

// **Business restructuring through insolvency proceedings**

A brief overview of:

- the application**
- the conditions**
- the procedure and its role for the German insolvency law**

Dr. Maximilian Krah
Dr. Torsten Voß

// Introduction



// Dr. Maximilian Krahl



// Dr. Torsten Voß

Personal details:

- 40 years old, widowed with five children, lives and works in Dresden

- 54 years old, married, no children, lives and works in Dresden

Education:

- law at TU Dresden, Dr. iur. (=J.S.D.), Participant of the EMBA Global-program, graduating as MBA of both the Columbia Business School (New York) and the London Business School

- business studies / Informatics at the Hamburg University and Leuphana University Lüneburg, PhD at the TU Ostrava

Occupation:

- lawyer, partner of WKP Partnerschaftsgesellschaft, entrepreneur, Dresden, during his career holding several board positions, i.e. in Riga, Vienna, Vaduz.

- management consultant, entrepreneur, assessor, board positions in Hamburg, Darmstadt, Lüneburg,

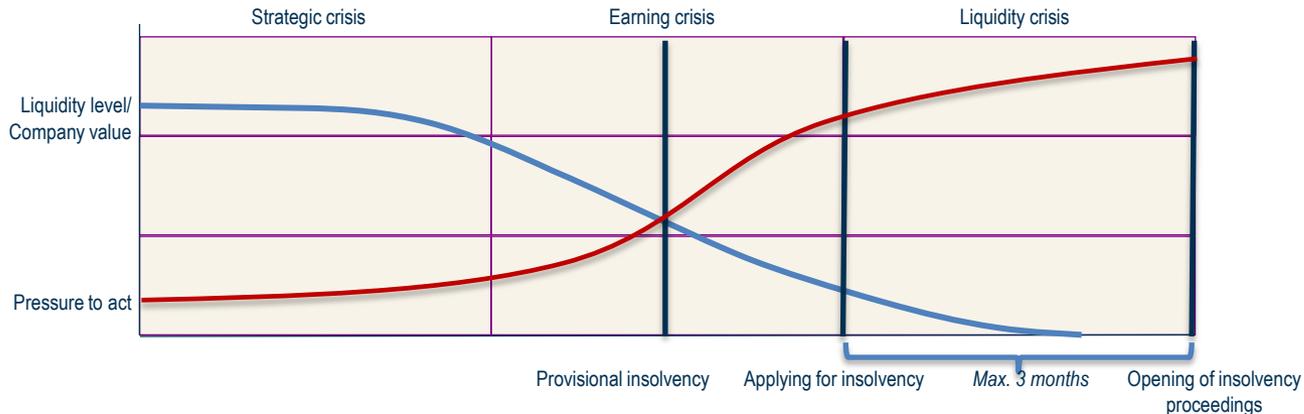
Hobbies:

- politics, philosophy, travelling

- art, culinary cuisine, sports

// PROCEDURE OF A CRISIS SITUATION

Company value and liquidity of a company decrease, need for the management to take action increases – a non-solvable task.



// PROVISIONAL INSOLVENCY

- communication with main parties about the coming crisis caused by (threatening) inability to pay and/or over-indebtedness

// APPLYING FOR INSOLVENCY

- Application to open insolvency proceedings, where applicable debtor-in-possession, §270a German Insolvency Code (InsO) or protective shield proceedings according to §270b InsO
- Opening proceedings for a maximum duration of 3 months:
 - Provisional debtor-in-possession
 - Provisional debtor-in-possession in protective shield proceedings
 - Assigning of provisional trustee
- After application stop of enforcement and prohibition of exploitation

// OPENING AND CLOSING OF INSOLVENCY PROCEEDINGS

- Implementation of insolvency plan and continuation of the company
- Transferring restructuring or liquidation

// System of the restructuring procedures in Germany

The choice of the right restructuring procedure depends on a number of details. The moment of recognition and the liquidity situation of the company are crucial.

