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Implementation of the EU Directive on Restructuring and Insolvency:¹ A Quick and Effective, thereby Cost-Efficient ‘German Scheme’ in the Aftermath of COVID-19²

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Synopsis

The imminent ‘German Scheme’, driven by the ‘EU-Directive on Insolvency and Restructuring’, overlaps with an ongoing review of the German debtor-in-possession insolvency process dubbed ‘rescue umbrella procedure’. Whilst strong industry voices advocate for a swift and pragmatic implementation of the Directive’s preventive restructuring framework to manage the aftermath of COVID-19, others would like to see (variations of) the ‘rescue umbrella’ steering or even ‘hibernating’ troubled German companies through the crisis. Both options should be available and decided on a case-by-case basis. The article demonstrates that the Directive’s objectives: quick, effective and thereby cost-efficient, can be achieved by underpinning the ‘German Scheme’s’ legal framework with tailored, successive restructuring reviews, building into a modular system. These economic reviews match the Directive’s ‘milestones’, likelihood of insolvency, drafting and negotiation of the restructuring plan and the prospects of the restructuring plan to prevent the debtor’s insolvency; the latter to be reviewed by the court without delay when confirming a voted plan, ideally based on the reviews already available. The authors further propose for the expert providing such reviews to be appointed as PIFOR to best achieve the Directive’s objectives.

I. Introduction, summary

1. Moratorium and cram-down procedure – tools currently missing in the German restructuring kit

Germany has always had a strong and successful pre-insolvency, out-of-court restructuring culture and practice. The Directive’s preventive restructuring framework, once implemented in Germany, will build upon and draw on existing, proven restructuring standards, that have evolved over the past 25 years during macroeconomic challenges such as German reunification, the New Economy crisis, the 2008 financial crisis and now the economic aftermath of COVID-19.

However, German restructurings can prematurely lead to formal insolvency proceedings for the lack of decisive statutory tools, i.e. (a) a moratorium (or instruments to defer individual enforcements) and (b) a cram-down procedure where fair and equitable restructurings, instead of formal insolvency, are achieved even when not all stakeholders unanimously support them. The lack of a cram-down option led to highly publicised cases of German companies restructuring under English Schemes of Arrangement in the London High Court.⁴

2. Discussions on the introduction of a ‘German Scheme’ go back before the EU Commission’s preventive restructuring initiatives

The introduction of a ‘German Scheme’ has long been requested (even before the EU Commission’s

Notes

- 1 EU Directive 2019/1023 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); in the following ‘Directive’.
- 2 This article is based on an article published on 29 April 2020 in INDat Report, www.indat-report.de, a German journal for restructuring and insolvency.
- 3 Both authors are independent experts in the German Ministry of Justice and for Consumer Protection, Bundesministerium der Justiz und für Verbraucherschutz (BMJV) hearings on the implementation of the Directive.
- 4 These English schemes for German companies span over more than the past ten years, prominent examples were e.g. Apcoa or Rodenstock. For an exhaustive compilation and analysis of such cases see Sax/Swierczok in Flöther/Madaus, Sanierungsrecht, p. 333 ff.

2014 recommendation on preventive restructuring or the Commission's subsequent Capital Markets Union Action Plan of 2015) by German restructuring professionals and has also been under discussion on Government level,⁵ prompted by the abovementioned English schemes for German companies. However, in 2012, when the last major German insolvency reform dubbed 'ESUG' came into force, the legislator introduced not a scheme-type procedure but what was dubbed 'rescue umbrella procedure', Schutzschirmverfahren, a variation of debtor-in-possession, Eigenverwaltung, i.e. a formal insolvency process. The 'rescue umbrella' incentivises the submission of a restructuring plan within a statutory time frame of 3 months and can only be commenced at the request of the debtor who can choose the office-holder (with mere supervisory powers for the office-holder). The 'rescue umbrella' requires the debtor to present a restructuring expert's report to the court confirming that the company is (a) still able to pay its liabilities as and when due but is either balance sheet insolvent or threatened with imminent insolvency; and (b) that the intended rescue does not manifestly lack prospects of success, Sec. 270b para. 1 subs. 3 Insolvency Code (Insolvenzordnung, InsO). 'Rescue umbrellas' have seen considerable use since the onset of the COVID-19 crisis, especially in the hospitality, tourism and retail sectors. Voices in the insolvency and restructuring practice, mostly insolvency practitioners and academics would now like to see (variations of) the Sec. 270b InsO rescue umbrella being used for steering or even 'hibernating'⁶ troubled German companies through the worst of the COVID-19 crisis. One of many ancillary suggestions would be to increase the maximum period of insolvency salaries and wages funding from currently 3 months to 6 months.⁷ It will have to be seen whether the ongoing law reform discussions will lead to a short-/medium-term 'renaissance' of rescue umbrella procedures or whether German professionals will also want to restructure through a lean, new preventive procedure as soon as possible. Ideally, both options should be available, with stakeholders taking decisions on a case-by-case basis.

