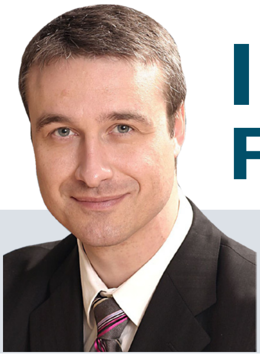

INSOLVENCY & RESTRUCTURING

Frank Tschentscher - Schultze & Braun
Phone: +49 40 3060457-0
Email - FTschentscher@schubra.de

The restructuring and insolvency market has undergone considerable change and development over recent years and according to a recent report, the global financial crisis has significantly contributed to an increase in insolvency work, keeping bankruptcy lawyers across the world very busy. Germany has fared particularly well during the last few years, and was one of the few countries to be spared any very serious consequences of the global financial crisis. To find out about how this has affected insolvency levels in the country and the issues facing German companies regarding insolvency and restructuring, *Lawyer Monthly* speaks exclusively to Frank Tschentscher, a dual qualified German attorney and solicitor of England & Wales and a partner in the cross-border business recovery and insolvency practice of specialist law firm Schultze & Braun (http://www.schubra.de/en/), one of Germany's leading insolvency law firms.

Can you begin by telling me a little about the general mood in Germany regarding insolvency at the moment?

Within the industry itself, it is definitely quieter. Insolvency cases are down and people are not as busy as they have been previously. There have been reports suggesting that insolvency numbers may be about to rise again, but in Germany, that doesn't seem to be the case at all. Over the past few years, the German economy has been relatively robust. When the financial crisis hit, Germany was less deeply affected than other countries and since then the economy has been doing really well. However, there is a concern that it is now running out of steam. If so, and assuming for a moment insolvency numbers did rise as a result of it, Germany would be prepared. We have a very modern and flexible insolvency regime with a proven track record. Practitioners are experienced and specialised; the German insolvency administrators know what they are talking about and the courts generally are up to speed.

Why do you think the economy fared well during the financial crisis and why do you think it may now run out of steam? What changed?

I think that over the years, German companies have become leaner and meaner and so when the world economy was on the brink of collapse, German businesses survived thanks to all those years of trying to be more efficient, cutting costs and streamlining processes. I am not for a moment suggesting that Germany was completely unaffected by the global recession, but a lot of industries were fairly robust and it was probably market sentiment more than anything else that seemed to cause problems. That said, at the beginning of the worldwide financial crisis, a lot of banks were shaky, and a lack of lending obviously cascaded down to the companies. Fortunately, many companies were sitting on sufficient cash reserves and/or had the trust of their creditors/investors and so they were able to bide their time and when a little bit of confidence came back to the market, I think they found it easier to expand and run full steam ahead. The problem now, in my opinion, is that there appears to be too much money in the market again. Investors are sitting on a lot of cash and are starved of yields, but investment opportunities are scarce. Saving money is not attractive as interest rates are down dramatically; some German banks have even started to introduce penalty fees for large deposits (although they call it differently). That, combined with the pressure to return yield to investors, seems to me a good explanation for some bad investment decisions we have seen in recent months.

A lot of German 'Mittelstand' companies, the much-vaunted backbone and engine of the German economy, were able to obtain new finance by way of issuing corporate SME bonds and a lot of them have benefited from it, doing incredibly good things. But then there are quite a few companies who should not have been allowed to tap that market and these businesses avoided problems because they were given a cash injection by private investors when traditional bank lending was no longer available to them. In many cases where operating activities did not generate enough income for debt servicing and maintenance of business operations, bank financing was refused for very good reason. But regardless of this, the easy procurement of external funds by issuing bonds enabled these companies to stock up on external funding. It was above all private investors who bought with great regularity, not necessarily on the back of risk/return considerations, but more on the grounds of the issuer's degree of recognition and popularity and sometimes also on ideological grounds. However, their problems are now catching up with these companies and a significant number of them has already failed. I believe this is going to continue. If the hypothesis is correct that these alternative financing options are used by companies that cannot obtain bank loans due to a mediocre credit rating and doubtful prospects, it must be assumed that the number of failures will see a sharp rise in the near future.

Can you tell me about any recent or imminent regulatory changes relating insolvency?

Germany recently reformed its insolvency regime. The old regime was only introduced in 1999 but on an international level it was always deemed too cumbersome, so it was reformed in March 2012. We now have more emphasis and focus on debtor in possession proceedings and creditors, rather than the courts, are now in the driving seat and able to exercise influence over the choice of the insolvency administrator via a preliminary creditors' committee. Creditors thereby exercise significant control over insolvency proceedings (and thus creating certainty as to the process).

The statistics seem to suggest that the market has accepted the change and that debtor in possession proceedings are actually being used more often. It is definitely a positive move, in my eyes, provided it is done properly and in conjunction with a corporate debtor's stakeholders. All the changes that have been made to the regime were designed to remove the stigma of insolvency, and it would appear that so far it is working.

I have heard that any further changes to be made to the insolvency regime are likely to come from the European Union, is this something you would agree with?

