



Focus on ESUG – Part 2: Protective Shield Proceedings

In 2012, the so-called ESUG was introduced in Germany to legally ease financial restructurings and insolvencies. A working knowledge of the new restructuring arsenal is beneficial for international investors in order to achieve successful distressed transactions in Germany. With the second chapter of our new series “Focus on ESUG” we will cut right to the chase by highlighting the best known tool – highly anticipated from practitioners and investors alike – the new set of German restructuring law has to offer: “Schutzschirmverfahren” (Protective Shield Proceedings).

Just like ESUG the protective shielding proceeding is not a singular comprehensive statutory approach by the German legislator, i.e. it is not a new restructuring tool in itself. In fact, it is a new rule (§ 270 b InsO) that outlines a series of steps by which the court can combine the newly enhanced debtor-in-possession (DIP)-proceedings with the insolvency plan proceedings. Following this new concept outlined by the protective shield rule, a business can be restructured within a short period of time (not counting the out-of-court restructuring process, about 4 months) and without having to open official insolvency proceedings.

Protective Shield Process – Step by Step

> **Early Filing to Open Insolvency Proceedings:** while the debtor has to file for insolvency, the protective shield rule allows such filing only for the state of impending insolvency (i.e. the debtor is not yet in a state of failure to pay but illiquidity is highly likely in the near future). It is mandatory to combine the filing to open insolvency proceedings with a request for the court to allow DIP-proceedings.

> **Statement of Restructuring Intention:** the court will only allow the opening of DIP-proceedings under the protective shield rule when the company officially states its intention to reorganise its business and the court is satisfied that such intention is not obviously without prospect of success.

> **Presentation of a Certification:** for the court to decide on the fact of the impending illiquidity and the prospects of the intended reorganisation, the request shall be accompanied by a certificate from a tax accountant, auditor, attorney or any other person experienced in insolvency matters, showing that the illiquidity is only impending and that restructuring the business as intended by the company and its advisors is not obviously futile.

> **Presentation of an Insolvency Plan:** upon such request and certification by the company, the court will determine a deadline (of max. 3 months) for the company and its advisors to present an insolvency plan.

> **No Conflicting Reasons:** even post ESUG some reasons remain which lead to a mandatory transfer from the protective shield proceedings to standard insolvency proceedings, e.g. if the preliminary creditor committee

so votes or the prospect of success for the pursued reorganisation becomes futile during the restructuring process.

> **Request for Protective Measures (optional):** the court can, or has to when the company so requests, order protective measures to avoid negative shiftings in the companies estate; e.g. prohibition of foreclosure or establishment of a preliminary creditor committee.

Advantages at a Glance

> **Not Out-of-Court but Out-of-Insolvency:** while filing an official request to open insolvency proceedings is still necessary, the protection shield proceeding is aiming for the avoidance of the opening of insolvency proceedings. When the court approves for the presented insolvency plan it will suspend the provisional proceedings and the company, its advisors and its creditors can implement the actions set out in the plan in an out-of-court scenario.

> **Control:** more influence on the appointment of the preliminary custodian (with mere supervisory powers and whose involvement in the out-of-court counseling is not a mandatory criteria for exclusion anymore) means that the management and its advisors stay in control.

> **Fast and Protected:** without the rules and restrictions of a formal insolvency proceeding and under the court's protection against creditors pursuing their claims, the company and its advisors should be able to restructure the business in less than 4 months.

> **Majority Voting:** in insolvency plan proceedings opposing creditors can be "cut-off" by majority vote (cram-down); at the same time, legal remedies available to those creditors having thus been outvoted are being reduced.

> **Pre-Packaged-Planning:** restructuring measures put in place before filing the request to open insolvency proceedings can be kept up in an ongoing business without disruption through the opening of insolvency proceedings and the appointment of an insolvency administrator. The out-of-court negotiations with the creditors can be transferred into the insolvency plan.

Conclusion

A distressed company, its advisors and investors/creditors seeking to invest in the companies debt need to be sure that their planning for the going concern of the business and the implementation of the reorganization measures as set out in the restructuring plan can, in case the avoidance of insolvency is not an option, be smoothly transferred into an in-court-scenario. The shifting of DIP-proceedings into the preliminary insolvency phase in combination with the preparation of an insolvency plan under the protective shield now provides for a powerful and fast restructuring tool without having to open official insolvency proceedings.



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