3. Implementation of Directive overlapping with forthcoming German insolvency law reforms (following Government 'ESUG' review) and Government's coalition treaty requesting for insolvency practitioners to be regulated

The implementation of the Directive (with a deadline of 17 July 2021 that could be extended by one year, Art. 34 para. 1 and para. 2 Directive) is not the only insolvency/restructuring topic on the German legislator's agenda. 'ESUG' was reviewed by a group of academics at the request of the Government, namely the Federal Ministry of Justice and Consumer Protection, BMJV, the results were published in 2018⁸ and the resulting reform issues will overlap with the introduction of the Directive's new preventive restructuring tool. Another topic that may have an impact on the implementation of the Directive (or vice versa) is that the coalition treaty, Koalitionsvertrag, of the current German Government proposes that German insolvency practitioners should be regulated (this potentially intertwining with Art. 26 and Art. 27 of the Directive).

4. Cherry-picking and a modular system of expert restructuring reviews for a swift, effective and cost-efficient German preventive restructuring framework

Germany was not the only EU jurisdiction that saw English Scheme 'migrations', another example were the Netherlands, where a 'Dutch Scheme' is now about to come into force.⁹ The evolution of this 'Dutch Scheme' – which, *inter alia*, combines elements of both a UK Scheme (cram-down) and a Chapter 11 (moratorium) and uses minimal court involvement – was very closely monitored by the German restructuring practice, with much debate on whether, with the London High Court route being unavailable post Brexit, German restructurings would then move to the Netherlands in the absence of a competitive German tool.

In this article the authors demonstrate how the Directive's objectives, i.e.: quick, effective and thereby cost-efficient, can be achieved by underpinning the legal framework of the 'German Scheme' with restructuring

Notes

- 5 See e.g. the 2008 conference held jointly by the Ministry of Economics, Bundeswirtschaftsministerium, and the Federal Ministry of Justice and Consumer Protection, BMJV: 'Sanierung im Vorfeld von Insolvenzverfahren'. For summaries of the conference talks see: Paulus et al., Sanierung im Vorfeld von Insolvenzverfahren – Vorträge der gemeinsamen Tagung des BMWi und des BMJ -, WM 2010, 1337.
- 6 See e.g. 'Die Jungen Unternehmer'/'Mittelstands- und Wirtschaftsunion (MIT)', https://www.junge-unternehmer.eu/fileadmin/junge-unternehmer/kommunikation/pressemitteilungen/200610_Forderungen_Insolvenzrecht.pdf, MIT equally advocates for a swift preventive restructuring framework implementation. The term/concept 'Hibernation' for (small) businesses was coined in a Conference on European Restructuring and Insolvency Law (CERIL) executive statement of 20 March 2020, <https://www.ceril.eu/news/ceril-statement-2020-1>.
- 7 See e.g. statement of 'Gravenbrucher Kreis', an association of leading insolvency practitioners, www.gravenbrucher-kreis.de/2020/03/23/gravenbrucher-kreis-nimmt-stellung-zum-gesetzentwurf-zur-abmilderung-der-folgen-der-covid-19-pandemie/.
- 8 www.bmjv.de/SharedDocs/Artikel/DE/2018/101018_Bericht_ESUG.html?jsessionid=B8F53D7E4A60B1FCEB8756D0BDD85E46.2_cid334.
- 9 Amendment to the Bankruptcy Act to make provision for court confirmation of private plans (Act on the Confirmation of Private Plans), Kamerstukken I, 35 249, nr. A; for an English translation see <https://resor.nl/wp-content/uploads/2020/05/English-Translation-Bill-on-New-Dutch-Scheme.pdf>.

reviews, and in the process building upon each other into a modular system. These restructuring reviews derive from the tried and tested, high standards developed by German restructuring experts over the past 25 years. The proposed modules are tailored to the ‘milestones’ the Directive prescribes for a preventive restructuring, i.e. (a) ‘likelihood of insolvency’, the entry threshold to access the framework, (b) ‘drafting and negotiation of the restructuring plan’ and (c) the ‘prospects of success of the restructuring plan to prevent the debtor’s insolvency, assessment of ‘viability’ in the context of a court confirming a voted restructuring plan.

5. Minimal involvement of the court

Defining the German courts’ role in the process will be crucial for the preventive restructuring tool’s success, not only because it will be completely new to the German restructuring arsenal but also because it will be heavily dependent on economic in addition to (formal) legal considerations. For this reason, the role of the courts has been a focal point of discussion ever since a German preventive restructuring tool was discussed, even before the EU Commission’s respective initiative.

The performance of German insolvency courts and insolvency practitioners in administering formal insolvency procedures currently ranks 4th worldwide, see the annual World Bank study ‘Doing Business’.¹⁰ To maintain the same high standard for the new preventive restructuring tool, it has been widely suggested by German restructuring experts and academia¹¹ that designated courts should be introduced, ideally at the level of Higher Regional Courts,¹² with specialised judges also trained in the economic aspects of preventive restructuring. However, specialisation requires time which is not available in the COVID-19 aftermath. This is one of the reasons why this article sets out how the modular economic expert reviews prepared in the preventive restructuring process and on which the restructuring plan is based could be used directly by the court. For courts ‘to be comfortable’ with such expert reviews the authors also suggest the optional

appointment of the expert preparing them as the Directive’s professional in the field of restructuring, ‘PIFOR’.

