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Sense of Modesty: Germany's Progress towards Corporate Rescue

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Germany's Approach to Corporate Rescue

The economic developments and difficult financial period over the last two decades have led to a rethinking of the purpose of restructuring and insolvency law in many jurisdictions. The primary objective and the purpose of legislative action is no longer the liquidation and dissolution of companies in distress, but the rescue for a going concern. Most continental European countries resisted amendments to their restructuring and insolvency laws until the economic downturn following the financial crisis. Among other countries and compared to other jurisdictions with a more competitive legal framework, Germany seemed to have difficulty dealing with distressed companies to provide them with corporate rescue rather than liquidation. Especially the United Kingdom seemed to be better prepared to handle large-scale complex restructurings, and even German companies were attracted to restructure their financial debt under English[1] law.

The German legislator acted with extreme caution before amending the German Insolvency Act with the "Act to Further Facilitate the Restructurings of Companies (ESUG)". The Insolvency Act originally introduced instruments for restructuring to the legal insolvency framework, and was seen as a stark paradigm shift in Germany.[2]

Historical Developments

German insolvency law has its foundations in the 19th Century. After the Franco-German War of 1870-71, Otto von Bismarck united the German principalities forming the German Empire. In the aftermath up until 1874, the German economy was booming. In this economic upturn, however, there were many companies unable to meet the growing competition in the market. With the stagnation of the economy, some companies became financially distressed, leading to insolvency. In order to meet the new situation, the Bankruptcy Act (*Konkursordnung*) of 02.10.1877[3] and

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[1] The law of England and Wales, made reference to as English law.
2 See Heinz Vallender, *Insolvenzkultur gestern, heute und* morgen (NZI 2010) 838, 840.
[3] RGBl. 1877 p. 351, published 20.5.1898, RGBl. 1898 p. 612, last amended by Art. 5 of the law of 25.7.1994, BGBl. 1994 I 1744.

the Settlement Act (*Vergleichsordnung*) of 02.26.1935[4] were passed, and both remained in force in the Western part of Germany until 1998. The main purpose of insolvency proceedings in Germany was the common compulsory realization of the debtor's assets for the benefits of the creditors, which were evenly satisfied with the distribution of proceeds.

In the Eastern part of the country, the collapse of the Berlin Wall and the hitherto bankruptcy safe, government funded, state-directed economy presented the completely unknown risk of corporate defaults. The last East German government passed the Total Execution Act (*Gesamtvollstreckungsordnung*) by the People's Chamber on 06.06.1990, which came into force on 01.07.1990.

Calls for reform of insolvency law started after the oil crisis in 1973. The Bankruptcy Act and the Settlement Act seemed inoperable at the time[5] with insolvency proceedings only being initiated to cover the legal costs of the proceedings because the creditors usually received no or very low recovery on their claims. Therefore, an independent Commission on Insolvency Law (*Kommission für Insolvenzrecht*) was established in 1978 with the purpose of discussing reforms and making policy proposals. The Commission finalised its work in 1985 and presented two detailed reports. It invited the public to comment on the reports, instigating discussions not only about their details but also raising fundamental questions about the purpose and requirements of insolvency law for the economic and legal order of Germany.

The newly-created political situation in the early 1990s accelerated the decision about a new insolvency law. The Bundestag adopted the Insolvency Act (*Insolvenzordnung, InsO*) on 21 April 1994 after almost twenty years of discussion, negotiation and hearing; the Insolvency Act came into force on 1 January 1999,[6] replacing the Bankruptcy Act, the Settlement Act and the Total Execution Act. It still provides a uniform legal framework for insolvency proceedings in Germany.

The Insolvency Act was introduced with several objectives.[7] On the one hand, the preconditions for opening insolvency proceedings should allow for a higher recovery rates for creditors and not be dismissed due to the lack of sufficient assets. On the other hand, the legislature had identified the need to encourage early restructurings

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[4] RGBl. 1935 I 321, last amended by Art. 5 of the law of 25.7.1994, BgBl. 1994 I 1744.
[5] BMJ, Begr. RegE-InsO, BT-Drucks. 12/2443, p. 72. *For historical background*, *see* Holger Altmeppen, *Zur Rechtsstellung der Gläubiger im Konkurs gestern und heute*, in *Festschrift für Peter Hommelhoff zum 70. Geburtstag,* p. 1, 2 et seq. (2012). *See also* Stephan Madaus, *Der Insolvenzplan,* p. 60 et seq (2011); Christoph Paulus / Matthias Berberich, *National Report for Germany, in Commencement of Insolvency Proceedings*, p. 313 et seq. (Oxford University Press, 2012).
[6] *See* Manfred Balz, *Market conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law*, 23 Brook. J. Int'l L. (1997) 167, 168: the law was "considered so radical that is was thought wise to postpone [it from its enactment in 1994] until its entry into force in January 1, 1999".
[7] *Compare* Sec. 1 InsO. Begr. RegE InsO vom *15.4.1992*, BT-Drucks. 12/2443, p. 77 neglects the liquidation as an automated response, restructurings, however, are not specifically mentioned as a goal of reforms.

of viable but insolvent companies for long-term going concern.[8] Restructuring of an insolvent company is ranked equally for both realization and liquidation.[9] There are two different ways to recovery: restructuring by business-asset-deal in a regular insolvency proceeding, or the insolvency plan proceeding and self-administration by interfering in the capital and management structures of a company. The introduction of self-administration under the supervision of a court-appointed custodian was intended to facilitate an earlier start for insolvency proceedings. Other changes included an intensified law of avoidance, more autonomy of the creditors with secured creditors now taking part in the insolvency proceedings by joining the meeting of creditors, and being entitled to vote. However, these new instruments were not widely used.[10] The plan to initiate a restructuring was only used in 2% of opened cases.[11] Legislation believed to increase the number to 20-30%.[12]

The shortcomings became apparent when German companies began to engage in forum shopping for a more favourable legal environment.[13] Legal competition has not only led to competition between corporate legal entities[14] but also competition between insolvency and restructuring law.[15] German companies such as *Deutsche Nickel*[16], *Schefenacker*[17] or *Brochier*[18] have engaged in forum shopping, particularly to England. They have realised that migrating to a country with a legal framework more favourable for restructuring can also be an important economic factor in the choice of location, despite the complexity and costs involved.[19] *Tele Columbus,*[20]

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[8] Erster Bericht der Kommission für Insolvenzrecht 1985, Sentence 2.1.1, para. 1, p. 162: "The aim of the restructuring is to ensure the survival of the debtor company and ensure sustainable profitability", however, restoring the competitiveness of the company in the long-term can neither be foreseen nor guaranteed in a dynamic market environment. *See also* Manfred Balz, *Sanierung von Unternehmen oder Unternehmensträgern?* p. 18 (RWS 1998) *whereas* it may well be in the economic interests of creditors to allow the company to continue trading for a while despite a lack of profitability in the case the company carries high sunk costs.

[9] Erster Bericht der Kommission für Insolvenzrecht 1985, p. 152. The Insolvency Commission considered it of particular importance for a modern social-market environment to preserve viable companies from unnecessary destruction by insolvency.

[10] Hans Haarmeyer/ Frank Frind, Insolvenzrecht, p. 112, mn 267 (2014).

[11] BT-Drucks. 17/2008 v. 9.06.2010 p. 1; further statistical data: INDaT-Report 8/09, p. 32; Kranzusch, ZinsO 2010, 841, 845; Frind, ZInsO 2009, 852 with further bibliography.

[12] BT-Drucks. 17/2008 v. 9.06.2010 p. 3.