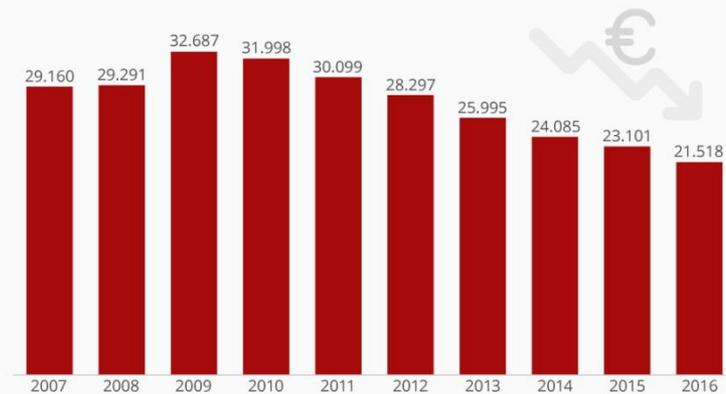
	Out-of-court proceedings	Judicial proceedings		
	moratorium	ordinary insolvency	Debtor-in-possession proceedings	
			Debtor-in-possession	protective shield proceeding
Condition	Threatening inability to pay	Inability to pay	Inability to pay	Threatening inability to pay
Provisional proceedings	No insolvency administrator	Provisional strong or weak insolvency administrator appointed by the court	Provisional trustee appointed by the court	Provisional trustee chosen by the company
Opened proceedings	No insolvency administrator	Strong insolvency administrator	trustee	trustee

// Insolvency proceedings in Germany

Facts and figures

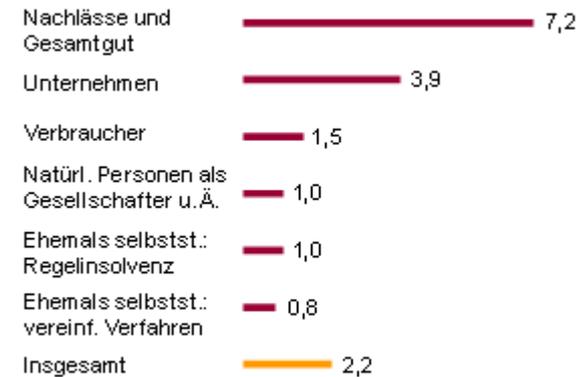
Weniger Firmen gehen in Konkurs

Anzahl der Unternehmensinsolvenzen in Deutschland pro Jahr



Deckungsquote in Insolvenzverfahren 2015

nach Art des Schuldners in %



Verfahren eröffnet 2011, beendet bis 31.12.2015

Bundesland	Gesamt ¹ 2012 – 2014	EV 2012 – 2014 ²	Anteil 2012 – 2014 ³	Anteil 2012 – 2013 ⁴
Baden-Württemberg	2.634	118	4,5 %	3,5 %
Bayern	3.805	112	2,9 %	2,6 %
Berlin	1.831	48	2,6 %	2,1 %
Brandenburg	764	21	2,7 %	2,2 %
Bremen	488	6	1,2 %	1,6 %
Hamburg	1.338	19	1,4 %	1,1 %
Hessen	2.233	37	1,7 %	2,1 %
Mecklenburg-Vorpommern	507	10	2,0 %	1,4 %
Niedersachsen	2.978	61	2,0 %	2,3 %
Nordrhein-Westfalen	7.299	176	2,4 %	1,9 %
Rheinland-Pfalz	1.164	25	2,1 %	2,1 %
Saarland	303	9	3,0 %	3,1 %
Sachsen	1.260	66	5,2 %	4,4 %
Sachsen-Anhalt	739	17	2,3 %	1,9 %
Schleswig-Holstein	1.278	44	3,4 %	3,1 %
Thüringen	615	15	2,4 %	2,6 %
Gesamt	29.236	784	2,7 %	2,4 %

Top-50-Unternehmensinsolvenzen

Kennzahlen

	2012 03 – 12	2013 01 – 08	2013 01 – 12	2014 01 – 12
--	-----------------	-----------------	-----------------	-----------------

Durchschn. Umsatz/Unternehmen (Mio. €)

Top-50 gesamt	432	122	235	195
Davon in EV	185	108	189	190

Durchschn. Anzahl Mitarbeiter/Unternehmen

Top-50 gesamt	2.058	460	1.201	603
Davon in EV	1.251	808	723	952

// Procedure of insolvency proceedings

The different stages explained at the example of insolvency plan proceedings

Before applying 1

- Identification of a state of inability to pay or the threatening inability to pay

The crisis has manifested itself. Liquidity shortages have become drastic and the number of payment reminders is increasing.