6. First experiences with KfW coronavirus aid loans, drawing lessons for a ‘German Scheme’

The article also describes how initial experience with the administration of the German ‘KfW-Coronavirus aid loans for companies’¹³ can be directly applied to economic aspects of the imminent ‘German Scheme’. The economic effects of the COVID-19 crisis present unprecedented challenges to the German restructuring market, which will place a heavy burden on the resources of the judiciary, advisers and office holders in the short to medium term. The preventive restructuring framework set out by the Directive should therefore be implemented swiftly and pragmatically into German law and, as set out above, with as lean a process as possible, especially with regard to court involvement.

II. COVID-19 challenges to the German restructuring practice, calls for a quick and pragmatic implementation of the Directive’s preventive restructuring framework

1. Short, medium and long-term knock-on effects of the German Government’s ‘coronavirus aids’ on the restructuring and insolvency practice

To mitigate the economic effects of the COVID-19 pandemic, German Government has responded with a wide range of measures, a combination of, *inter alia*, adjustments to existing laws¹⁴ such as suspending the statutory German insolvency filing requirements until 30 September 2020, direct Government cash contributions and loans given or guaranteed by KfW.¹⁵ At the time this article went to press, KfW had received applications in relation to ‘coronavirus aid loans’ in the amount of EUR 48.850 million from companies that got into financial difficulties as a result of the COVID-19 crisis.¹⁶ Although these loans have maturities of up to

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10 www.doingbusiness.org/en/data/exploreeconomies/germany#.

11 See e.g. statement of ‘Gravenbrucher Kreis’, an association of leading German insolvency practitioners; www.gravenbrucher-kreis.de/2019/07/04/gravenbrucher-kreis-begrüßt-weitere-fachliche-spezialisierung-von-gerichten-in-insolvenz-und-restrukturierungssachen/.

12 Germany currently has more than 180 courts dealing with insolvency matters (‘Insolvenzgerichte’), whose local jurisdiction corresponds with the registered seat or ‘COMI’ of the debtor. Insolvenzgerichte are designated divisions of local courts (‘Amtsgerichte’).

13 KfW: The German Bank for Reconstruction, Kreditanstalt für Wiederaufbau, www.kfw.de/kfw.de-2.html.

14 ‘Act on Mitigation of the Consequences of the COVID 19 Pandemic in Civil, Insolvency and Criminal Procedure Law’ of 27 March 2020, ‘Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht’. An English convenience translation of this Act is provided by the German Ministry of Justice and for Consumer Protection (BMJV): www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/Dokumente/Bgbl_Corona-Pandemie_EN.pdf;jsessionid=5F7FADA6B8BC4C56F5B8634D711B BE23.1_cid297?__blob=publicationFile&v=2.

15 For a summary of all such COVID-19 measures see: Schiebe/Zenker, Germany, in: INSOL International/World Bank Group, Global Guide: Measures adopted to support distressed businesses through the COVID-19 crisis, 2020, www.insol.org/library/opendownload/1604.

16 www.kfw.de/KfW-Konzern/Newsroom/Aktuelles/KfW-Corona-Hilfe-2.html, also available in English.

ten years, they lead to additional debt service burdens and to higher debt ratios for COVID-19 troubled companies, where new borrowings are added to existing financing. Unlike consumer loan agreements, the 'Act on Mitigation of the Consequences of the COVID 19 Pandemic in Civil, Insolvency and Criminal Procedure Law' of 27 March 2020¹⁷ does not (yet¹⁸) affect the enforceability of existing corporate loans.

2. Majority of COVID-19-troubled German companies neither 'market exit candidates' nor 'zombie companies' earmarked for formal insolvency procedures

From today's perspective, these COVID-19 troubled companies, which would be viable in 'normal circumstances', are exposed to forward looking factors that are difficult to quantify such as when there will be a return to domestic economic normality and the speed of recovery of the world markets – key issues being international supply chains and the German economy's strong export dependency. Many of these companies which are 'healthy in normal circumstances' may therefore not be able to achieve a complete return to normality in the short term despite – or tragically also because of – current Government support, although they will be successful with their business models in the medium and longer term. Such companies are neither the 'market exit candidates' nor so-called zombie companies (having survived on little to no capital expenditure in recent years) for which insolvency proceedings would be or have been long ago the appropriate remedy, nor should they be hastily restructured with the very effective, but in the circumstances too sharp tools of German insolvency law. Statutory insolvency tools can result in substantial collateral damage. The costs of interim funding of salaries and wages, Insolvenzzgeld, and for the Pension Security Fund, Pensionssicherungsverein, are borne by viable, non-insolvent German companies. These contributions could be disproportionately increased by an inappropriate rise in (large) insolvencies – an effect last seen in the massive 2009 Karstadt/Quelle insolvency. Shareholders, employees and contractual partners would be also penalised for the force majeure which is COVID-19: shareholders by inter alia the subordination in the waterfall of regular insolvency

proceedings and employees or contractual partners by the exercise of special short-notice termination rights by the office holder. For these companies – in need of restructuring, but not (yet) candidates for the sharp instruments of insolvency proceedings – the appropriate statutory restructuring instrument is currently still lacking where consensual solutions cannot be reached.