[13] *Jasper*, p. 20 et seq., 93 et seq. This is especially in cases where the natural forum does not provide for mechanism to arrange for a more beneficial position, see *Boys v Chaplin* [1969]2 All ER 1085. See also *Reuss*, p. 8; *Walters / Smith*, 19 Int. Insolv. Rev. (2010) 181, 202 on good and bad forum shopping.

[14] *Eidenmüller*, ZGR 2007, 168, 170 et seq.; *Witt*, ZGR 2009, 872. 873.

[15] *Eidenmüller*, ZGR 2006, 467 et seq.; *Jacoby*, ZGR 2010, 359, 362 et seq.; *Bork*, ZIP 2010, 397, 398 et seq.

[16] *Vallender*, NZI 2007, 129, 131 et seq.

[17] *Windsor / Müller-Seils / Burg*, NZI 2007, 7.

[18] *Hans Brochier Holdings Ltd v Exner* [2006] EWHC 2594 (Ch), [2007] BCC 127 (Ch).

[19] *Jasper*, p. 25, stating that proceedings in an English court are not necessarily more cost effective than a proceeding in a continental court.*Eidenmüller*, ZIP 2010, 649, 650; *Eidenmüller / Frobenius / Prusko*, NZI 2010, 545, 546 et seq.

[20] *Trimast Holding Sarl – and – Tele Columbus GmbH* [2010] EWHC 1944 (Ch).

Rodenstock,[21] *PrimaCom*[22] and *APCOA Parking*[23] benefitted from English law without fully moving to the country by using schemes of arrangements to restructure their financial debt.

Calls for reforms, especially for a pre-insolvency proceeding, became louder.[24] After discussions, hearings and negotiations with different stakeholders, the "Act to Further Facilitate the Restructuring of Companies" (*Gesetz zur Erleichterung der Sanierung von Unternehmen*) amended the Insolvency Act and came into force on 1 March 2012. The amendments of the Insolvency Act by ESUG included, among others: the improved self-administration and protective shield proceedings - used as an early restructuring proceeding, intrusion into shareholder rights, opportunity for debt-equity-swaps, and a faster court process. Legislature did realise that in certain cases a corporate restructuring might be more appropriate than a liquidation, however, it did not introduce a pre-insolvency or out-of-court proceeding.[25]

Today's Reality

The questions remains how successful the new proceedings have been in their practical application.

Self-Administration

There was clearly a positive development of the self-administration procedures. While between 2002 and 2010 the proportion of self-administration proceedings were only about 1% (equivalent to 147-235 procedures per year) of the total opened regular insolvency proceedings, just 18 months after the amendments, more than 500 self-administration procedures were opened. Among large companies, self-administration became increasingly popular. They account for about one third of companies with more than 100 employees and more than 20 million € turnover. [26] However, out of 559 opened proceedings (of which 436 applied for preliminary self-administration) between March 2012 and February 2015, 236 companies (288 single

[21] *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch).

[22] *Re Primacom Holding GmbH* [2011] EWHC 3746 (Ch); *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch).

[23] *Re APCOA Parking (UK) Ltd & Ors* [2014] EWHC 997 (Ch)

[24] *Paulus*, WM 2010, 1337 et seq.; *Beissenhirtz*, ZInsO 2011, 57 et seq.; *Frind*, ZInsO 2010, 1426 et seq.; *Geldmacher*, ZInsO 2011, 353 et seq.; *Hölzle*, NZI 2010, 207 et seq.; *Jacoby*, ZGR 2010, 395 et seq.; *Jaffé / Friedrich*, ZIP 2008, 1849, 1856 et seq. Contrary see *Pape*, ZInsO 2010, 1582, 1583 et seq.; *Uhlenbruck*, NZI 2008, 201 et seq.

[25] *See* Sacha Lürken, *Not so dead yet – A fresh impetus from Brussels for a pre-insolvency procedure*, IILR 2015, 224, et seq. The Ministry of Justice and the Federal Ministry of Economy hosted a colloquium on out of court restructuring procedures, where two proposals were presented; one by *Brunke/Kraus/Seagon/Topp/Voß,* and another by the German chapter of the *Turnaround Management Association*. Following the evaluation of various comments, a ministerial draft (*RefE-ESUG*) was presented on 25 January 2011 and accepted as a government draft (*RegE-ESUG*) on 23 February 2011. None of these draft bills contained a reference to an out-of-court or pre-insolvency restructuring procedure, notwithstanding the prior discussions on the subject.

[26] *BV ESUG*, ZInsO 2015, 549, 549.

proceedings) had initially applied for self-administration, but were opened as a regular insolvency proceeding; a quota of 42%. This is also an increase of regular insolvency proceedings compared to previous studies (25-35%). Out of the 42%, 24% were directly opened as regular insolvency proceedings; 18% were opened as self-administration but were shifted to regular insolvency proceedings during the process. On average, the change from the self-administration procedure to regular insolvency took approximately 120 days. One may assume that creditors refused to allow for a self-administration in the remaining 24%.[27] This finding is supported by the fact that in 18% of the transferred proceedings the primary reason for failure was the submitted insolvency plan.[28] The remaining 58% of companies opened a self-administration proceeding.[29]

The rejection by the preliminary creditors' committee has increased by 2 percentage points to 47%, whereas the rejection of the process made by the insolvency courts decreased by 2 percentage points to 53%.[30] In 2012, the rejection of self-administration applications was still at 34%.[31] The main success factor in the application for self-administration is the involvement of stakeholders, but the application with a complete restructuring plan remains the biggest challenge. The success based on the restructuring plan and continuous coordination with all parties concerned allowed the option of opening insolvency proceeding in self-administration. [32] The independence from management and extensive experience are the main requirements for self-administration. Above all, the importance of a Chief Restructuring Officer (CRO) to ensure such independence on the part of the existing management has increased significantly.[33]

<u>Insolvency Plan Proceeding: Protective Shield Proceeding and Intrusion into Shareholder Rights</u>

In 2015, 63% of respondents had experience with an insolvency plan with intrusion into shareholder rights compared to only 46% in 2013.[34] The limited experience with the instrument is probably caused by the fact that the debt-equity-swap was used by only 44% of respondents for the conversion of creditors' claims, 80% of them very rare (less than one out of four cases) and 16% in one out of two cases; 56% of respondents did not use the debt-equity-swap as restructuring tool.[35] 81% of respondents[36] felt they were informed about the insolvency plan, whereby 44% considered the instrument as a success and 16% deemed failed.[37]

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[27] *BCG*, Drei Jahre ESUG, p. 6.
[28] *MAZARS*, ESUG-Radar 2014, p. 17.
[29] *BCG*, Drei Jahre ESUG, p. 6.
[30] *Roland Berger*, ESUG-Studie 2014/2015, p. 16.
[31] *Roland Berger*, ESUG-Studie 2012, p. 23.
[32] *Roland Berger*, ESUG-Studie 2013, p. 5/27-28.
[33] *Roland Berger*, ESUG-Studie 2013, p. 5/ 29.
[34] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 15.
[35] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 20.
[36] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 15.
[37] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 23.

