A comprehensive change to German insolvency and restructuring law has become effective starting 1 January 2021. The change allows that a company’s reorganization is possible without insolvency and includes the majority decision of its creditors.

In its final session in 2020, the German Bundestag passed the so-called Act on the Further Development of Restructuring and Insolvency Law (SanInsFoG), which will be applicable starting 1 January 2021. The law is based, among other things, on an EU
directive that requires all member states to allow non-insolvency restructuring. The expected economic dislocations, as a result of the Covid-19 pandemic, have prompted German lawmakers to bring forward this legislative project and also create additional extensive mitigations for the economic consequences of the lockdown for companies.

The provisions of the SanInsFoG are divided into three main areas: At its core is the Stabilization and Restructuring Framework Act (StaRUG), the amendments to the German Insolvency Code (InsO) (which are substantial), and the specific relief linked to the impact of the COVID-19 pandemic, is intended to mitigate its economic consequences.

As a result of these new regulations, German restructuring law will become more flexible. This being said, restructuring will be carried out, and adapted to individual cases based on need. Ultimately, the new regulations, along with the existing possibilities of the German Insolvency Code, can be utilized to achieve the best possible restructuring of a company.

German legislation has broken new ground with regard to the StaRUG. Restructuring proceedings under the StaRUG will not be considered insolvency proceedings and court decisions are only necessary to a manageable extent.

The prerequisite for the application of the StaRUG, is the imminent illiquidity of a company. According to the legislator's new definition, imminent illiquidity exists when a company is not predominantly likely to be solvent for the subsequent 24 months. This will be inevitable for many companies that are experiencing a crisis situation. However, the provisions for out-of-court restructuring are excluded if a company is over-indebted, i.e., will only be solvent for less than twelve months, or are already illiquid. In the latter case, however, companies have the autonomy to self administer restructuring via insolvency proceedings.

The critical element of the new regulations specifically focuses on the restructuring plan. The restructuring plan is developed by the company and, includes considerations with regard to the company's liabilities. Thus, a new loan, a debt waiver, the extension of credit periods, and interest rate adjustments is among others possible. The overall goal of the restructuring plan is the preservation of the company, and the proper management of the creditors' claims. The restructuring plan can also be used to intervene in creditors' security interests, as well as the security interests of affiliated companies. Restructuring claims will have the ability to be converted into equity of the company, with the proper consent of the claim holders. The company responsible for organizing the restructuring plan, is not required to intervene in all creditor claims, but can select which claims are to be covered by the restructuring plan on the basis of appropriate criteria.

The new regulations, however, exclude the rights of the employees. Should the restructuring process result in job cuts or losses, the company must cover the costs of such cuts from its existing assets or opt for restructuring through insolvency proceedings. Originally, the draft law provided that the company has the right to terminate current contracts (e.g., leases), however, these options have not yet been addressed by the legislator.
The affected creditors will be required to vote on the restructuring plan. The company has the option of dividing the creditors into groups. Voting rights are based on the amount of the claim. Restructuring plans are accepted if three quarters of the creditors in each group, are in agreement. Should the creditors in each group disagree, their approval can then be replaced if a majority of the other groups agree to the plan and the rejecting group is not placed in a compromised position. The process of dividing creditors into groups can therefore be of conclusive importance.

A new provision includes such that different treatment in the individual groups may be justified only if this is due to the economic difficulties of the company, which cannot be resolved in any other manner. The change with regard to the "absolute priority rule" is a major shift within German law and is now evident in the regulations on insolvency plans. This innovation makes it clear that, under certain circumstances, the interests of the company can take precedence over the interests of creditors.

The extent to which court involvement is necessary in these proceedings, is determined by the company. It is possible for a company to reach an agreement with its creditors under a restructuring plan, with no involvement from the court, in confirming the restructuring plan, as long as all parties agree to this arrangement. It is also possible that the restructuring plan is drafted, voted on and confirmed by the court, at the company's request. In this case, the court is not required to examine the specifics of the restructuring plan, rather their role is to verify whether the requirements for StaRUG proceedings have been satisfied. Unless the federal states regulate otherwise, the responsibility for this is concentrated within the insolvency courts in whose district a higher regional court has its seat.

It is also possible that the StaRUG procedure, comparable to the rules governing insolvency proceedings, will include greater involvement of the court and may necessitate the appointment of a restructuring officer. A more formal form of StaRUG proceedings is particularly recommended, should additional measures to support the restructuring be ordered by the court. This is the case, if the court issues stabilization orders for a period of up to three months, which allows the company to carry out the StaRUG proceedings: For example, measures of foreclosure can be prohibited or discontinued, or creditors who possess the rights of segregation and separation can be prohibited from realizing the secured items. Moreover, during the term of the stabilization orders, creditors are unable to file for insolvency.