3. Calls for rapid and pragmatic introduction of the Directive's preventive restructuring framework into German Law

As a consequence of the economic COVID-19 effects, strong voices in the German restructuring industry and academia are therefore calling for the preventive restructuring framework of the Directive to be implemented into German law 'swiftly and pragmatically'.¹⁹ 'Swift' implementation should be doable for the German legislator. BMJV, the Ministry responsible at Government level for the respective draft law, had already invited representatives of the German restructuring and insolvency practice (such as representatives of insolvency practitioners' and restructuring advisers' professional bodies and organisations; independent experts, judges, academics and union representatives) and other interested parties to a hearing in Berlin on 19 March 2020 to present and discuss the status of its implementation work on the preventive restructuring framework. The meeting was cancelled as the COVID-19 pandemic spread. 'Pragmatism' is likely to be the order of the day. Both swiftness and pragmatism have been displayed throughout by both the German Government and Parliament from the outset of fighting the economic impacts of the COVID-19. On 3 June 2020 the German Government coalition partners' committee agreed on a comprehensive economic stimulus and crisis management package, including the introduction of a preventive corporate restructuring framework '*vorinsolvenzliches Restrukturierungsverfahren*'.²⁰

Notes

17 See footnote 14.

18 Art. 240 sec. 3 Abs. 8 EGBGB authorises the Federal Government to include (in particular) micro-enterprises in the scope of the COVID-19 pandemic regulations.

19 See statements Gesellschaft für Restrukturierung – TMA Deutschland e. V. of 13.03. and 18.03.2020; Stephan Madaus (www.stephanmadaus.de/2020/04/04/covid-19-massnahmen-weltweit-ein-ueberblick/), published 04.04.2020; Deutscher Industrie und Handelskammertag (DIHK): Restrukturierungsrichtlinie kann in der Corona-Krise helfen, <https://www.dihk.de/de/aktuelles-und-presse/presseinformationen/unternehmen-sanieren-insolvenzen-vermeiden--24830>.

20 See coalition committee (Koalitionsausschuss) results paper of 3 June 2020 'Corona-Folgen bekämpfen, Wohlstand sichern, Zukunftsfähigkeit stärken' (Combating corona effects, securing prosperity, strengthening sustainability) of 3 June 2020 page 3, point 9, https://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Schlaglichter/Konjunkturpaket/2020-06-03-eckpunktepapier.pdf?__blob=publicationFile&v=8.

III. Expert economic restructuring reviews to be used as building block modules underpinning the preventive restructuring framework

1. Module 1: Likelihood of insolvency

1.1 Definition

'Likelihood of insolvency' Art. 1(1)(a) Directive, is an 'entry control', threshold into the preventive restructuring framework. According to the wording of the Directive, the preventive restructuring framework should be 'available for debtors in financial difficulties when there is a likelihood of insolvency, with a view to preventing the insolvency and ensuring the viability of the debtor' (Article 1(1)(a), Article 4(1) Directive). The Directive leaves the definition of 'likelihood of insolvency' to the national legislators, Article 2(2)(b) of the Directive, with the caveat however that the debtor has not yet become insolvent (recital 24 of the Directive) to prevent misuse.

There is an abundance of suggestions for how this 'likelihood of insolvency' should be defined under German law. The obvious choice would be to use an existing legal concept, i.e. the definition of 'imminent insolvency', sec. 18 InsO, a statutory provision based on which management may file for insolvency, i.e. where filing for insolvency and its restructuring tools is an option for management of a troubled company. The two mandatory statutory filing requirements where management must file for insolvency without undue delay, and at the latest within 3 weeks, are: inability to pay debts as and when due, Sec. 17 InsO and balance sheet insolvency, Sec. 19 InsO. The test for balance sheet insolvency involves a prognostic element regarding the company's likelihood of continuing viability until the end of the next financial (calendar) year, i.e. for max. the next two years. Since 2015 and during the Directive's evolution one of its most discussed aspects from a German perspective was that in German restructurings the Directive's prerequisite 'likelihood of insolvency' would always trigger the balance sheet insolvency filing requirement, thereby ruling out preventive restructuring from the start as the prognostic element of viability would lapse – a Catch-22 situation.²¹ The simplest way of course to solve this problem would be to abolish completely balance sheet insolvency, something that has been heatedly discussed and widely demanded in the German insolvency/restructuring industry even before the Directive's evolution started.

Views on abolishing the test have changed over the past 2 years, with voices that had always advocated maintaining balance sheet insolvency continuing to do so adamantly,²² others following suit or suggesting new approaches. A constructive and thoroughly pragmatic approach would be to support restructurings with a reasonable chance of success by adjusting the current defined prognostic time period required for ruling out balance sheet insolvency to a flexible 'survival prognosis', thereby 'emancipating' likelihood of insolvency from balance sheet insolvency.²³ In this way the prospects of viability when defining likelihood of insolvency could be ignored and instead focus only on liquidity planning. If and when necessary, the forecast period for the liquidity planning could be adjusted. At the same time, the prognosis for viability would of course continue to be positive if it can be assumed that the restructuring will be successful.