Regarding the possible intrusion into shareholder rights in the insolvency plan proceedings, 81% of respondents said that the shareholders would not be too adversely affected by this.[38] When asked whether the amendments of instruments fulfilled the legislative objectives to promote the use of insolvency plans and delete obstacles in the plan process, 56% agreed with while 17% rejected the claim.[39] The thesis that the restructuring in an insolvency plan proceedings according to ESUG is more economical than the previous norms, 61% of respondents rejected the point; 51% of respondents agreed with the proposition that the restructuring in an insolvency plan proceedings has accelerated the entire restructuring process.[40] In relation to the legal certainty of the insolvency plan, numbers have deteriorated from 2013 to 2015: in 2013, respondents evaluated legal certainty with 21% as low or very low; in 2015, the number increased to 24%, meaning more respondents evaluate the insolvency plan proceedings with less legal certainty.[41] While the insolvency plan process is becoming increasingly important, the link between the protective shield proceeding and its resounding acceptance by the practice makes this especially clear. Self-administration approaches that require business knowledge often fail due to the complexity of the procedural requirements, or to the lack of cooperation of individual proceedings.[42] Nevertheless, there are also successful insolvency plan proceedings with interesting solution models, in particular cases where the retention of the legal entity is a prerequisite of the realisation of surplus value for the creditors in comparison to a liquidation. Restructuring has developed further, especially in terms of complexity, and provides all parties with new challenges. This will in turn lead to an increased incidence of distressed investors in the German market.[43]

Debt-Equity-Swaps in Insolvency Plan Proceeding

There is also an increase in knowledge of the respondents with respect to the debt-equity-swap: while in 2012 54% and in 2013, 62% of respondents felt adequately informed about the debt-equity-swap, the number increased to 81% in 2015.[44] Respondents perceived an increased risk for creditors by the debt-equity-swap with 51% consenting in 2014/2015 compared to 17% in 2013.[45] Insolvency is still perceived to be the cornerstone of a restructuring in the different corporate divisions.[46] Progress in operating performance is achieved only after the insolvency proceeding. The enhanced intrusion into existing shareholders' rights were also used in half of the cases.[47] The instrument mainly used was a debt-equity-swap. The

[38] *Noerr/ McKinsey*, InsO-Studie 2015, p. 12.
[39] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 21.
[40] *Roland Berger*, ESUG-Studie 2013, p. 25.
[41] *Roland Berger*, ESUG-Studie 2013, p. 33; *Roland Berger*, ESUG-Studie 2014/ 2015, p. 24.
[42] Braun/ *Frank*, InsO, Preliminary remark before Ss. 217 - 269, mn. 23 f.
[43] Handelsblatt/ *Kraus*, Konferenzbericht 2015, p. 7.
[44] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 15.
[45] *Roland Berger*, ESUG-Studie 2014/ 2015, p. 27.
[46] *hww*, ESUG-Radar 2015, p. 4.
[47] *BCG*, Drei Jahre ESUG, p. 11.

percentage of the original shareholders' rights were, on average, 10% in the course of these measures. In individual cases, the existing shareholders remained involved with up to 50% despite intrusion into their rights. A dual track mergers and acquisitions process was performed in 40% of the cases. [48] Banks refrain from using debt-equity-swaps for their own claims because of the risk-weighted assets implications and the increased consolidation rules under IFRS. This would be a field of activity more for distressed debt investors but it has been only sporadically found in practice so far.[49] Risks in insolvency plan proceedings are, among others, the considerable time and coordination efforts and the small practical experience of those involved with the insolvency plan, including debt-equity-swaps. When opening an insolvency proceeding, quick solutions are demanded, which cannot be realised due to the high time and coordination efforts. In addition, a business sale in accordance with an insolvency plan inherits unclarified warranty issues such as the withdrawal from the contract, potential price reductions or with respect to the other party.[50] The coordination effort stirred particularly from the fact that most intensive negotiations with creditors are necessary and the insolvency plan adoption requires a high effort to achieve a successful result.[51] It is moreover disadvantageous that the insolvency plan can only be implemented after court approval. [52]

The increased application of self-administration is a result of increased experience among the participants. In 2015, 86% of respondents said they have made? succeeded? With the preliminary self-administration and 69% with the protective shield proceedings. [53] The duration of the protective shield proceeding under Sec. 270b InsO is faster (on average 150 days) than the self-administration under Sec. 270a InsO (on average 190 days). However, the average duration of the protective shield proceedings has risen by about 1.5 months from the previous evaluations. [54] 55% of respondents agreed that the existing management is not suitable to proceed under self-administration but needs support. One can stipulate that creditors do not have much trust in debtors who are, in general, responsible for the financial distress in the first place. More than 70% think that a responsible CRO in the company is necessary in order to achieve a successful restructuring of the company. [55] Just over a third of respondents agreed that the protective shield proceedings and preliminary self-administration have led to an earlier application.[56] Despite the fact that 90% of respondents have already applied the ESUG norms, the creditors, judges and investors still feel poorly informed about the instruments.[57] That particular creditors are still critical and often refuse to agree to self-administration is because there is no

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[48] *BCG*, Drei Jahre ESUG, p. 11.
[49] *MAZARS*, ESUG-Radar 2014, p. 7.
[50] *Haarmeyer/ Frind*, InsR, p. 114.
[51] *Römermann/ Praß*, Das neue Sanierungsrecht, p. 176.
[52] *Haarmeyer/Frind*, InsR, p. 113, mn. 267.
[53] Roland Berger, ESUG-Studie 2015, p. 15.
[54] *BCG*, Drei Jahre ESUG, p. 8.
[55] *Roland Berger*, Pressemitteilung of 11.02.2014.
[56] *Roland Berger*, ESUG-Studie 2015, p. 25.
[57] *Roland Berger*, Press Release of 11.02.2014.

coherent restructuring plan.[58] Most companies are not able to present a complete restructuring plan when applying for self-administration, which rattles creditors.[59] Over 90% of respondents find the independence of the administrator and the management and its restructuring experience crucial for successful self-administration.[60] The communication with the trustees and all stakeholders[61] (especially in pre-application process) is extremely important.

Insolvency judges, however, are still critical of the self-administration application; the first hurdle in court would be the professional preparation of the application that would need to be made at least two weeks in advance.[62] Among the issues mentioned above, it will show how scepticism among users of self-administration will develop. The business-asset deal, subsequently leading to liquidation and dissolution of the legal entity, is still the major proceeding to rescue the company's business for going concern.[63]

Reasons for Modest Progress

Progress for corporate restructuring using an insolvency plan proceeding with self-administration or the protective shield proceeding are still slow. Therefore, one needs to consider reasons for such slow progress.

Stigma of Insolvency: a reason for filing (too) late?

The stigma of insolvency has been around throughout history[64] and is still valid in some countries today.[65] In order not to concede to the financial failure, debtors will try to avoid insolvency as long as possible.[66] With the Insolvency Act of 1999, the law shifted towards providing debtors with the opportunity to restructure rather than to liquidate.[67] This ought to change the perception that insolvency is not the end than as an opportunity for a new beginning.[68] There could be various reasons for the German attitude. One may be of the German mentality of caution and defensiveness towards entrepreneurial risk. This approach is regularly seen in cases of companies in financial distress where creditors are unwilling to grant entrepreneurs a second chance.

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[58] *Roland Berger*, ESUG-Studie 2013, p. 23.
[59] *Roland Berger*, Press Release of 11.02.2014.
[60] *Roland Berger*, Press Release of 11.02.2014.
[61] *Roland Berger*, Pressemitteilung v. 11.02.2014.
[62] Buchalik/ Brömmekamp/ *Stahlschmidt*, Newsletter 2014,p. 4.
[63] *Ulmer*, ZHR 149 (1985) 541, 544.
[64] *Bridge*, p. 37.
[65] *Sullivan / Warren / Westbrook*, 59 Stan. L. Rev. (2006-2007) 213, 233 on reasons what drives changes in the perception of stigma. See also *Leutheusser-Schnarrenberger*, ZInsO 2011, 2078, 2079.
[66] *Richter*, p. 148 et seq.
[67] BMJ, Begr. RegE-InsO 1992, BT-Drucks. 12/2243, p. 77.
[68] *Heinrich*, FS Greiner, p. 111, 113; *Tashiro*, Recovery, Winter 2009, p. 23.