-> Calculation of the insolvency according to a ruling by the German Federal Court (BGH): quotient smaller than 90 % between cash funds and payments from receivables of the next 21 days and liabilities of the next 21 days.

- Declaration of imminent insolvency and the non-hopelessness of the restructuring approach

An accredited person needs to be assigned for this task. Auditors and tax advisors offer such services. The person must be independent of the insolvent company.

Formulation of the insolvency application for the submission to the court

Most courts have standardised application forms und information sheets for the applicants. The court wants to get a first impression of the financial situation of the debtor firm. It is absolutely essential to provide good summery listing all assets and liabilities, especially indicating the highest receivables, the highest secured receivables, claims of the fiscal authorities, the social insurance agencies (criminal law!) and of company pension funds, stating also the average number of staff and the members of the creditors' committee (including the consent of the members).

F
A
C
T
S

// Procedure of insolvency proceedings

The different stages explained at the example of insolvency plan proceedings

Before applying 2

F

A

C

T

S

- Organisational requirements – a pragmatic approach:
 - Calculation of the insolvency loan and how to get it
 - Inventory and determination of third-party securities as well as identification of free assets
 - Setting up of a data room
 - Employing of experienced restructuring consultants for:
 - Legal advice
 - Pay roll accounting (insolvency payments, difference payments, etc.)
 - Insolvency accounting (cameralistics) and accounting (advance payments)
 - Controlling / planning / **restructurer**
 - PR and agreements with the court
 - Coordinator / planner
- These tasks are very divers and have to be executed by people with specialised expertise. Logically it is not common that such knowledge is taught intensively at university or at further training programmes.
- Besides all organisational requirements a lot of legal obstacles have to be overcome.
- Moreover, customers, suppliers, banks and credit insurers need to be involved.
- Only then the application should be submitted to the court.
- The number of necessary preparatory actions seems to be infinite. Thus the list of measures cannot be exhaustive.

The organisational effort is enormous and challenging. The same tasks also have to be executed in case of an ordinary insolvency but not in such a short time.

// Procedure of insolvency proceedings

The different stages explained at the example of insolvency plan proceedings

After applying 1

A

D

M

I T

N I

I O

S N

T

R

A

- Court makes a decision on the application and starts the provisional insolvency proceedings and appoints the provisional weak insolvency administrator (in case of debtor-in-possession the trustee).
- Provisional insolvency administrator/trustee starts his activities:
 - meets with the debtor company
 - summons the constituent meeting of the creditors' committee
 - safeguards the assets of the company
 - temporarily takes over the payment transactions
 - coordinates and supervises the consultants
 - checks the third-party securities
 - negotiations on insolvency loans
 - Non-genuine insolvency loan (assigned receivables can be used, new receivables will be assigned, retentions of title will be removed as required)
 - first report to the court
 - keeps in contact with all participants
 - checks if debtor-in-possession is working correctly
 - prepares his survey for the court
 - submits documents to public prosecutor

Provisional proceedings

R

E

S

T

R E

U R

C

T

U

R

- During debtor-in-possession the management of company keep their position and continue their activities.
- Due to the new situation some organisational changes have to be made:
 - accounting has to be set up for insolvency matters
 - liquidity is controlled in agreement with the trustee
 - financing of insolvency payments needs to be completed
 - staff members have to be motivated
 - Market participants have to reassured
- Restructuring plan has to be set up, including all necessary measures:
 - staff-related measures
 - use of settlement options
 - exceptional rights of termination
 - adapted calculations
 - sale of operating units
 - etc.
- Pressure on turnover is enormous. Only very well trained experts are able to manage this complex task in a short time.

Timely application is crucial for successful proceedings!

// Procedure of insolvency proceedings

The different stages explained at the example of insolvency plan proceedings

After applying 2

Opened proceedings

I
N
S
O
L
V
A
E
N
N
C
Y
P
L

- During opened proceedings, the insolvency plan becomes the crucial element of a successful restructuring.
- The insolvency plan contains two major parts: the descriptive section and the constructive section. In principle, the insolvency plan constitutes an agreement between the creditors and the debtor – this means contractual autonomy.
- The following matters are usually reorganised by the insolvency plan:
 - staff-related measures
 - continuing obligations
 - sale of fixed assets
 - closing of operational units
 - redemption of pension commitments
 - termination of works agreements
 - transformation of loans into shares
 - supply of new loans
 - quota regulation and payment of dividends by third parties
 - accepting of new shareholders
 - change of the legal form
 - loan waivers
 - plan monitoring
 - credit lines
 - etc.