1.2 Avoidance of abuse and 'coronavirus aid' parallels

The early determination of 'likelihood of insolvency', which can also be tested in court, is key to prevent abuse of the preventive restructuring framework, i.e. 'healthy debtors' must not encroach on the constitutionally guaranteed property rights of creditors and/or shareholders. A parallel assessment, albeit of course in the opposite direction, can currently be found in the case of 'coronavirus aid', which is only to be granted to those who are demonstrably economically affected by the COVID-19 pandemic or at risk of insolvency and for whom there are reasonable prospects of overcoming the crisis triggered by the COVID-19 pandemic. Economic third-party support – whether from the state or from creditors – must always be justified.

1.3 Levels of proof for 'likelihood of insolvency' and required expert reviews

Here, too, parallels can be drawn to the KfW 'coronavirus aids' and their viability test (under 'reversed sign'). Banks are granting KfW guaranteed loans based on documented proof including that future competitive operating profitability can be achieved on the basis of historical profitability and on the basis that in principle the business model is viable. These tests are designed to prevent abuse.

From the outset KfW coronavirus aids loan application documentation to assess eligibility could be completed quickly (approx. one to two weeks) and

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21 Andersch/Philipp, 'Damoklesschwert Insolvenzverschleppung – Nachweis der positiven Fortbestehensprognose noch vor Finalisierung des Sanierungskonzepts', NZI 2017, 782, 784.

22 Steffan/Poppe in INDat Report 07_2019, S. 32.

23 See e.g. Moritz Brinkmann, 'Die Antragspflicht bei Überschuldung', in Ebke/Seagon/Piekenbrock (Hrsg.): Überschuldung: Quo vadis?, S. 73; or Lars Westpfahl in 'Wesentliche Elemente eines vorinsolvenzlichen Sanierungsregimes für Deutschland', ZRI 4/2020, S. 166.

with rather limited expenditure for all parties involved. The necessary assessment and ‘prognostic yardstick’ is both far removed from mere ‘good feeling’ that could of course not serve as proof in court and from a fully comprehensive expert review complying with both the Institut der Wirtschaftsprüfer in Deutschland e.V. (IDW) ‘Standard IDW S 6’²⁴ and the related minimum case law requirements by the German Federal Court of Justice, Bundesgerichtshof (BGH).²⁵ The ‘prognosis yardstick’ is based on the plausible substantiation (i.e. quickly understandable for third parties within reasonable time) of the (practical) prospects of recovery. This approach (adjusted on a case-by-case basis) can be developed and prepared at pace and thus at minimum cost, and as with the the ‘rescue umbrella’ expert review confirming likely viability²⁶ confirmation, can be verified ex post by the court without additional work incurred and is dubbed ‘IDW S-6-Light Approach’ or step-by-step model.

2. Module 2: The drafting and negotiation of the restructuring plan

2.1 The core of the restructuring plan

The restructuring plan, Art. 8 of the Directive, will be the core of the preventive framework. It must set out in a logical and understandable way why the restructuring plan has a reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business, including the necessary pre-conditions for the success of the plan. The restructuring plan must provide for a statement of reasons to this extent. Member States when implementing the Directive can request for the statement of reasons to be provided or validated either by an external expert or by the PIFOR if appointed (Art. 8 para. 1 lit. h).

2.2 Use and further development the high IDW standards for a ‘German Scheme’

The above substantive requirements of the Directive’s restructuring plan are almost identical to those of the established IDW S 2 standard,²⁷ which includes a restructuring concept in accordance with an IDW S 6 standard and additional prerequisites for group situations, for the ‘best-interest-of-creditors-test’ and which sets out the economic and legal implications of restructuring measures. IDW standards have evolved into tried and tested practice standards used throughout the German restructuring practise, have the ‘seal of approval’ of the Federal High Court, BGH, and could be easily adjusted to the new preventive restructuring tool.

2.3 Content of the restructuring plan

The required contents of the restructuring plan also follow the logical considerations that must always be taken into account when drawing up a restructuring plan, in particular the mapping of future cash flows in an integrated business plan (Art. 8 para. 1 lit. Directive), in order to provide a basis for decision-making, especially for the banks who are parties to the restructuring. Whenever German banks are involved as creditors, the drafting of economic restructuring expert reviews, then called ‘Sanierungsgutachten’, are typically required and will have to comply with special regulatory requirements:

- In accordance with the BaFin (Federal Financial Supervisory Authority) MaRisk requirements BTO 1.2.5,²⁸ credit institutions must have a restructuring concept submitted to them if they want to support the restructuring of a crisis company, and
- the European Banking Authority definition²⁹ of borrower default and the ECB regulations on