Another reason lies in the history of insolvency law in general. The Bankruptcy Act tended to imply automatic liquidation.[69] Politically, corporate restructurings were only pursued in election campaigns and to save jobs.[70] The implementation of the Insolvency Act made a technical shift in the law,[71] but even almost 20 years later, corporate insolvency proceedings still inherit the stigma of insolvency.[72]

This stigma is partly responsible for the fact that that two-thirds of companies file for insolvency too late.[73] The average delay is about ten months,[74] resulting eventually in the failure of most companies.[75] The reason for the frequent failure of restructurings are always inadequate preparation of the plan and lack of time. A previously created restructuring concept could be the basis for a viable restructuring plan; the later preparations begin the more complex the task, and consequently this decreases the chances for developing a sound plan. Only external expertise may then help.

For these reasons, the ESUG has amended the Insolvency Act with the objectives to strengthen creditor rights (*inter alia* establishing a "provisional creditor committee") and the self-administration (*inter alia* the imposition of provisional self-administration and protective shield proceedings). In addition, the use of the insolvency plan should be promoted by the intervention into shareholder rights. Increased predictability of insolvency proceedings was declared a main goal. The amendments should lead to an earlier restructuring approach. This early restructuring should be operated easily even in insolvency proceedings to reduce the number of insolvencies due to lack of time of preparation, providing a more suitable legal environment for restructurings.

In comparison to Anglo-American investors, German companies still do not have the mind-set to see insolvency as an opportunity to restructure the company and, after a successful restructuring, to return to profitability.[76] The creation of ESUG was also designed to strengthen the rescue approach compared to the liquidation approach in German insolvency law.[77]

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[69] BMJ, Begr. RegE-InsO, BT-Drucks. 12/2243, p. 73; *Undritz*, Kölner Schrift zur InsO, 2009, p. 936.
[70] Examples in Germany include the public involvement of politics in *Philip Holzmann AG* and *Adam Opel GmbH.*
[71] BMJ, Begr. RegE-InsO, BT-Drucks. 12/2243, p. 77.
[72] *Jaffé*, ZIP 2001, 2302; *Paulus*, ZGR 2005, 309, 310 et seq.; *Undritz*, ZGR 2010, 201, 202.
[73] *Bitter/ Röder*, ZInsO 2009, 1283, 1287.
[74] Vgl. *Haarmeyer/ Frind*, InsR, Anhang, S. 136.
[75] *Hingerl*, ZInsO 2008, 404.
[76] *Flessner*, Sanierung und Reorganisation, p. 139; *Smid*, WM 1998, 2489, 2506; *Smid / Rattunde*, Der Insolvenzplan, 2005, mn. 2.37 et seq.
[77] *Vriesendorp / Gramatikov*, 19 Int. Insolv. Rev. (2010) 209, 223: providing data that the importance of rescue as a primary goal was declining after 2008.

Rescue Culture versus Insolvency Culture?

Although the 'rescue culture' is not uniformly defined and

> "has rather become a fashionable[78] epithet in international insolvency circles, it represents a belief that the insolvency process should be seen as a value-added commercial process rather than a merely legalistic burial of the business." [79]

Whether a national framework provides an 'insolvency culture' or 'rescue culture' depends on numerous factors: legal culture,[80] education,[81] history and traditions,[82] the relative national and societal attitudes, values and roots,[83] and the nation's economic development.[84] Others also influence one's own national legal culture[85]: it is not static but dynamic.[86] The liberality of legal culture[87] is its response to evolving needs and changing circumstances[88] and, thus, the desire for change.[89] More importantly, legal culture also implies the reliability of law and public confidence in the law.[90] In this sense, legal comparison also has a cultural mission in raising awareness of the advantages and disadvantages of different legal systems and traditions.[91] National law ought to be predictable, affordable and enforceable.[92] While some legal fields in Germany may have a good reputation, insolvency law with the focus on rescue is still working to achieve one. [93] A legal culture needs to evolve in accordance ton changing requirements; the law itself will not be able to create a culture.[94]

The differentiation between 'insolvency culture' as opposed to a 'rescue culture' shows the different national understandings of the insolvency and restructuring framework. 'Rescue culture' may provide a legal environment and proceedings to

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[78] *Wells*, BLR 2012, 156.
[79] *Nigel / Jones*, p. 138.
[80] *Skouris*, ZEuP 2012, 1: there is no consensus of a definition of 'legal culture', it is a framework that goes beyond a given legal system and encompasses it, that affects the operation of this legal system, which in turn reflects a given legal culture. Legal system and legal culture interact."
[81] *Griffiths / Hellmig*, NZI 2008, 418.
[82] *Vallender*, NZI 2010, 838, 839; *Mankowski*, JZ 2009, 321, 324.
[83] *Lechner*, AJICL 2002, 975, 977, *Vallender*, NZI 2010, 838, 839; *Finch*, 6 J.B.L. (2010) 502, 521.
[84] *Ibid.* p. 52, 53.
[85] Mankowski, JZ 2009, 321, 322 et seq.
[86] *Ibid.* 324 also refers to the fact that a missing dynamic may also be an attribute of a certain legal culture.
[87] *Ibid.*
[88] *Vallender*, NZI 2010, 838, 839.
[89] *Mankowski*, JZ 2009, 321, 324.
[90] *Von Münch*, p. 132; *Vallender*, NZI 2010, 838, 839.
[91] *Von Münch*, p. 132, *Mankowski*, JZ 2009, 321, 324 et seq.
[92] *Zypries*, Ein Rechtssystem mit Qualitätssiegel, in FAZ Nr. 251, 27.10.2008, p. 10.
[93] *Balz*, 23 Brook. J. Int'l L. (1997) 167, 167 "rescue Neanderthals";
[94] Minister of Justice Heiko Maas, Speech on 10.03.2016, see https://www.bmjv.de/SharedDocs/Reden/DE/2016/03102016_Insolvenzrechtstag.html. See also *Paulus*, WM 2011, 2205. *Vallendar. NZI 2010,* 838.

intervene into a situation[95] to avert a corporate failure[96] when a company is restructured as a going concern rather than being liquidated in cases where the company's assets are more valuable on a going-concern basis than in dissolution. Such an environment may be a mere perception rather than reality.[97] In reality, however, the trust in the legal framework and the business environment, whether justified or not, leads the perception to be a self-fulfilling prophecy.