Yes, definitely. Germany introduced the new insolvency legislation I referred to above at the beginning of 2012, bringing Germany much more in-line with the well-known UK and US insolvency regimes. As indicated, the main features of the reformed law included that (i) creditors now exercise significant influence and control over insolvency proceedings; (ii) in an insolvency plan procedure under German insolvency law, the conversion of debt to equity is now available even without the consent of legacy shareholders, who are being crammed-down in the voting process (subject to fairness and valuation considerations); and (iii) the introduction of debtor in possession proceedings and 'protective shield proceedings', the latter being a reorganisation procedure under insolvency legislation.

Last but by no means least, Germany also introduced legislation dealing with the insolvencies of groups of companies, something that is of vital importance in today's global market. If you add into the mix the introduction of a new German Bond Restructuring Act in August 2009, then that is a lot of new legislation. We tried to persuade the German legislator that the one thing missing was an out of court restructuring regime, but – maybe unsurprisingly – to no avail. The German Government felt that it had introduced more than enough new tools already, and we should see how it goes. Therefore, if there is any further reform to come, it can only come from Europe.

Do you see that as being imminent or some years away?

To some extent, it is already happening. On 4 December 2014, the Council of the EU issued a press release to report that it had endorsed a compromise agreement reached with the European Parliament on the proposed regulation amending Council Regulation (EC) 1346/2000 on insolvency proceedings (the "Insolvency Regulation"). Practitioners and insolvency specialists all over the EU had eagerly awaited the announcement; the general view has been for quite some time that the Insolvency Regulation was ripe for an overhaul. For instance, it has been the topic of many learned articles that, quite remarkably, the Insolvency Regulation did not contain a definition of COMI (centre of main interest). The debtor's COMI is important to determine the international jurisdiction to commence insolvency proceedings and the law to be applied in those proceedings. That omission caused high levels of litigation and paved the way for what some labelled abusive business relocations. The new proposal appears to provide some legal certainty and safeguards against insolvency and/or bankruptcy tourism. It introduces a formal definition of COMI and, further, if a debtor was to move to another Member State before filing for insolvency, the courts will have the ability to investigate and identify if the move was genuine and not abusive.

Very helpfully, the compromise agreement also makes away with the requirement that secondary proceedings are always winding-up proceedings. I believe that this will help to improve the efficiency of the administration process as local creditors will be protected from secondary proceedings being issues in another location. Apparently, it is also going to be easier for the office holder to challenge secondary proceedings through notification rights.

One of the most important features is the introduction of legislation dealing with the cross-border insolvency proceedings of groups of companies. The consensus seems to be that the courts and the liquidators are to work together to coordinate the insolvency proceedings so that there is a greater chance for the group of companies to be saved as a whole. This change should generate greater efficiency within insolvency proceedings for all the different members of the companies groups.

Overall then, what do you think the impact of the EU will be on the Insolvency sector over the next few years?

It depends on many things really, but I am concerned that the recast of the Insolvency Regulation may be a little too restrictive. The EU Commission's initial proposal for amendments was refreshingly moderate; it wished to address a number of key deficiencies in the existing rules to increase the legal certainty of cross-border cases and identify clear rules determining jurisdiction. Its vision was also to move the Insolvency Regulation away from liquidation proceedings, thus allowing distressed businesses the opportunity to restructure, while protecting creditor's rights and improving the outcome for them.

As far as I am concerned, the problem is that the EU Council and the EU Parliament adopted substantial amendments to the Commission's initial proposal and these were subsequently discussed in trialogue between the Commission, the EU Parliament and the Council, leading to the compromise agreement I referred to above. Now, they do say that the text will be finalised by 'legal-linguistic experts' following which it will be formally approved by the legislating bodies of the EU without any further amendments and subsequently presented as a recast of the current legislation. I am not entirely convinced, however, that that is actually going to happen. I am also not convinced that the compromise agreement is in fact an improvement of the Commission's initial proposal.

The problem as I see it is that every member state has their own idea of what should and should not be allowed. Just think of the controversy surrounding the migration of corporate debtors from one jurisdiction to another for the purpose of the restructuring of its own debt. What some may call abusive insolvency tourism and 'bad forum shopping' others call a clever use of all restructuring tools at one's disposal.

Again, the Insolvency Regulation purpose is to establish the mandatory recognition of insolvency proceedings within the EU and help determine the proper jurisdiction for a debtor's insolvency proceedings and the applicable law to be used in those proceedings. I respectfully suggest that it is not its purpose to protect the interests of individual groups of professionals who wish to see 'their' cases safeguarded.

However, a positive point is that if they are now going to introduce frameworks for the insolvency of groups of companies on a European level. The immediate and automatic recognition of such proceedings throughout the EU together with the introduction of a formal protocol of cooperation and communication between practitioners and the courts in different EU-member States seems to me incredibly helpful.

Of course, it is still early days and all we can really do is wait and see what happens. But I am always optimistic that experienced practitioners and insolvency specialists will always find a way to achieve the best possible results, no matter what! **LM**