If a court-ordered restructuring plan vote is desired, the overall plan will be formally voted on through discussions or meetings. At the request of the company, the court can conduct a preliminary examination of the plan and address the concerns of the parties that could be affected. Such an approach is recommended when a large number of creditors' rights are affected by the restructuring plan or if creditors are affected who have different interests or who have not yet participated in such a procedure.

The restructuring plan, which is confirmed by the court, undergoes a confirmation procedure. During this procedure, the requirements of the restructuring plan are examined. The final decision of the court can be disputed by any party affected by the plan, by means of an immediate appeal. The appeal must require credible evidence that the result of the restructuring plan will place the creditor in a
compromising position. Only at the request of the creditor, who is adversely affected, will the court order the suspensive effect of the appeal, when disadvantages for the creditor affected, cannot be reversed.

The appointment of a restructuring representative (Restrukturierungsberater), comparable to the authority in self-administration proceedings, is not mandatory for StaRUG proceedings. The court will only appoint a restructuring representative if the company files a corresponding application or if the rights of small creditors are interfered with, as part of the restructuring, or if stabilization orders are directed against all creditors of the company. In order to act as a restructuring officer, an experience in restructuring matters, as well as the qualification of a tax advisor, auditor, lawyer or comparable training is required. The remuneration of the restructuring officer shall be based on hourly rates which, as a rule, shall not exceed EUR 350. Exceptions may be made, based on individual cases.

The announcement of the decisions in a StaRUG proceeding, which is only possible beginning 17 July 2022, can be done only if requested by the company itself. The publication means that the StaRUG measures must also be recognized in other EU/EEA states.

Also regulated in the StaRUG is the so-called "remediation moderation". As part of the reorganization facilitation, the court appoints an expert individual at the request of the company, to facilitate the company's settlement negotiations with its creditors. The facilitator is provided with the reorganization details as well as the company's financial information. A reorganization settlement, which is mediated by the reorganization facilitator, can be approved by the court. Stabilization measures cannot be enacted as part of the reorganization facilitation process and the reorganization settlement requires the consent of all creditors.

The StaRUG process grants a struggling company several options for reorganization. The StaRUG also requires the company's management to continuously monitor potential threats to its economic status. The draft law stipulates that a "shift of fiduciary interests" in favor of creditors should occur from the onset of imminent insolvency, and that the managing directors would be liable should they fail to comply. However, this provision has not been adopted by the legislator. Nevertheless, liability of the executive bodies is to be assumed in situations where they fail to take into account impairments in their management activities that could potentially jeopardize the existence of the company. If their prerequisites for ordering are not met, after the application for the stabilization orders, the management shall be liable for the damages suffered by the affected creditors as a result of the ordering of the measures.

If the restructuring plan is legally confirmed, the related enforcement measures cannot be challenged in insolvency proceedings which may follow StaRUG proceedings. This stands in situations where the StaRUG proceedings end prematurely, i.e., before the restructuring plan is confirmed, support acts such as emergency loans can only be challenged under more difficult conditions or judged to be immoral. These regulations aim to ensure that StaRUG proceedings are generally accepted and not obstructed.

The SanInsFoG also introduces significant legal changes with regard to self-
administration. Whereas it was previously standard practice for well-prepared self-administration proceedings to have a financial plan for at least the period of the preliminary proceedings available at the time the application was filed, this is now also to be found in the law as a requirement for an insolvency application. The new regulation goes beyond this and formulates single requirements for the annexes to be attached to the application for an order for self-administration. For example, self-administration planning must be submitted, which, in addition to a financial plan, must also contain a concept for the implementation of the insolvency proceedings with the aim of self-administration. The concept shall include a description of the measures to be taken for this purpose, a description of the status of negotiations with creditors, a description of the precautions to be taken to ensure compliance with the obligations under insolvency law and a substantiated description of any additional or reduced costs which are likely to be incurred in the course of self-administration as compared to normal proceedings.

Furthermore, the applying company must declare whether and to what extent, it is in arrears with the fulfillment of liabilities arising from employment relationships, pension commitments or the tax debt relationship, vis-à-vis social security institutions or suppliers, whether enforcement or security realization stays have been ordered in the last three years pursuant to the InsO or the StaRUG and whether it has complied with its disclosure obligations pursuant to the German Commercial Code with regard to its annual financial statements in the last three financial years.

Should the applying company be deficient in these mandatory additional disclosures, the appointment of a temporary administrator (and thus the order of temporary self-administration), can only be made if, despite these circumstances, it is to be expected that the applying company is willing and able to align its management with the interests of the creditors. The same applies if self-administration significantly exceeds the costs of regular proceedings and if the financial plan to be submitted shows a liquidity gap. The requirements for self-administration have thus been significantly increased.

Whereas it was previously common practice (following numerous court rulings) for self-administration proceedings to include the possibility of creating debts to the insolvency estate, this has now also been incorporated into the law. At the request of the debtor, the court must order that the requesting company establishes liabilities to the insolvency estate.