An 'insolvency culture' focuses on insolvency proceedings, maximising the satisfaction of creditors' interests – which may be reached, among others, by a restructuring of the debtor.[98] These may be facilitated via an insolvency plan proceeding, increasing the chances of a successful restructuring, which may be even higher than in an informal restructuring.[99] The focus, therefore, is not on the rescue of the company itself but on the restructuring being rather a means for the satisfaction of the creditor. Since the instruments in the German legal framework did not serve their purpose for a more rescue-friendly environment,[100] the legislature put forward legal changes with the ESUG to make progress towards a *rescue culture*.[101] The terminology was important since it was repeatedly discussed whether Germany already has an *insolvency culture*[102] that would shift from the liquidation of the debtor's assets towards the going-concern of the debtor company and towards a *rescue culture*,[103] also counteracting the stigma of insolvency.[104] The questions remain of how a *rescue culture* is established and whether a developed *rescue culture* is more civilised than an *insolvency* or *liquidation culture*.[105] Only in the case where the restructuring of a company as opposed to liquidation provides for maximum creditor satisfaction, do *rescue culture* and *insolvency culture* overlap. However, it should be kept in mind that liquidation as an option in an insolvency proceeding

> "is not an economic ill or a "destroyer" of wealth [but r]ather, reallocating the assets amidst the drama of bankruptcy […] to the economy because idle factors of production can be put to use more efficiently."[106]

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[95] *Finch*, 6 J.B.L. (2010) 502, 503.
[96] *Belcher*, p. 36; *Wells*, BLR 2012, 156.
[97] *Walters / Smith*, 19 Int. Insolv. Rev. (2010), 181, 203, stating that it is "the perception that the English insolvency system facilitates efficient outcomes."
[98] *Vallender*, NZI 2010, 838.
[99] *Heinrich*, in FS Greiner, p. 111, 113.
[100] *Eidenmüller*, Unternehmenssanierung, p. 50. As long as the insolvency plan or self-administration does not supply the same proceeds as the liquidation, they will not be the choice of proceeding.
[101] *Moldenhauer et al*., September 2013, the progress is rather hesitant. See also *Gravenbrucher Kreis*, ZIP 2014, 1262, pointing out where ESUG needs further adjustments, rather now than after the evaluation period of five years' time.
[102] *Vallender*, NZI 2010, 838, 840; *Braun / Heinrich*, NZI 2011, 505, et seq.
[103] *Vallender*, NZI 2010, 838, 842.
[104] See Chapter II 3.2.1; also *Undritz*, ZGR 2010, 210, 216.
[105] *Balz*, 23 Brook. J. Int'l L. (1997) 167.
[106] *Ibid.* 169.

There are various aspects to consider in a *rescue* or *insolvency culture*, and it may have an implication if the business or the legal entity is rescued in a corporate restructuring.[107]

What to Rescue: Legal Entity or Business?

At the last reform, the German Insolvency Commission did not provide any reason for whether preference was given for restructuring the legal entity prior to restructuring the business.[108] It did not recognise, however, the business-asset deal as a restructuring alternative.[109] In the legal-political discussion, the restructuring of the company's legal entity was preferred over the business-asset deal.[110] This aspect is surprising. The decisions in a restructuring process regularly lead to a conflict between the management of the debtor[111] and the creditors when they do not agree on legal measures, e.g. having the creditors intrude into the corporate structure of the company by implementing a debt-equity-swap.[112] Such a conflict regularly leads to suboptimal creditor satisfaction while it is the primary objective of the Insolvency Statute to fully serve the interests of creditors and their satisfaction in the insolvency proceedings.[113] It is therefore not enough for a company to be viable, they have to be restructured in a reasonable way for creditors.[114] Otherwise, creditors could take the decision to realise the going concern value of the company by enforcing their claims, which may not necessarily lead to the survival of the company's legal entity.

One may argue that there could be economic reasons for preferring the restructuring of a company's legal entity to a business-asset deal.[115] However, this cannot be a justification for the continuation of the company's legal entity. Especially in a market economy, this approach cannot be followed because otherwise the law intrudes too far into the market forces that ensure that companies are run by the most efficient corporate legal entity. The liquidation of a business with the concurrent dissolution of its legal entity does not comply with the forces of a dynamic market economy, especially if the assets of the company rated stand-alone carry a higher value than the company as a whole, and thus there is no market-based interest in the going concern of the company's legal entity.[116] A new corporate legal entity for the

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[107] *Balz*, Sanierung von Unternehmen, p. 14, 15; *Madaus (Fn 5)*, p. 29.
[108] *Balz*, Sanierung von Unternehmen, 1986, p. 2, 21.
[109] *Ulmer*, ZHR 149 (1985) 541, 544.
[110] *Balz*, Sanierung von Unternehmen, p. 1.
[111] *LoPucki,* 57 Vand. L. Rev. (2004) 741,767, stating that "[T]he members of the board of directors, acting as fiduciaries, decide which of these claims to recognize and how much to pay the claim holders."
[112] *Balz*, Sanierung von Unternehmen, p. 5. Comparison was always especially made with U.S. bankruptcy law, whose goal is not the restructuring of the debtor by courtesy of the financiers but rather the acquisition of its assets by the creditors, who seek to satisfy their claims in the going concern of the company as part of a debt-equity-swap.
[113] *Berges*, KTS 1955, 49, 51.
[114] Erster Bericht der Kommission für Insolvenzrecht 1985, p. 152.
[115] *Balz*, Sanierung von Unternehmen, p. 21.
[116] *Balz*, Sanierung von Unternehmen, 1986, p. 23.

business may be a solution particularly when the creditors are not otherwise willing to participate in a restructuring.

Despite the fact that creditor satisfaction is the main goal of the Insolvency Act, the first insolvency reform discussed whether and how much participation in decision-making the existing shareholders of the company should have or even is required, or whether they should just be ignored.[117] Since the shareholders were granted the right to obstruct any legal measures that would violate or intrude into their own rights[118] and were not made a party involved in the insolvency plan proceeding, one could argue that it was the aim of the legislator to rather restructure legal entities in appropriate cases in a commercially reasonable manner.[119] The literature also disagreed over whether restructuring by means of a business-asset deal would suffer a legitimacy deficit because it would preclude the creditors from the success of the restructuring[120] or not, as the proceeds from the sale of the company in a business-asset restructuring would flow into the insolvency pool and would therefore be available for creditor satisfaction.[121]

The success of the business-asset deal as a form to encourage the restructuring of the business rather than the legal entity was foremost due to the fact that the creditors were able to implement restructuring measures after the business was transferred to a new entity. And they did not have to deal with obstructing shareholders, which is generally time-consuming and therefore value destructive. Although some restrictions may apply in business-asset deals with reference to certain rights, it allows companies to restrict liability to the old legal entity, which is especially important for the recognition of unknown future claims.

With ESUG, shareholders are now a party involved in insolvency and are not able to obstruct legal measures anymore for the case that the company is insolvent. This could lead to the conclusion that the focus of restructuring may now have shifted from restructuring the business after a business-asset deal to restructuring the legal entity in an insolvency plan proceeding.[122] The insolvency plan may include the temporary going concern of the company as well as partial liquidations and restructuring or complete restructuring, implementing a debt-equity-swap at the old or a new corporate entity. Therefore, the focus is yet not on the restructuring of the company's legal identity.[123]

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[117] *Ibid.,* p. 4.
[118] BMJ, RegE-InsO, BT-Drucks. 12/2443, p. 78 et seq. This was contrary to the suggestions of the Insolvency Commission, *see* Erster Bericht der Kommission für Insolvenzrecht 1985, p. 282 et seq. allowing for the intrusion into the shareholder structure of the company.
[119] *Balz*, Sanierung von Unternehmen, 1986, p. 18.
[120] *Schmidt*, ZIP 1980, 328, 337 et seq.
[121] *Stürner*, ZZP 1981, 263, 285; *Stürner*, ZIP 1982, 761, 771.
[122] *Brinkmann*, WM 2011, 97, 99.
[123] *Balz*, Sanierung von Unternehmen, 1986, p. 12.

Whether or not the rescue of a company refers to the business or the legal entity of the company is only important when considering the goal of the restructuring proceeding for a company in financial distress, which is rather the going concern of the viable business for the benefit and satisfaction of the creditors.

With ESUG in Germany and the limitation of obstruction potential for shareholders in implementing any legal measures to change the corporate structure in an insolvency plan proceeding, creditors are encouraged to engage in debt-equity-swaps. This would firstly lead to the restructuring of the legal entity and, in the next step, the restructuring of the company as a whole. Despite the fact that this may be carried out in a timelier manner than a business-asset deal, new liabilities arise from future unknown claims, endangering the validity of the insolvency plan proceeding ex post when enforced.