Notes

- 24 The Institut der Wirtschaftsprüfer in Deutschland e.V. [Institute of Public Auditors in Germany, Incorporated Association] (IDW) is not a ‘recognised professional body’ or institute of of chartered accountants, but a privately run organisation established to serve the interests of its members who comprise both individual Wirtschaftsprüfer [German Public Auditors] and Wirtschaftsprüfungsgesellschaften [German Public Audit firms]. IDW Standards (IDW S) contain requirements relevant to services provided by German public auditors other than in respect of audit engagements and accounting matters, which are covered by *IDW Auditing Standards* and *IDW Accounting Principles*, respectively. Examples for IDW Standards would be services provided in insolvency and restructuring with the most relevant being IDW S6, the requirements of an expert restructuring opinions, Sanierungsgutachten, or IDW S2, For further details see IDW’s website (also available in English) www.idw.de.
- 25 The BGH tests compliance with IDW S6 and thereby (indirectly) also defines IDW S6 prerequisites when ruling e.g. on directors’ or advisers’ liabilities for non-compliance with insolvency filing requirements. For details see Andersch/Philipp, Anforderungen an die Erstellung von Sanierungskonzepten – Erste praktische Erfahrungen mit dem neuen Standard IDW S6, Corporate Finance law, 3/2010.
- 26 See I. 2 above.
- 27 The IDW S 2 standard describes the essential requirements of an insolvency plan as set by the Institute of Chartered accountants in Germany. IDW S 2 sets out objectives, types and regulatory background of insolvency plans, procedural prerequisites and timeline pursuant to the German Insolvency Code as well as their recommended structure.
- 28 MaRisk, Annex 1: Annotated text of the Minimum Requirements for Risk Management (MaRisk), Requirements relating to the organisational and operational structure, BTO 1.2.5 Treatment of problem loans, no. 1 and 3.
- 29 See ECB, Addendum to the ECB Guidance to banks on non-performing loans: supervisory expectations for prudential provisioning of non-performing exposures, March 2018, retrievable under www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.npl_addendum_201803_en.pdf (download as at 18 June 2020).

non-performing loans (NPLs) require, in very simple terms, for banks to be able to assess the degree of default risk of credit exposures. Ultimately, this also requires a sound restructuring concept, but at least in the first step a resilient, ideally externally confirmed liquidity planning.

2.4 Time frame

Experience shows that at least three months are required to come up with a useful basis for initial decisions and negotiations, and in the case of particularly complex situations without preparatory work provided by the company and with a lack of data, up to four months. Restructuring expert reviews should therefore be provided by experienced and recognized restructuring professionals, especially in the case of more complex companies and financing structures, in order to ensure the necessary speed whilst fully covering all legally defined minimum contents.

3. Module 3: Prospects of success of the restructuring plan to prevent the debtor's insolvency; assessment of viability

3.1 The prospects of a successful rescue in the restructuring plan

The restructuring plan, when submitted to the court for confirmation, must contain a statement that there is a 'reasonable prospect of preventing the insolvency of the debtor and ensuring the viability of the business' (Art. 8 No. 1 lit. h Directive). The prerequisites of this statements are already requested by the German Federal High Court, BGH, for a conclusive restructuring concept and are also included in the substantive IDW Standard S 6 requirements on comprehensive restructuring concepts. A restructuring plan will only receive the necessary majority voting approval for its implementation if the review prepared by the restructuring expert assesses that the outcome of the company's restructuring is likely to be positive – with a predominant probability and thus unconditionally.

3.2 Viability test

The 'reasonable prospect' is covered in the statement on the ability of the company to restructure in so far as, in addition to a positive prognosis of its viability under insolvency law, it reflects a thorough restructuring of the company, i.e. the restoration of the company's profitability as a prerequisite for sustainable competitiveness. The underlying restructuring concept fully defines the corporate structure on which the plan is based and thus covers the viability review required by the Directive. The expert restructuring review defines

the future shape of the company and 'fills in the gaps' in the hitherto unclear concept of what the future shape of the company to be restructured will be.

4. Cost-efficiency of a modular system of economic expert reviews

The modules just described under 1. to 3., i.e. the economic restructuring reviews building blocks used in the preventive restructuring framework, build on each other – increasingly in their scope. They do so from the outset of the restructuring and result in a step-by-step model in which the liquidity and corporate planning is successively expanded into a comprehensive restructuring plan that meets all legal requirements and information needs by the parties involved. In the interest of cost-efficiency of the preventive framework, this step-by-step approach avoids the creation of unnecessary documents if the preparations and negotiations fail or if they are broken off before a restructuring plan is adopted.

IV. Involvement of the court

1. When should 'likelihood of insolvency' be examined

According to the Directive, the preventive restructuring framework to achieve the two central objectives of swiftness and efficiency should be a flexible procedure, with judicial involvement to be limited to what is necessary and proportionate (Recital 29 of the Directive). The Directive does not necessarily provide for a formal judicial procedure from the outset, i.e. a formal process with a judicial entry threshold. It will be sufficient to involve the court only where the Directive requests such involvement, i.e. in particular for the ordering of a moratorium or individual protection against execution; the appointment of the PIFOR in certain circumstances and confirmation of the adopted restructuring plan in the cases provided for this purpose (Art. 10 of the Directive). This gives the German legislator the possibility – and it is to be hoped that she makes use of this – to achieve a swift and effective procedure. Particularly 'likelihood of insolvency' should be tested in court only if and when the court is approached, i.e. at the very latest when the restructuring plan is confirmed by the court, not at the outset of a formal process. If a likelihood of insolvency test were to be the 'entry test' for a formal process to be reviewed by the court this would slow down the process (and undoubtedly also make it public). When reviewing likelihood of insolvency at a later stage, the court should be allowed or even required to rely on the review of the restructuring expert (see below).