I
M
P
L
E
M
O
E
N
N
T
A
T
I

- The agreement on the plan should preferably take place during the first report meeting at the first creditors' meeting.
- Voting rights are divided into the number of people and the claim amount. Creditors are sorted into the different creditors' groups. Votes take place within the group and between the groups.
- Within the group a double majority is required (per-capita and amount), for the groups it is necessary that all groups agree with the plan.
- If a double majority cannot be reached within a group, the missing agreement can be replaced by the court (prohibition of obstruction). This only applies if
 - the creditors are not put in a less favourable position by the plan
 - the share of the creditors at the plan has to correspond to the financial value
 - The majority of voting groups have to agree on the plan with the majorities required therefore.

// Procedure of insolvency proceedings

Outlook

- Insolvency administrators in Germany complain about the small number of insolvency proceedings. This will certainly change again, the economy is always affected by different cycles.
- The procedure is too complicated and expensive for small businesses, transaction costs are far too high – the lawmakers will need to put more thought into this situation.
- The so-called protective shield proceedings have not reached their objective, it is hard to fulfil all requirements. Also in this case improvements are required by the lawmakers.
- Banks receive an exceptional right of termination after applying for insolvency. This results in the necessity to get an insolvency loan, which is difficult to get in such a short time.
- The creditors' committee is facing high pressure due to the M&A process. This sometimes clearly runs contrary to the interests of an insolvent company (for example: Entrepreneur has massive loss in turnover due to external influences, such as roadwork directly in front of his shop. He constantly invests equity capital until he has depleted his own funds entirely. The competitor buys the good location for little money, as the creditors' committee start the M&A process too early and do not want to wait for the ruling of the liabilities between the bankrupt and the creditors.)
- The subject requires extensive knowledge both in civil law and business administration. This close interaction is rarely taught during the studies, although it would be necessary for the restructuring by insolvency plans in view of the limited time available.
- Company restructuring is a wide scientific field which needs to be developed systematically in the next years. In times of industry 4.0 business administration processes are becoming more and more important and consequently the preservation of companies and their processes will get an outstanding importance for the economy.

Insolvency Law, overview

- Reorganization vs. Liquidation
- Most codes offer regulation for reorganization
- Germany: insolvency plan (§§ 217 – 269 InsO), debtor in possession (§§ 270 – 285 InsO)

Preliminary bankruptcy

- Voluntary vs. involuntary bankruptcy, § 13 InsO
- Three reasons for insolvency:
 1. Indebtedness, § 19 InsO
 2. Insolvency – illiquidity / inability to pay, § 17 InsO
 3. Impending (foreseeable) insolvency, § 18 InsO

Preliminary bankruptcy (2)

- File for bankruptcy
- Audit by the insolvency court
 1. Formal audit by judge
 2. Audit of the economic situation, mostly by an external auditor, mostly the later insolvency administrator
 3. Routine information to the prosecutor.

Preliminary bankruptcy (3)

- Security measures, §§ 21 – 25 InsO
 1. Preliminary bankruptcy administrator, § 22 InsO, either the „strong“ or the „weak“.
 2. Bankruptcy protection, § 21 III 3 InsO – no automatic stay.
 3. Restrict the debtors rights to act.
- Preliminary bankruptcy ends with the opening decision, § 30 InsO.

Creditor groups

- Decision over the plan is done in groups. The plan binds everyone.
- Law gives three groups (§ 222 InsO):
(preferential) creditors, subordinated creditors, secured creditors.
- The key to success is to form more groups. The groups are defined by the insolvency plan. The plan can be proposed by either the debtor or the administrator. Usual groups are: employees, suppliers, banks etc.

Developments in bankruptcy law

- Shift from involuntary to voluntary bankruptcy.
- Shift from liquidation to reorganization.
- Bankruptcy law is becoming a tool of reorganization.
- Competition among bankruptcy regulations.
- Struggling companies are getting interesting for investors.
- The power within the bankruptcy will move from the administrator to the investor.

// Procedure of insolvency proceedings

Thank you very much for your attention!