Scheme are generally barred from claw-back in a subsequent insolvency. Hence, such new money financings forming part of a court-sanctioned restructuring plan are also generally excluded from claw-back in a subsequent insolvency, providing a safe harbor for lenders. This claw-back privilege expires if and once a sustainable restructuring of the debtor has been achieved. Such claw-back privilege does, however, not apply to shareholder loans and economically comparable transactions which, by operation of German insolvency law, would be subordinated in any German insolvency proceedings.

The lender liability regime imposed by German case law on turnaround financings is not suspended in its entirety. Under German law, lenders providing financing to a company in a state of crisis may be exposed to tort liability vis-à-vis the company‘s other creditors if such loans merely delayed the company's insolvency filing (or in the words of the German Federal Supreme Court

(*Bundesgerichtshof*): "merely prolonged the futile struggle for survival") and the delay caused a shortfall in the recovery of other creditors. No lender liability, however, will arise if the lender has granted or extended the financing in order to facilitate a successful turnaround. Even if the restructuring ultimately fails, the lender will escape liability if it legitimately and reasonably – ideally on the basis of a sound restructuring concept – expected the restructuring to succeed. For this purpose (amongst other purposes), the debtor usually commissions a restructuring opinion (pursuant to the requirements of the German Federal Supreme Court (*Bundesgerichtshof*) and the IDW S6-standard) which analyzes if a success of the restructuring efforts is predominantly likely.

The new law clarifies that such lender liability cannot solely arise from the creditor's knowledge that a restructuring matter is pending with the restructuring court or that the debtor has applied for certain instruments under the new German Scheme. Consequently, lender liability risks are not excluded in their entirety, and the lender should ensure that it is able to demonstrate that it was of the reasonable opinion that the restructuring will succeed. Insofar, we expect that lenders will continue to require restructuring opinions pursuant to the requirements of the German Federal Supreme Court (*Bundesgerichtshof*) and the IDW S6-standard.

While the EU Directive provided for the option of a priming of new money financings in a subsequent insolvency of the debtor, the German Scheme has not made use of that option. New money financings will not enjoy such preference in a subsequent insolvency of the debtor.

4.5. Safeguarding measures such as moratorium and invalidity of ipso facto clauses

The German Scheme includes various safeguarding options the debtor can utilize to protect the restructuring process.

Most importantly, the debtor can apply for a moratorium on foreclosures and security enforcements. This also applies to guarantees and security granted by affiliates of the debtor. The restructuring court can grant such moratorium for an initial period of up to three months. An extension by one month is possible if the debtor has submitted a restructuring plan and no facts are known which would prevent the adoption of that restructuring plan in that month. The extension can be granted for up to eight months if the sanctioning of the restructuring plan by the restructuring court is pending.

As long as a moratorium is in effect, counterparties cannot deny performance of their contractual obligations due to payments which have been outstanding at the time the moratorium was ordered by the restructuring court. This does not apply to contractual obligations the performance of which is not required for the continuation of the debtor's business. During the moratorium, creditors are also barred from filing a creditor petition for the commencement of insolvency proceedings over the debtor's assets.

The fact that a restructuring matter is pending with the restructuring court or that the debtor has applied for certain instruments under the new German Scheme as such is not capable of triggering any termination or acceleration right or rights of retention of the debtor's creditors or counterparties. Any contractual provisions to the contrary are deemed invalid. Any termination or acceleration right or rights of retention based on other grounds remain unaffected.

4.6. Debtor-in-possession process with a shift in directors' duties towards protection of creditors' interests

German Scheme proceedings are debtor-in-possession proceedings. The debtor, respectively its management, remain fully in charge to manage the debtor's affairs.

To safeguard the interests of the creditors within the restructuring process of the German Scheme, the debtor's directors are required to conduct the German Scheme proceedings with the due care of a proper and diligent director of a company to be restructured and thereby taking into account the interests of the creditors as a whole. Especially, the directors have to abstain from any actions which would be inconsistent with the objective of the restructuring or would jeopardize its prospects of success. Any discharge or collateralization of claims to be rearranged by the restructuring plan is generally deemed to be inconsistent with the restructuring objective.

4.7. Appointment of a restructuring officer

Without restricting the right and responsibility of the debtor's management to remain in charge of the debtor's affairs, the restructuring court can appoint a so-called restructuring officer. The restructuring officer can be any person which is independent from the debtor and its creditors and is qualified and suitable for the specific case. If the debtor proposes a specific person as officeholder and evidences that the restructuring is not obviously futile, the restructuring court can only abstain from appointing the proposed person if such person is obviously inept. If the court is not bound by a debtor proposal, it must follow the joint proposal of creditors representing 25 per cent. of the voting rights (see above, section 4.3 (*Creditor classes, voting and cram-down*)) in each class or, if a creditors' committee has been constituted (see below, section 4.8. (*Constitution of creditors' committee in insolvency-like German Scheme proceedings*)), a proposal of the creditors' committee, unless such person is obviously inept.

The appointment of a restructuring officer by the restructuring court is mandatory if

- the plan compromises rights of consumers or SMEs;
- the debtor has applied for a moratorium affecting substantially all creditors;
- a cross-class cram-down other than a cram-down of financial creditors is required; or
- the restructuring plan provides for the appointment of a restructuring officer to supervise the implementation of the restructuring plan.