German insolvency law did not previously offer the opportunity to enforce financial measures against shareholders. Instead it kept the insolvency plan proceeding in the tradition of a liquidation rather than a restructuring-oriented process, which served to simplify the management of the insolvent debtor.[124] The question is whether this would have been the only reason for the rare application of the insolvency plan procedure as an effective legal restructuring option in practice.

The slightly positive perception in the application of the insolvency plan in the insolvency practice is primarily due to the publicity-effective restructuring success of major German companies through insolvency plan proceedings.[125] It also shows, however, that even the most experienced restructuring experts cannot prevent the subsequent liquidation in an insolvency plan proceeding.[126]

In German law, the creditors generally decide how they want to deal with the assets of an insolvent debtor. The creditors' meeting decides whether the debtor's assets should be liquidated or whether the business activity of the debtor has future potential. Particularly for companies whose going concern value exceeds the liquidation value, a going concern may ensure the best possibility to satisfy creditors.[127] The Insolvency Statute offers several alternatives to creditors to obtain the best possible satisfaction[128] and it provides for a going concern, liquidation and business-asset-deal as equal proceedings.[129] The assets of a debtor can be liquidated in a regular insolvency proceeding[130] or in an insolvency plan proceeding.[131] A going

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[124] *Madaus (Fn. 5)*, p. 590.
[125] *Rattunde*, ZIP 2003, 596, 597 (*Herlitz*); *Fritze*, DZWIR 2007, 89, 90 (*Senator Entertainment*).
[126] *Geldmacher*, p. 29.
[127] BMJ, Begr. RegE-ESUG, BT-Drucks. 12/2443, p. 195. See *Scheunemann / Hoffmann*, DB 2009, 983; *Rattunde*, ZIP 2003, 2103, 2110.
[128] BMJ, Begr. RegE, BT-Drucks. 12/2443, p. 78, 94. All alternatives may be supported by a plan proceeding, see BMJ, Begr. RegE InsO 1992, BT-Drucks. 12/2443, p. 91.
[129] BMJ, Begr. RegE-InsO, BT-Drucks. 12/2443, p. 77 et seq.
[130] *Smid*, Praxishdb. Insolvenzrecht, Ss. 24 et seq.
[131] „*liquidation plan*“, see *Kranzusch*, ZInsO 2007, 804, 805.

concern of a company may also be achieved by a business-asset deal[132] in a new legal entity or in an insolvency plan proceeding.[133] The Insolvency Act does not prefer any particular solution. The method depends on the economic condition of the debtor and the preferences of the creditors.[134] In addition, although the Insolvency Act provides for three conceptual options[135] for the restructuring of a company, debt-equity-swaps usually do not take place (anymore) in liquidation or business-asset-sale. The implementation focuses on the insolvency plan proceeding.

Progress Out-Of-Court?

Provided there is not already a legal obligation to file for insolvency under German law, the question is whether the debtor should pursue an informal proceeding by negotiation or by a statutory proceeding in court to agree with the company's creditors on a restructuring and, thereby, on the going concern for a company in financial distress to return to profitability.[136] A profitable company is viable when the going concern may be achieved without any losses and when the income generated can cover the liabilities and costs of the ongoing operations. That the company has prospects of returning to profitability without further losses is probably a necessary but not a sufficient condition for creditors to engage in a restructuring from an economic perspective. They will consider this possibility for the case that the going concern value of the company is often, but not necessarily always, greater than its liquidation value.[137] If the parties in insolvency determine autonomously on restructuring or liquidation, a decision to restructure is always also a decision to use the liquidity value of the legal status of their claims.[138] Creditors would engage in a restructuring when their anticipation is to regain a higher recovery rate through the restructuring of the company than that which would materialise from the insolvency quota in liquidation.[139] In addition, in economic terms the capital invested in the restructuring should bring at least the same yield as alternative investments; only then is a restructuring feasible.[140]

In an informal process, the debtor and its creditors agree on a consensual contractual solution outside a given legal framework[141] generally regarding the interests of the

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[132] A business-asset deal may also be done in an insolvency plan proceeding, "*transfer plan"*; *see* BMJ, Begr. RegE, BT-Drucks. 12/2443 p. 94 et seq.; W*arrikoff*, KTS 1997, 527, 541 et seq.
[133] „*reorganisation plan*", see BMJ, Begr. RegE, BT-Drucks. 12/2443, p. 195; *Warrikoff*, KTS 1997, 527, 542 et seq.
[134] Begr. RegE, BT-Drucks. 12/2443, p. 76; *Maus*, in *K. Schmidt/Uhlenbruck*, GmbH in Krise, Sanierung und Insolvenz, p. 159 mn. 355; *Fröhlich / Köchling*, ZInsO 2005, 1121, 1125; *Balz*, Sanierung von Unternehmen, p. 18 et seq.
[135] S*assenrath*, ZIP 2003, 1517, 1518.
[136] *Undritz*, Kölner Schrift zur InsO, p. 938.
[137] This is a mandatory requirement for the company's restructuring, see also *Hax / Marschdorf*, BFuP 1983, 112, 115; *Gröner*, ORDO 1984, 247, 252.
[138] *Gröner*, ORDO 1984, 247, 253 et seq.
[139] *Balz*, Sanierung von Unternehmen, p. 20.
[140] *Gröner*, ORDO 1984, 247, 254.
[141] *Eidenmüller*, BB 1998, Beil. 10, p. 19.

company's creditors as a whole.[142] There are several advantages to an informal consensual restructuring proceeding.[143] There is the potential for higher value preservation or recovery[144] due to the private autonomous negotiations.[145] The process provides flexibility in implementing appropriate measures and it allows for "early, quickly and quietly"[146] restructuring, which is usually less complicated and less expensive[147] but more effective.[148] However, the need for lender consent[149], the blocking potential of (minority) stake- and shareholders,[150] the difficulties of acquiring going concern financing or the legal uncertainties *ex post* with regard to risk of remedies[151] or liabilities for directors for filing late[152] are a trade-off. In addition, the consensual agreement does not have access to the instruments provided in a statutory proceeding.[153] Without supervision of independent mandatory parties such as the insolvency court or the insolvency administrator,[154] there is the risk of single creditors being individually disadvantaged,[155] which would not occur in a statutory proceeding.[156] A consensual restructuring should only be initiated when there is a high probability that the restructuring will be successful.[157] The informal approach of rescuing companies has gradually spread and is used in a considerable number of jurisdictions all over the world, particularly in cases where a financial and economic crisis is present.[158]

