

New restructuring framework brings company valuations into focus

New restructuring framework

▶ While the second wave of the Covid-19 pandemic is causing the German economy to hold its breath, a new restructuring law is expected to come into effect on January 1, 2021. On October 14, 2020, the German government presented the government draft bill on the "The Further Development of Reorganization and Insolvency Law" (Sanierungsrechtsfortentwicklungsgesetz - SanInsFoG). In essence, the draft bill contains the implementation of a preventive law on the "Stabilization and Restructuring Framework for Enterprises" (StaRUG), which significantly changes and extends the existing insolvency law. The draft bill is intended to offer companies the possibility to restructure themselves rather easily in the event of imminent insolvency.

A central component of StaRUG is the preparation of a restructuring plan (§4 StaRUG-E), which can provide extensive interventions in contractual relationships, liabilities and shareholder structures, such as haircuts, waivers of claims or dilution of existing shareholders. The restructuring plan requires the approval of the affected creditor groups (§27 StaRUG-E), whereby in principle a majority of at least 75% of the votes within each affected creditor group must be achieved. In addition, the consent of certain creditor groups can be replaced under particular conditions within the framework of the so-called "cram down" (§28 StaRUG-E). Even if the restructuring plan could in principle be implemented out of court, a court confirmation according to §58 StaRUG-E might be advisable or necessary to avoid

contradictions of individual creditors to the restructuring plan.

Extended responsibilities for executive and supervisory board members

▶ Since the preparation of the restructuring plan is the responsibility of the debtor, the independent restructuring is accompanied by an extended responsibility of the executive and supervisory board members. In the event of imminent insolvency, the executive and supervisory board members are primarily obliged to safeguard all creditor interests (§2 StaRUG-E), with the interests of the shareholders being secondary.

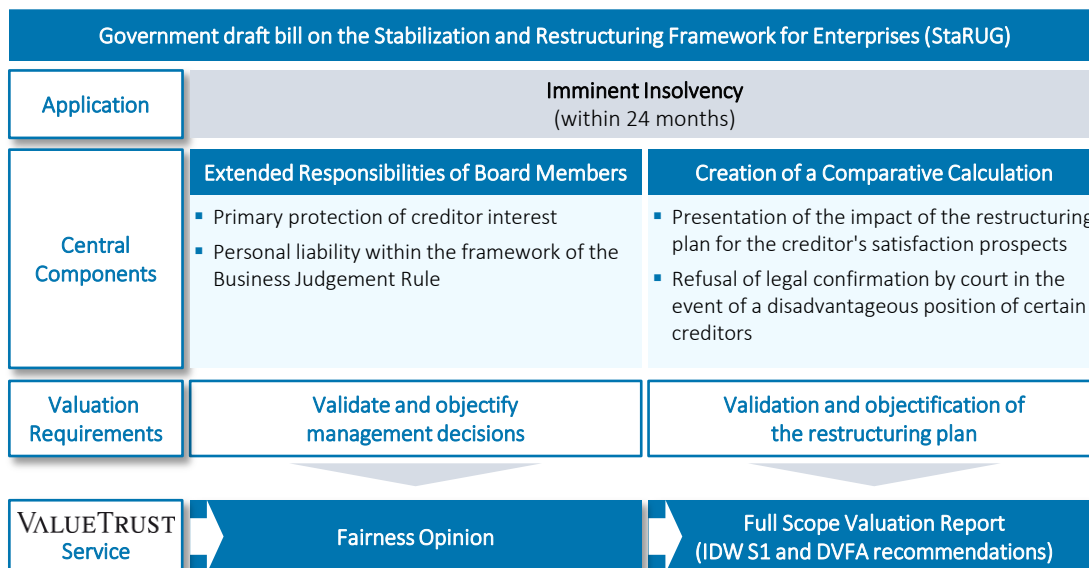
In the event of a breach of these obligations, the executive and supervisory board members shall be personally liable to the company (§3 StaRUG-E). Liability for the breach of duty is subject to the Business Judgement Rule, according to which a breach of duty by the executive and supervisory board members does not exist if they could reasonably assume,

consideration for material business transactions, especially corporate transactions, which can be confirmed by obtaining an independent fairness opinion and thus exclude a potential breach of duty and liability at an early stage.