2. In practice restructuring plans will always be reviewed in court as part of confirming the plan

According to the Directive, the restructuring plan adopted by the required majority must be confirmed by the court if the restructuring plan impairs dissenting parties, if the restructuring plan provides for new financing or results in the loss of more than 25% of jobs (Art. 10(1) of the Directive). In practice restructuring plans will therefore almost always have to be confirmed by the courts since they will regularly provide for new financing and since the preventive restructuring tool will only be used if it becomes apparent that a consensual solution cannot be achieved, i.e. if opposing (impaired) creditors are to be out-voted. The court then will not only examine compliance with formal criteria, but also economic aspects, as the court ‘may refuse to confirm a restructuring plan if there is no reasonable prospect that the plan would prevent the insolvency of the debtor or ensure the viability of the enterprise’ (Art. 10 para. 3 of the Directive, for the substantive requirements see II.3. above).

3. The court examining economic considerations and calculations

3.1 Avoiding timing uncertainties

So the court will have to consider the same economic assessments and calculations which had already been made by economic experts in the weeks and months of the preparation and negotiation of the plan prior to the court’s considerations. In typical German restructurings, a time-consuming (and costly) expert opinion obtained by the court at this point in time (bearing in mind that the process pruning up to the successful vote on the plan will typically already have taken three months) will disrupt the restructuring success achieved by the majority of creditors (shareholders), may jeopardise it or even cause it to fail. Most importantly banks will only make necessary internal decisions deriving from the agreed restructuring plan and, above all, will only make further funds available to the company once the court has confirmed the restructuring plan.

3.2 Also the Directive seeks to avoid a timing vacuum

The above is also recognized by the Directive (Art. 10 (4) of the Directive, Recital 29): the German legislator must ensure that the decision of the court confirming the restructuring plan as binding ‘is taken in an efficient manner with a view to expeditious treatment of the matter’ and that the involvement of the court is limited to ‘what is necessary and appropriate’. It is

therefore particularly appropriate for Germany (not yet having the infrastructure of designated preventive restructuring courts or judges and expecting a tidal wave of COVID-19 workload) to allow the courts to use the restructuring documentation leading to the restructuring plan as a neutral basis for their decisions. To this extent, restructuring expert reviews must be geared to such later use from the outset, so that the court can dispense with the involvement of a further expert opinion.

V. Using the modular restructuring reviews as a basis for the court’s decision

1. Minimum requirements regarding the suitability and neutrality of the restructuring expert

The use of the expert restructuring reviews as a basis for a decision by the court requires the suitability of the expert and her neutrality in addition to the clear definition of the necessary minimum requirements of the restructuring review. These aspects must be presented in a way that is transparent and plausible for the court. Therefore, the professional prerequisites for the expert should be defined by law – e.g. in accordance with section 270 b (1) InsO,³⁰ i.e. ‘a tax advisor, auditor or lawyer or a person with comparable qualifications’; or perhaps ‘an expert experienced in corporate restructuring’ – and assured by the expert in his expert review(s). The same applies to the neutrality of the restructuring expert reviews: The restructuring review should contain a legally binding statement by the expert to the extent that (1) the documentation has been prepared by an objective third party, (2) the restructuring concept does not unduly prefer/disadvantage any of the creditors and (3) the expert considers a return to viability through the assumptions made and thereby the success of the restructuring to be predominantly probable.

2. Practice checklists

On the basis of these mandatory key points, the court can then decide without delay whether the formal minimum requirements and the confirmation with regard to neutrality and suitability of the restructuring expert are met. At present, the German restructuring practice (especially work out units at banks) already uses checklists for internal quality control in order to check whether such minimum contents are contained in the restructuring expert’s opinion. Such checklists are based on the minimum requirements set out by the Federal Court of Justice, BGH, so this approach can be easily used by courts.

Notes

³⁰ See above I. 2, sec. 270b InsO, the ‘rescue umbrella’.

3. Liability of the restructuring expert as an additional corrective

Expert opinions used by the court will typically be contested by crammed down creditors or by stakeholders unhappy with valuations. A further corrective to ensure a restructuring expert's professionalism and neutrality is the expert's civil and criminal liability for culpably false confirmation of his suitability and neutrality. Although German restructuring experts who provide economic restructuring reviews, namely the essential IDW expert reviews, 'S6 Gutachten',³¹ are very often regulated professionals (lawyers or accountants) this is not always the case, i.e. many of Germany's top professionals in the field of restructuring are not regulated by professional bodies. Here courts will seek an 'equivalent' to such regulation and where liability could prove the necessary corrective. Such liability is – if necessary – verifiable in a separate court proceeding without blocking the restructuring process. Such safeguarding – ultimately vis-à-vis the court – should already result from § 311 para. 3 German Civil Code (BGB) and could be explicitly introduced for preventive restructuring, combined, if necessary, with limitation language analogous to § 323 para. 2 German Commercial Code (HGB).

