

Germany's StaRUG

A saviour for the distressed or a blunt sword?



On 1 January 2021, the new German Business Stabilisation and Restructuring (StaRUG) Act went into effect. The draft law was quite far-reaching but was watered down in some respects at the last minute, so it's important to review whether StaRUG is a saviour for distressed companies or a blunt sword. After six months with German StaRUG, it is time to discuss the first experiences and proceedings and draw some initial conclusions.

In this article, Uwe Goetker and Matthias Kampshoff, partners at McDermott Will & Emery in Düsseldorf, briefly summarise the development of the insolvency and restructuring market in Germany in recent years, providing an overview of the StaRUG framework and its modular system while sharing a cursory look at first experiences with the instruments and initial conclusions.



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Therefore, management is typically required to involve the shareholders/supervisory board before it makes use of StaRUG.

The restructuring tools

The restructuring tools of StaRUG include a stabilisation order, which restricts individual enforcement actions in order to preserve the prospects of achieving the restructuring goals and various instruments in connection with the heart of StaRUG and the restructuring plan. These might include preliminary court examination of disputed issues, court-controlled voting on the plan and court confirmation of the plan.

The draft law also provided the termination of executory contracts as a further restructuring instrument, which would have facilitated performance-related restructurings.

However, the legislator shied away from this instrument as a piercing of the 'pacta sunt servanda' principle.

Thus, StaRUG does not contain contract termination rights, which remain reserved for insolvency proceedings.

The core instrument of StaRUG is the restructuring plan, which is similar to the German insolvency plan but much more variable because within StaRUG, the debtor is able to choose certain groups of creditors who shall be affected by the plan and pursue silent (in camera) restructurings with these stakeholders and avoid negative publicity.

Public restructurings

As of 17 July 2022, StaRUG can also be used for public restructurings, which will then qualify as insolvency proceedings in the meaning of Annex A of the EU Insolvency Regulation 2015/848 (EIR).

This will be essential for cross-border restructurings as such proceedings have to be recognised in other EU countries (Art. 19 EIR).

On the basis of a restructuring plan, the claims of creditors, the security rights of creditors and group-internal third party security rights (this is new in Germany) can be affected or modified.

Economic context

In order to properly understand the current relevance of StaRUG, it is necessary to understand its economic context first.

Because of Germany's dynamic development and the European Union's continuing low interest rate policy, the level of insolvencies has dropped to an all-time low from year to year in Germany.

The effects of the Covid-19 pandemic then threatened drawing Germany's and the world's economy into the abyss.

In order to avoid or cushion the socio-economic consequences of the pandemic, Germany suspended the obligation to file for insolvency for many months, and the government granted comprehensive financial state aid, such as short time allowance and state or KfW loan, totalling around 140 billion euro.

For this reason, among others, no insolvency wave has materialised by now. Quite the contrary: The number of insolvencies is still sinking, not just in Germany but throughout the whole Western European Union.

This may change as many businesses will face increased liquidity needs because the German state protection shield for trade credit insurers expires and businesses are expected to ramp up towards the end of the pandemic.

Moreover, many state aid programs provided loans rather than subsidies and resulted in highly-leveraged businesses.

A brief overview of StaRUG

In order to facilitate restructuring efforts after the pandemic and revitalise company balances in a socially acceptable way, the German Government, driven by EU directive (Directive (EU) 2019/1023), quickly passed a legislative procedure regarding the "further development of restructuring and insolvency law" because the legislator saw the risk of many "zombied" businesses under artificial state aid liquidity respiration.

Thus, the implementation of StaRUG was pushed forward in record time in order to be available when the suspension of the insolvency filing obligation expired.

StaRUG is designed as a flexible restructuring framework, which offers tools for out-of-court restructurings.

This toolbox is available to every debtor who is not obliged to file for insolvency yet but is becoming illiquid with predominant likelihood within the next 24 months and notifies the restructuring court of a proposed restructuring with the goal to sustainably eliminate the impending illiquidity.

While the draft law provided a shift of duties for the management of imminently illiquid debtors and, thus, a special protection for creditors and a reduction of shareholder influence at this stage, this substantial interference with corporate governance did not ultimately become part of StaRUG.

The latter particularly facilitates groupwide restructurings.

Debt-to-equity swaps

The plan can also affect the shares and membership rights of equity interest holders, allowing debt-to-equity swaps. The conversion of receivables into equity interests as well as other corporate law transactions is explicitly permitted.

Thus, shareholders may not necessarily be in favour of such restructurings. Moreover, StaRUG allows modifying the terms of multiparty financial arrangements, such as inter creditor agreements or the terms of bonds and promissory note loans (Schuldscheindarlehen). This makes StaRUG a universal weapon for financial restructurings.

The key advantage of a restructuring plan is that it does not require the consent of all affected stakeholders.

The selected affected stakeholders will vote on a plan in classes of similar legal interest (at least the equity holders, subordinated creditors, non-subordinated creditors and secured creditors shall be distinguished).