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[142] *Finch*, J.B.L. 2008, 756, 758.
[143] *Uhlenbruck*, BB 2001, 1641 et seq.; *Drukarczyk / Schöntag*, Sec. 3; *Oberle*, in FS Wellensiek, p. 73, 75; *Eidenmüller*, Unternehmenssanierung, p. 331 et seq.
[144] *Kranzusch / Icks*, p. 103 et seq.; Eidenmüller, Unternehmenssanierung, p. 332 et seq.; *Jostarndt*, p. 105 et seq.; *Eidenmüller*, ZHR 160 (1996) 343, 348. Contrary *Spliedt*, InsVZ 2010, 27, 29: high advisory costs in the consensual restructuring solution.
[145] *Eidenmüller*, ZHR 160 (1996) 343, 349 et seq.; *Drukarczyk / Schöntag*, Sec. 3, mn. 1.
[146] *K. Schmidt*, Gutachten D zum 54. DJT, 1982, S.D. 133. See also *Eidenmüller*, ZHR 160 (1996) 343, 349 et seq.; *Uhlenbruck*, BB 2001, 1641, 1644; *Ehlers*, ZInsO 2005, 169, 170; *Drukarczyk / Schöntag,* Sec. 3, mn. 1 et seq.
[147] *Eidenmüller*, Unternehmenssanierung, p. 331 et seq. for empirical evidence.
[148] *Finch*, J.B.L. 2008, 756, 776; *Howard / Hedger*, mn. 1.17. *Drukarczyk / Schöntag*, Sec. 3 mn. 42; *Uhlenbruck*, BB 2001, 1641, 1644.
[149] *Drukarczyk / Schöntag*, Sec. 3 mn. 3; *Eidenmüller*, ZHR 160 (1996) 343, 344 et seq.: The main obstacle is that the plans only have effect on creditors which have agreed upon it in a consensual way.
[150] "Akkordstörer" BGHZ 116, 319 II 1.a) b) of the decision, NJW 1992, 967, 968 et seq. = ZIP 1992, 191: "From this follows that an agreement negotiated outside of such a proceeding is not binding on creditors who have not agreed to it." See also *Eidenmüller*, ZHR 160 (1996) 343, 346; *Bitter*, ZGR 2010, 147, 167 et seq.
[151] *Cranshaw*, ZInsO 2008, 421, 422.
[152] *Rattunde*, ZIP 2003, 2103, 2105; *Uhlenbruck*, BB 2001, 1641, 1644; *Cranshaw*, ZInsO 2008, 421, 422; *Ehlers*, ZInsO 2010, 257; *Spliedt*, InsVZ 2010, 27, 32 et seq.
[153] *Spliedt*, InsVZ 2010, 27, 29 et seq.; *Uhlenbruck*, GmbH in Krise, Sanierung und Insolvenz, p. 144. Examples are the termination of contracts (Ss. 103 et seq. InsO) and redundancy period for employees (Ss. 113 et seq. InsO), a moratorium (Ss. 21(2)(1)(no.3), 89 InsO) or prohibited netting (Sec. 96 InsO). *See also* Euler Hermes, Rettung aus der Insolvenz, p. 10: an important liquidity source is the state funded money for employees in the first three months (Insolvenzgeld).
[154] *Drukarczyk / Schöntag*, Sec. 3 mn. 1.
[155] *Finch*, J.B.L. 2008, 756, 766 et seq.
[156] *Uhlenbruck*, BB 2001, 1641, 1645.
[157] *Rattunde*, ZIP 2003, 2103, 2105.
[158] *Cárdenas*, in *Buljevich*, xvi.

Although publicly announced statutory proceedings are assumed to be more complex and lasting, costly and value-destroying due to the negative effect on the company's reputation,[159] the legal framework provides for a regulated process with an acceptable solution carried by a majority of creditors. The choice of process depends on the company and the state of the financial crisis. Overall, the advantages and disadvantages weigh up,[160] but all parties involved gain from an agreement to use the more efficient method.[161]

With the initiatives from the European Union, progress could be further pushed to implement an out-of-court and preventive restructuring proceeding in Germany. The law-making process for a pre-insolvency restructuring procedure was stalled in favour of a review of the results yielded by ESUG, whose review is scheduled for 2017.

The European Approach to Corporate Rescue

The European Commission's Strategic Approach

Strengthening the European Union' economy and the stimulation of investments in the internal market[162] is high on the list of priorities of the European Commission. Due to the economic detriments of insolvencies for the internal market in the aftermath of the financial crisis,[163] one aspect to create a strong capital market are insolvency and restructuring proceedings. In the context of the recast of the European Insolvency Regulation on (cross-border) insolvency proceedings,[164] which is a further step towards a more harmonized European framework, the European Commission recommended "A new European approach to business failure and insolvency."[165]

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[159] *Hass / Tschauner*, ICR 2005, 93, 94.
[160] *Uhlenbruck*, KSI 2010, 125, 126.
[161] *Easterbrook*, 27 J Fin. Econ. (1990) 411, 416.
[162] Investment plan ("Juncker Plan), see https://ec.europa.eu/priorities/jobs-growth-and-investment/investment-plan_en; Action Plan on Building a Capital Markets Union, COM(2015) 468 final; Single Market Strategy, see https://ec.europa.eu/growth/single-market_en, accessed 10.10.2016.
[163] Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee – A new European approach to business failure and insolvency, COM(2012) 742 final, p. 2: "From 2009-2011, an average of 200,000 firms went bankrupt per year in the EU. About one-quarter of these bankruptcies have a cross-border element. About 50 % of all new businesses do not survive the first five years of their life. 1.7 million jobs are estimated to be lost due to insolvencies every year."
[164] Regulation (EU) 2015/848 on insolvency proceedings, OJ L 141, 5.6.2015.
[165] Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee – A new European approach to business failure and insolvency, COM(2012) 742 final, accessed 30.06.2016; Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, COM(2012) 743 final, http://ec.europa.eu/justice/civil/files/insolvency-report_en.pdf, accessed 30.06.2016. See also *Marks*, ICR 2012, 227 et seq.

The European Commission's Recommendation

The non-binding recommendation[166] aims to provide a minimum standard for

> "access to national insolvency frameworks which enable [companies] to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole."[167]

This has put considerable pressure on the Member States to modernize their national insolvency law, where appropriate.[168] The Commission deemed it necessary to

> "encourage greater coherence between the national insolvency frameworks in order to reduce divergences and inefficiencies which hamper the early restructuring of viable companies in financial difficulties […] to lower the cost of restructuring for both debtors and creditors. Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence would also facilitate the restructuring of groups of companies irrespective of where the members of the group are located in the Union."[169]

While the Member States were invited to implement the principles, the Commission has assessed the implementation within 18 months of publication to decide whether additional measures to consolidate and strengthen the approach should be proposed.[170] While the European Union itself respects different legal traditions and values,[171] this is a clear statement towards further alignment of legal standards in the area of restructuring and insolvency law within the European Union. Overall, the (new or amended) legal rules should shift the focus away from liquidation to develop a new approach to helping businesses overcome financial difficulties, while at the same time protecting creditors' right to get their money back[172] where appropriate,[173] in the best case towards a harmonised European rescue culture.[174]

The "Evaluation of the Implementation of the Commission Recommendation"[175] clearly shows that the European Commission is taking its approach seriously. It had to realize, however, that only a few Member States had undertaken reforms to implement the recommendation.

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[166] Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, C(2014) 1500 final, http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf, accessed 30.06.2016.
[167] *Ibid.*, Recital (1).
[168] *Paulus*, NZI 2012, 297, 298.
[169] Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, C(2014) 1500 final, Recital (11).
[170] Ibid. Nr. 34, 36.
[171] *Jayme*, RabelsZ Bd. 67 (2003) 211, 214; *von Bogdandy / Schill*, ZaöRV 70 (2010) 701: on the European Union to respect the national identities of the Member States.
[172] European Commission Justice / Insolvency Proceedings, http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm, accessed 30.06.2016.
[173] *Paulus*, NZI 2012, 297, 298.
[174] *Konecy*, NZI 2008, 416.
[175] Directorate-General Justice & Consumers of the European Commission, 30 September 2015, http://ec.europa.eu/justice/civil/files/evaluation_recommendation_final.pdf, accessed 30.06.2016.