VI. The restructuring expert in the role of the Professional in the Field of Restructuring (PIFOR)?

1. The Directive no longer defines profiles of the PIFOR exhaustively

The Directive defines the PIFOR to be appointed by the court as a person (or body) who, in particular, performs one or more of the following tasks: (a) assisting the debtor or creditors in the preparation or negotiation of a restructuring plan; (b) monitoring the debtor's activities during the negotiations on a restructuring plan and reporting to a judicial or administrative authority; (c) taking partial control of the debtor's assets or transactions during the negotiations (Art. 2 para. 1 (12) of the Directive).³² This list of profiles is – unlike in the previous draft versions of the Directive – no longer exhaustive, in particular due to the insertion of the wording 'in particular'. Therefore, preparing economic restructuring expert reviews could also be regarded (part of) the profile of a PIFOR and enable the court

– who may later want to base its decisions on same expert reviews – to (co-)decide on the expert at an early stage and to appoint the expert as PIFOR with, in a typical scenario, the same expert also assisting (time- and cost-efficiently) on the drafting and negotiating of the restructuring plan.

2. Restructuring experts have always assumed the role of the moderator and mediator in restructuring processes

Successful restructuring processes are based not only on the preparation and presentation of convincing plans, but often also on the moderation and mediation of the restructuring expert, who uses her special position of trust as well as neutrality and detailed knowledge of the financial and performance-related possibilities of the company to achieve solutions for the conflicting interest groups.

For a future 'German Scheme', especially in larger and complex proceedings, restructuring experts will be regularly called in to provide economic restructuring expert reviews, namely 'IDW S6 Gutachten',³³ if only because banks require them to comply with the BaFin (Federal Financial Supervisory Authority) MaRisk³⁴ requirements. With regard to the 'content of restructuring plans', the Directive stipulates that the plan must contain a justification of the prospects of avoiding insolvency and of the ability to continue as a going concern, including the necessary conditions for the success of the plan³⁵ the Directive allows for this justification to be submitted or confirmed either 'by an external expert' or by the restructuring officer, if one is appointed.

3. Remuneration of the PIFOR, cost and profile/role considerations

Where the PIFOR appointed by the court to assist the debtor or creditors in drawing up or negotiating a restructuring plan also instructs an external expert to produce the economic restructuring expert reviews (and in practice this will happen regularly), this will result in additional costs. Costs are synergistically reduced if the PIFOR and the restructuring expert providing the expert reviews are (partly) identical, performing (partly) identical tasks.

Notes

31 For IDW S6 see III. 1.3 above.

32 For an analysis and innovative suggestions on how the typical profiles of German restructuring experts / insolvency practitioners can be matched to the PIFOR profiles see Fritz in 'Neue Zeitschrift für Insolvenzrecht' (NZI), 2020, p. 49 ff.

33 For IDW S6 see III. 1.3 above.

34 For MaRisk see footnote 27.

35 For details of the business management requirements see III.2. above.

Of the Directive's PIFOR profiles³⁶ German restructuring experts specialising in providing economic restructuring expert reviews, 'Sanierungsgutachter', will typically not (not want to) assume the monitoring and controlling role, in particular not take (partial) control over the debtor's assets or business: in the German insolvency and restructuring market this will be a task typically performed by insolvency practitioners.

The Directive indirectly provides guidance on the fees of the PIFOR in Art. 5 para. 3 lit. c. Only if the majority of creditors apply for the appointment of the PIFOR, will the creditors bear the costs. Alternatively, the costs of the restructuring agent appointed by the court upon debtor's application or ex officio – irrespective of his profile – are borne by the debtor, as is already the case in the restructuring reports requested by banks.

VII. Conclusion

'We will prevent economically sound companies from going bankrupt' said Federal Minister of Economics Peter Altmaier on 13.03.2020 at the outset of the Government COVID-19 aids programme.³⁷ The Minister's statement should become a motto for the German restructuring and insolvency practice: viable companies in need of restructuring should neither in the present extraordinary COVID-19 circumstances nor 'under normal circumstances' be put into insolvency prematurely. Although German insolvency law and

and practice can facilitate very effective and successful restructurings, its tools (e.g. short-term statutory contractual termination rights; insolvency wage funding and Pension Trust contributions borne jointly by – solvent – German companies as a whole) are rigid, the collateral damage caused can be considerable and – in these existential COVID-19 times, with normally healthy companies experiencing exogenic problems – put disproportionate burdens on solvent German companies. It also gives restructured (formerly insolvent) companies, who 'cleared their balance sheets' through insolvency, unfair advantages over their 'supportive' competitors who have borne the collectivised costs. Germany has a successful restructuring practise, however it still depends on 100 % consensus, i.e. lacks a cram-down option and a moratorium (or remedy against individual enforcement). These options should now be quickly introduced as a lean procedure via the implementation of the Directive's preventive restructuring framework. Where creditors' rights are impaired by a cram-down or otherwise in a preventive restructuring, it is essential under German rule of law that the courts must be involved, however this should be limited to a minimum. To this extent, this article suggests the courts should base *inter alia* their fairness assessment of a restructuring plan on the modular expert restructuring reviews s prepared in the course of the restructuring. Such expert reviews must be prepared by recognized experts and they must be neutral, which could also be facilitated by the court appointing the same expert providing the expert reviews as PIFOR.

Notes

³⁶ For these see VI 1. above.

³⁷ www.spiegel.de/politik/deutschland/peter-altmaier-cdu-werden-verhindern-dass-wirtschaftlich-gesunde-unternehmen-in-die-insolvenz-geraten-a-00000000-0002-0001-0000-000169988523.