A majority of 75 per cent of the voting rights per group is sufficient. A group without such majority can be overruled using cross-class cram-down, under certain conditions. This factor may cause disputes in the German restructuring market.

First experiences with StaRUG

Not many StaRUG cases have had public exposure.

This is not surprising because of the in camera approach of StaRUG. However, according to surveys, the actual number of StaRUG restructurings still seems to be low.

There are many reasons for this: As described, the number of insolvency proceedings is also very low.

So far, many businesses have been able to survive with the state aid programs. Liquidity needs may change this and first restructuring plans, which are aimed at reducing credit obligations resulting from financial state aids, have been drawn up.

The cases that have come to attention are all concerning smaller companies so far.

However, this may also change in the near future. This is to be welcomed, though it might not have been in the mind of legislature.

Another reason for the small number of cases is that StaRUG no longer provides tools for performance-related restructurings, making insolvency plan proceedings the better alternative. Insolvency plans have a reliable track record.

Finally, the mere existence of StaRUG helps achieve consensual out-of-court restructurings because the former holdout value of individual creditors is factually eliminated.

The first cases

The first court cases already show that StaRUG is of particular value to financial restructurings in certain situations.

One of the first decisions of the restructuring court of Hamburg (AG Hamburg NZI 2021, 544) concerned the restructuring plan of a logistics company with a minority shareholder who was also one of the biggest subordinated creditors, and who could have blocked a consensual out-of-court restructuring (which encompassed the subordinated debt).

The court took a restructuring-friendly decision and confirmed the restructuring plan, which was adopted by the group of the non-sub-ordinated creditors and the shareholders' group.

The dissenting group of the subordinated creditors was overruled by a cross-class cram-down.

The court stated that:

- 1) the group formation under StaRUG is subject to a wider discretion of the plan creator than under German insolvency plan proceedings,
- 2) the second best alternative as benchmark for the plan can well be the insolvency scenario, if there is no concrete and reliable other alternative, and
- 3) prior negotiations with the affected stakeholders are no requirement of a restructuring plan.

Modification of a pre-existing Plan

Another decision, which attracted a lot of attention, was the pre-assessment of a financial restructuring plan by the restructuring court of Cologne (AG Köln NZI 2021, 433).

It allowed a modification, not only of a syndicated loan agreement, but also of a pre-existing restructuring agreement by a restructuring plan.

So, in principle, all interventions in creditor legal positions are supposed to be possible, which is appropriate for the restructuring process.

In other words: This jurisdiction supports the proposition that StaRUG plans are the right tool for the restructuring of complex financing situations, such as bonds (haircuts, maturity extensions and so on) or syndicate loans but also of existing restructuring agreements.

However, the same court questioned the availability of StaRUG as it required "full conviction of the court of an impending illiquidity."

This was quite an arguable interpretation of the admission prerequisites under StaRUG and shows that common standards will have to be found over time.

Auto supplier

In another StaRUG case, one of the subsidiaries of an automotive supplier filed for insolvency and

threatened the existence of the entire group.

However, a StaRUG plan helped reduce credit obligations and preserve jobs at the group, while the creditors received a significantly higher quota than in regular insolvency proceedings, and within a shorter period of time.

In particular, the insolvency-proofed and quick sale of assets as part of the StaRUG plan was one of the keys to the solution in this restructuring.

Interim conclusions

Now that the first six months have passed, we can draw some interim conclusions.

The last-minute changes to StaRUG, which eliminated the contract termination right as a performance-related restructuring tool, prompted some excited speculation that StaRUG would fail to take off.

With this change, hopes disappeared that StaRUG would become the natural tool for out-of-court restructurings for 'bricks and mortar' retailers, who had been eager to terminate certain lease agreements.

On the positive side, the first cautious applications of StaRUG already show:

- 1) It provides an attractive restructuring route for debtors with complex debt structures, or with multiparty financing or restructuring agreements which have to be adjusted.
- 2) StaRUG offers an attractive solution for group-internal third-party security and holdout situations, broadening the spectrum for restructurings.
- 3) It is starting to look like Germany's restructuring courts are leaning towards a 'restructuring-friendly' interpretation of StaRUG.

StaRUG does not fit any and all restructuring situations, nor does it replace regular insolvency (plan) proceedings as a more comprehensive restructuring approach. However, StaRUG is anything but a 'blunt sword.'

Rather, it is a fully-fledged restructuring instrument and can be a saviour for businesses in specific situations.

As is typical for the application of new rules, there may be some teething problems along the way in terms of the correct interpretation and application of StaRUG. The early signs are that there's a good chance the restructuring courts and practitioners will quickly find the right approach.

StaRUG, as well as consensual out-of-court restructurings and restructurings through insolvency plan proceedings, will each continue to play a decisive role for the restructurings ahead of us.

And there will be more than a few!