The German government did not engage in a review of the existing German law in the light of the minimum standards of the recommendation. This may be undertaken by a review of ESUG in 2017. The instruments introduced by ESUG ought to be sufficient to meet the requirements for facilitating early company restructurings in Germany, especially the protective shield proceeding. Indeed, this is a good starting point, especially in combination with the insolvency plan proceeding. However, it cannot replace a stand-alone pre-insolvency proceeding. While Germany will continue to promote early filings, it is doubtful that it will provide solutions for successful restructurings outside a statutory insolvency process. It was unlikely that the recommendation would trigger further amendments to the current insolvency law framework. Despite the critique, the German framework already offers sufficient opportunity for successful, efficient and sustainable early restructurings. For sensible creditors and debtors who are willing to agree on proper moratoria, negotiate in good faith and with the willingness to acknowledge the difficult situation, accept support and agree a fair compromise, it will continue to work (well). The German legal framework is and will remain restricted to formal insolvency processes. In this regard, the German government has achieved significant improvements over recent years. For restructurings in insolvency situations, German insolvency law provides an ample toolkit with a multitude of options for successful and sustainable restructuring. With more marketing and the willingness of non-German stakeholders to accept methods that are different from those they are familiar with, nevertheless they will achieve results close to those achievable in their home jurisdictions. Creative counsel and open communication may therefore outweigh the absence of a framework for pre-insolvency restructurings.

<u>The European Commission's Directive on Preventive Restructuring Frameworks</u>

The European Commission's ambitions for more harmonized restructuring and insolvency laws with key principles in the national frameworks of Member States resulted in the proposal for a "Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures".[176] The Commission's legislative proposal is far reaching and goes beyond the recommendation in some aspects. The directive aims to ensure minimum standards for pre-insolvency or preventive restructuring proceedings, which would significantly change the current German insolvency law. The proposal emphasizes – among others – especially:

- early warning tools available to debtors;[177]

[176] Proposal for a Directive of the European Parliament and of the Council on the preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending the Directive 2012/30/EU, 22.11.2016, COM(2016) 723 final.
[177] Ibid. Article 3.

- the availability of preventive restructuring frameworks for debtors in financial distress with the likelihood of insolvency,[178] putting provisions in place, which limit the involvement of judicial or administrative authority where necessary and appropriate;[179]
- the debtor remains in possession when accessing preventive restructuring procedures,[180] with no mandatory judicial or administrative authority of a practitioner;[181]
- the stay of individual enforcement actions of up to four months,[182] under certain prerequisites, up to twelve months[183] with suspension of the obligation to file for insolvency,[184] except where the debtor become illiquid during the stay period;[185]
- a restructuring plan,[186] which will be voted on by all affected creditors[187] will be binding to all (also dissenting) when a majority of creditors (75%) voted in favour of the plan[188] and a court confirmed the plan,[189] providing reasonable prospects of preventing an insolvency;[190]
- the possibility of a cross-class cram-down when the plan is not approved by each and every class,[191] the judicial or administrative authority may confirm the plan depend upon certain requirements (best interest test, one creditor class have approved the plan and compliance with the absolute priority rule),[192] which is then binding on each party involved:[193]
- the protection of new financing, interim financing and other restructuring related transactions, which will be subject to protection against liability, action of voidance and unenforceability;[194]
- measures to increase the efficiency of restructuring, insolvency and second chance with special judicial and administrative authorities who receive initial and further training to a level appropriate to their responsibilities[195] thereby ensuring efficient dealing with the necessary expertise and specialisation;[196]
- initial and further training for practitioners in the field of restructuring and insolvency who provide their services in an effective, impartial and competent

[178] Ibid. Article 4(1).
[179] Ibid. Article 4(3).
[180] Ibid. Article 5(1).
[181] Ibid. Article 5(2).
[182] Ibid. Article 6(4)
[183] Ibid. Article 6(7).
[184] Ibid. Article 7(1).
[185] Ibid. Article 7(3).
[186] Ibid. Article 8.
[187] Ibid. Article 9.
[188] Ibid. Article 9(4).
[189] Ibid. Article 10(1).
[190] Ibid. Article 10(3).
[191] Ibid. Article 11(1).
[192] Ibid. Article 11(1)(a)(b)(c).
[193] Ibid. Article 14(1).
[194] Ibid. Article 16(1), 17(1).
[195] Ibid. Article 24(1).
[196] Ibid. Article 24(2).

> way in relation to the parties[197] and who are appointed in a clear, predictable and fair process.[198]

When the proposal will be adopted into a directive, it will provide minimum requirements to be fulfilled by the Member States. It will lead to amendments of restructuring and insolvency frameworks throughout the European Union because the Member States have to implement the directive into national law within two years after adoption and publication.[199]

The directive will also have a far-reaching impact on the German legal framework and there are several challenges to consider. A positive aspect of the directive is to ensure preventive restructuring, out-of-court proceedings in all Member States. In Germany, such a proceeding would allow for a restructuring of a viable company with only a majority consent compared to the current unanimous consent requirement with free-rider challenges and dissenting creditors torpedoing the restructuring if they do not get it their way.

The idea of creating a positive-perceived 'preventive restructuring' versus a negative-perceived 'pre-insolvency' proceeding in order to provide companies in distress with a new restructuring while avoiding the stigma of insolvency is useful.

However, a negative aspect is that the differentiation between preventive, out-of-court proceedings and statutory insolvency proceedings would further elevate that stigma: viable businesses with a going concern will be restructured in a preventive restructuring proceeding while all other companies in insolvency proceedings would rather be liquidated. This would be very counterproductive towards the progress that was made in the previous years from an 'insolvency culture' towards a 'rescue culture'.

A huge chance for the German legislator will be the specialization of courts because the number of insolvency courts[200] gave particularly rise to criticism. The high number was a reason for the courts' (partial) inexperience and low qualification in dealing with insolvency plan proceedings and self-administrations. A reform of the judiciary to concentrate more on insolvency issues to promote effective corporate restructurings was initiated with the discussions for ESUG with the idea to have one insolvency court for each district court.[201]. So far, it was a political problem because the legislator lacked the willpower to initiate a structural court reform and the concentration of courts was abandoned and, in accordance with the principle of subsidiarity, left to the federal state. [202] With the directive's proposal, the expertise

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[197] Ibid. Article 25(1).
[198] Ibid. Article 26(1).
[199] Ibid. Article 34.
[200] There are 187 lower district courts (Amtsgerichte) able to open an insolvency proceeding, see INDat-Insolvenzstatistik (www.indat.info/statistiken.php)
[201] Sec. (2)(2)(4) RegE-ESUG.
[202] BMJ, RegE-EUSG, BT-Drucks. 17/7511, p. 2.

of the courts would increase, insolvency judges must have specific knowledge and initial and further training.

Less Modesty and More Progress

While the German legislator has already discussed a possible pre-insolvency proceeding within the framework of ESUG, it ultimately decided against its implementation. Instead, ESUG introduced the protective shield proceeding as an alternative to the other instruments for companies to restructure, which has not been a successful option for companies in distress yet to initiate earlier negotiations with its creditors. With its recommendation, the European Commission showed that it views an efficient insolvency and restructuring important for the success of the internal market and the economic prosperity of the European Union. Since the Member States did not seem to take the recommendation serious, the European Commission initiated the directive's proposal to ensure a more harmonised framework between the Member States.

It will be interesting how the German legislator will react to the directive if adopted with no further changes. It had already accepted the plans of the European Commission with restraint.[203] The evaluation of the ESUG insolvency law reform from 2012 will begin in 2017, and this will give the legislator a chance to proactively react to the directive's proposal, regarding Germany's legal culture and tradition more towards a 'rescue culture'. There is no more time for modesty but time for progress now!

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[203] Heiko Maas, Fn. 97.