Consequently, for restructurings confined to financial liabilities, the appointment of a restructuring officer is not mandatory.

The restructuring officer is supervised by the restructuring court and mainly responsible for reporting on certain factual and procedural prerequisites of the new German Scheme to the restructuring court. In certain cases, the restructuring court can extend the responsibilities of the restructuring officer, especially with a view to protecting the interests of the creditors.

4.8. Constitution of creditors' committee in insolvency-like German Scheme proceedings

If a restructuring of all of the debtor's liabilities by means of a German Scheme (see above, section 4.2 (*Comprehensive restructuring of the capital structure*)) is contemplated and the German Scheme proceedings are, in substance, akin to all-encompassing insolvency proceedings, the restructuring court can install a creditors' committee.

The creditors' committee is supposed to support and supervise the debtor's management.

4.9. Recognition in other jurisdictions

The recognition approach in the bill is twofold:

- If the restructuring proceeding is conducted as a public proceeding, the bill assumes recognition under the European Insolvency Regulation[4]. Recognition under the European Insolvency Regulation by the EU member states (other than Denmark) only requires that the debtor has its COMI in Germany. To this end, Germany intends to register public German Scheme processes in the list of insolvency proceedings set out in Annex A of the European Insolvency Regulation.
- If the restructuring proceeding is non-public, recognition will not be awarded under the European Insolvency Regulation. Insofar, the rules on jurisdiction and the recognition and enforcement of judgments under the Brussels 1a Regulation[5] should generally

---

4 Regulation (EU) No 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

5 Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).

apply, which has been a tried and tested approach for the recognition of schemes of arrangements sanctioned by English courts.

The debtor can elect if the proceedings are conducted as public proceedings. If the proceedings are public, the restructuring court will publicly announce the venue and date of any hearings, the appointment and dismissal of the restructuring officer and any of its decisions made in the proceedings.

However, while the non-public restructuring proceeding will be available from 1 January 2021, public proceedings will only be available from 17 July 2022 onwards. Hence, German Scheme proceedings may only be subject to recognition and enforcement under the Brussels 1a Regulation, but not the European Insolvency Regulation, until 17 July 2022.

4.10. Accompanying changes to the insolvency regime

The new law also contains certain consequential changes to the German Insolvency Code (*Insolvenzordnung*). The changes mainly aim at facilitating the implementation of restructurings under the new German Scheme prior to the occurrence of a mandatory insolvency reason, i.e. illiquidity or over-indebtedness, and shall thereby separate the pre-insolvency German Scheme proceedings from insolvency proceedings.

The new pre-insolvency restructuring regime can be accessed by the debtor upon the occurrence imminent illiquidity. Pursuant to the incumbent German Insolvency Code applicable until 31 December 2020, the tests for imminent illiquidity and for a positive continuation forecast, which is one element of the over-indebtedness test, are substantially identical. This results from the circumstance that both tests aim at determining whether or not it is predominantly likely (>50%) that the debtor will be able to honor its payment obligations when they fall due from time to time within the applicable forecast period. The forecast period is not defined in the incumbent German Insolvency Code, but typically encompasses the debtor’s current and next business year. Importantly, the forecast period is generally considered to be identical for both tests, i.e. the imminent illiquidity and the over-indebtedness test apply the very same forecast period.

This will change under the new law. Under the new law, the forecast period for the test of **imminent illiquidity** is now set to **24 months** in general. As regards the test of **over-indebtedness**, the forecast period is now set to **twelve months**.

In light of the economic consequences and uncertainties the COVID-19 pandemic caused for the majority of businesses, the new law also provides for certain interim relief measures which remain available until 31 December 2021. Considering the increased forecasting uncertainties during the ongoing COVID-19 pandemic, the forecast period in relation to the **over-indebtedness** test is reduced even further to **four months** until 31 December 2021, but only for companies which

- were not illiquid as of 31 December 2019;
- achieved a positive result from ordinary business activities in the financial year ending prior to 1 January 2020; and
- suffered a decline in turnover from ordinary business activities by 30 per cent. in 2020 compared to 2019.

In addition, if these three requirements are met or it can otherwise be evidenced by an expert opinion that the insolvency was caused by the COVID-19 pandemic, the debtor will have easier access to protective-shield proceedings (*Schutzschirmverfahren*) under the German Insolvency Code. Insofar, the occurrence of illiquidity which would normally preclude the availability of protective-shield proceedings will not prevent access to protective-shield proceedings until 31 December 2021.

5. Outlook

The German Scheme provides for a practical, efficient and internationally competitive new restructuring regime. It will close the gap between consensual out-of-court and in-court restructurings by providing a pre-insolvency instrument for a quasi-consensual restructuring enabling the cram-down of hold-out creditors and shareholders.

We believe that the German Scheme is especially well-suited for over-leveraged debtors which require a financial restructuring of their capital structure and at the same time need to be able to continue their business operations in an ordinary manner without disruption.

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

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 *Practice Group Leader*	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
Dennis F. Dunne	ddunne@milbank.com	+1 212.530.5770
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

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any member of our Financial Restructuring Group.