Comparison calculation as a prerequisite

▶ The restructuring plan shall be divided into a descriptive and a formative part (§7 StaRUG-E). While the formative part regulates the legal relationships after implementation of the restructuring plan, the effects of the restructuring plan must be explained in the descriptive part. It contains all information relevant for the decision of those affected by the plan and relevant for legal confirmation (Section 8 (1) StaRUG-E). The central component is a comparative calculation showing the effects of the restructuring plan on the prospects of satisfying those affected by the plan. At the same time, upon request of a creditor, the legal confirmation of the plan is to be refused if

the creditor is disadvantaged by the plan compared to without the plan (§71 para. 1 StaRUG-E). Thus, the settlement calculation refers to the comparison of the recoverability of the



on the basis of reasonable information, that they were acting in the interest of the creditors. The extended liability for executive and supervisory board members is not only likely to be a gateway for activist creditors but may also be reviewed by an insolvency administrator in the event of subsequent insolvency. For this reason, the executive and supervisory board members are recommended to exhibit correctness regarding the

affected creditors' claims before and after the implementation of the restructuring plan. In order to be able to make this comparison, the enterprise value of the debtor as a going concern must be determined before and after implementation of the restructuring plan as well as the distribution of the enterprise value. Furthermore, the individual claims for each creditor group must be determined by

taking into account the ranking of the claims and any collateralization. If the restructuring plan is successfully implemented, the enterprise value should be higher than before the implementation of the restructuring plan due to the elimination of direct and indirect insolvency costs, the disclosure of restructuring profits and the elimination of the deferred risk of insolvency or bankruptcy.

Independent business valuation

▶ Although some of these analyses may already have been prepared by the debtor's restructuring advisor when the restructuring plan was drawn up, the high demands made on the transparency and objectivity of the comparative accounts require that an independent expert opinion be obtained in accordance with the relevant standards "Principles for the Performance of Business

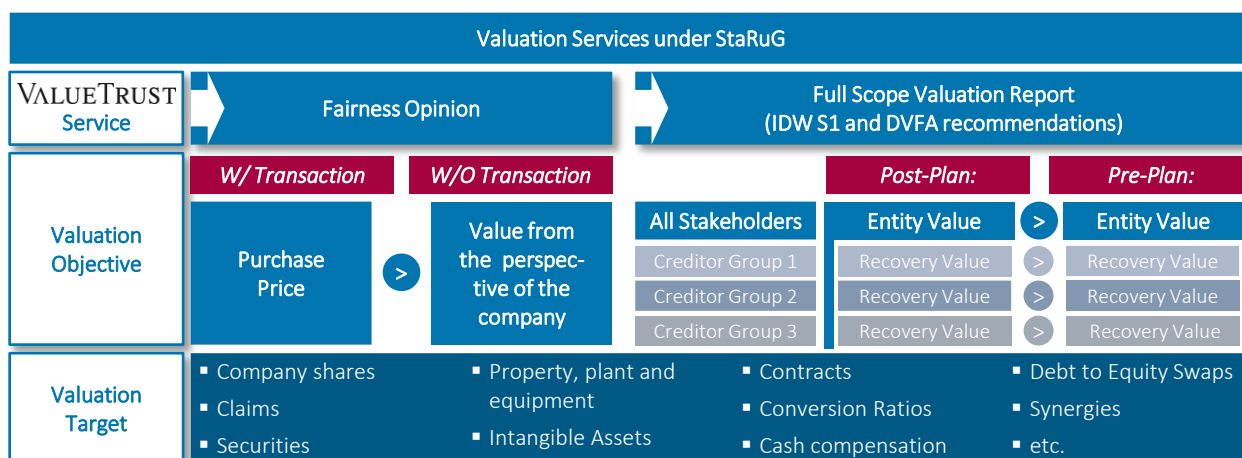
Valuations" (IDW S1) from the Institute of Public Auditors in Germany e.V. (IDW) and "Best Practice Recommendations for Company Valuations" from the German Association for Financial Analysis and Asset Management (DVFA). The involvement of an independent expert thus contributes significantly to the successful preparation of the restructuring plan by the debtor through

the following:

- the **objectivity of the comparative calculation** as well as the restructuring plan is improved;
- the **acceptance and approval of the restructuring plan** by creditors is promoted due to the transparent presentation of the valuation expert's procedure, the valuation methodology and the valuation result;
- **excluding creditors from being placed in a less favorable position** and thus ensuring that legal confirmation may not be prohibited by the court.

the framework of StaRUG and the prospects of reorganizing a company improve significantly, especially in case of imminent insolvency due to excessive financial liabilities. In addition, objections by individual creditors can be effectively circumvented without jeopardizing the implementation of the restructuring plan.

The extended liability for executive and supervisory board members associated with StaRUG can be cushioned as effectively as possible by obtaining independent fairness opinions. In addition, independent opinions ensure the necessary transparency, objectivity and acceptance



Conclusion and outlook

▶ In Germany, the government draft bill referred to as the SanInsFoG, creates an important framework for the restructuring of companies beyond just insolvency. This is welcome, as indirect insolvency costs, such as the conversion of supplier credits for prepayment, loss of customers, etc., can be avoided within

of the restructuring plan. Practical experience will reveal how widespread the acceptance as well as the procedural and monetary advantages of the new draft bill will be compared to the existing possibilities for restructuring under self-administration. In any case, the draft bill should come into force in time to cushion part of the financial consequences of the Covid-19 pandemic.

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