Also regulated by law, is a right of the applying company to a preliminary meeting with the insolvency court who is responsible. According to this provision, the applying company has a right to a preliminary meeting, if it meets certain requirements, in order to discuss with the competent judge the issues relevant to the proceedings, in particular the requirements for self-administration, the self-administration plan, the composition of the preliminary creditors' committee, the person of the preliminary administrator, protective orders, and the authorization to create liabilities to the assets involved in the insolvency proceedings. Up to now, this has been handled differently by the individual courts (in the absence of a legal entitlement).

The law is also amended with regard to the obligation to file for insolvency, the resulting payment prohibitions, and the liability of the managing director. If a legal
entity becomes illiquid or over-indebted, the insolvency petition must be filed immediately and without delay. The filing must be submitted no later than three weeks after the occurrence of illiquidity and six weeks after the occurrence of overindebtedness. In the case of over-indebtedness, the period for filing the petition is extended to six weeks. This is intended to provide the petitioning company with the opportunity to bring ongoing restructuring efforts to a successful conclusion or also to prepare for restructuring via insolvency proceedings, for example in the form of self-administration.

The provisions on payment prohibitions in the current law, which are distributed among the company law codifications, are now combined into one general provision, which will henceforth be found in the InsO. At the same time, there is a deviation from the established case law of the German Federal Court of Justice on this subject: payments within the maximum periods do not give rise to liability on the part of the managing directors, if they were necessary to maintain the business operations and as long as the managing directors subject to the application took measures to permanently eliminate the maturity for insolvency or to properly prepare the insolvency application.

AMENDMENTS TO THE COVID-19 INSOLVENCY SUSPENSION ACT (COVINSAG)

After the legislator had already extended at the end of September 2020, the suspension of the insolvency filing obligation until 31 December 2020 for those companies whose over-indebtedness is caused by the consequences of the COVID-19 pandemic, the suspension of the insolvency filing obligation was suspended a further time from 1 January 2021 to 31 January 2021. This suspension applies in the event of an over-indebtedness but also in the event of an illiquidity. This time, however, the suspension will only apply to companies:

1. which submitted an application for financial assistance under state assistance programs to mitigate the consequences of the COVID-19 pandemic in the period from 1 November 2020 to 31 December 2020, or, if such an application could not be submitted within the period for legal or factual reasons, which fall within the group of eligible applicants under the terms of the state assistance program;

2. which have a prospect of obtaining the assistance; and

3. for which the obtainable financial assistance under the state assistance programs is sufficient for the elimination of the insolvency reasons.

Should an organization’s obligation to file for insolvency be suspended between 1 January 2021 and 31 January 2021 hereunder, the statutory exemptions from lender liability and set aside claims for new financings and their collateralization and the exemptions from management liability continue to apply (see COVID-19: Update to the Amendments of the German Insolvency Act)

In connection with the introduction of the StaRUG and the amendments to the Insolvency Code, transitional relief measures have been introduced to mitigate the consequences of the COVID-19 pandemic. In order to demonstrate that a company is
not over-indebted, management is required to provide a liquidity forecast covering the following 12 months, which illustrates that no liquidity shortfall exists. However, if an over-indebtedness is determined to be a result of the COVID-19 pandemic, management may use a shorter period of four months versus 12 months between 1 January 2021 and 31 December 2021.

This is presumed if:

1. the company was not illiquid on 31 December 2019;
2. the company had in its P&L a positive result from its ordinary business activities in the last fiscal year ending before 1 January 2020; and
3. sales from ordinary business activities in calendar year 2020 fell by more than 30 percent compared to the previous year.

In addition, between 1 January 2021 and 31 December 2021, companies may still apply for protective shield proceedings even if illiquidity has already occurred and (whether within or outside of such protective shield proceedings) companies may still apply for self-administration under the old simplified conditions (i.e., without having to submit a financial plan and without the other conditions set out above) if the illiquidity or over-indebtedness of the company is attributable to the COVID-19 pandemic. This is (irrefutably) presumed when the company submits a certificate from a person qualified in insolvency matters (auditors, lawyers, etc.) stating that:

1. the company was neither illiquid nor overindebted on 31 December 2019;
2. the company generated a positive result from ordinary activities in the last financial year ending before 1 January 2020; and
3. sales from ordinary business activities in the 2020 calendar year decreased by more than 30 percent compared with the previous year.

In so far as the requirements set forth in no. 2 or 3 are not satisfied or not satisfied in full, it shall also be sufficient to state in the certificate that, due to special circumstances that are embedded in the company or the industry to which it belongs, or due to other circumstances or conditions, it can nevertheless be assumed that the insolvency is attributable to the COVID-19 pandemic.

Alternatively, insofar as the application of the simplified old conditions for self-administration is concerned, it is also sufficient for the company to clearly state in its insolvency petition that, as of the petition date, it no longer has any liabilities that were due and undisputed on 31 December 2019. Additionally, as far as the application of the protective shield proceedings is concerned, there is no requirement regarding the absence of over-indebtedness as of 31 December 2019.