



THREAT TO INVOKE GERMANY'S STARUG

Speeds Execution of Amend and Extend Transactions

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10

Recent geopolitical and macroeconomic developments, including inflation, the interest rate environment, money supply, and signs of recession, have had a significant impact on the financing market globally.

In Germany, the decline in the financing volume of leveraged loans, high-yield bonds, and direct lending, combined with a significant relative increase in spreads for financing at risk of default, has made refinancing problematic loans much more difficult. As a result, primarily only companies with a good rating can guarantee the refinancing of their maturities. For low-rated loans or overleveraged companies, the financing situation has become much more difficult.

Germany is characterized by mid-cap companies which are typically bank-financed; thus, it is essential to start negotiations at an early stage with existing and new creditors. The main objective must be to extend maturities to allow further time for demonstrable business recovery. With foreseeable problems of securing further fundings in 2023 and 2024, borrowers should therefore start early on with financial restructuring measures.

What is urgently needed in such cases is a concept based on a solid business plan that demonstrates a clear path to recovery. In addition to classic amend and extend solutions, solutions such as upsizing, asset drop-downs, retracings, and share pledges will increasingly be considered in loan restructurings in the upper SME segment in the coming years.

In practice, the focus for amend and extend transactions is on consensual

out-of-court solutions, but if this is not achievable, Germany's StaRUG—Law on the Stabilization and Restructuring Framework for Enterprises—is the most suitable solution.

Out-of-Court Restructuring Regime

StaRUG is a stabilization and restructuring regime for corporates which establishes a legal framework for out-of-court restructurings in Germany on the basis of the EU Restructuring Directive (Directive (EU) 2019/1023). It is a debtor-in-possession process for the restructuring of secured and unsecured liabilities.

One core element of StaRUG is the option of a pre-insolvency restructuring by way of a restructuring plan with restructuring measures and contributions which the creditors give to the debtor. It needs a qualified majority decision (75%) of the creditor groups. If the required majority is not achieved in one class of creditors, the approval may be replaced by a cross-class cram-down.

StaRUG also enables an impairment of shareholder rights, including debt-for-equity swaps. There is the possibility of stabilization measures in the form of a ban on foreclosure and enforcement. In order for a debtor to be able to prepare and negotiate the restructuring plan, StaRUG offers the possibility of imposing a moratorium, which may restrict measures of individual enforcement of creditors' rights. In certain cases, a restructuring officer shall be appointed to monitor the process. Since StaRUG proceedings are not

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continued from page 11

public per se, there are no official statistics on the actual number of cases to date. Experts estimate the procedure has been used in 30 to 40 cases, but not all of them were successful. The most prominent case thus far concerns Eterna Mode Holding GmbH, which restructured a corporate bond with a nominal value of €25 million (\$27.1 million) by means of a debt cut of 87.5% and a waiver of shareholder loans in the order of €32 million within only a few weeks by a plan confirmed by the court.

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Linchpin Comparative Calculations

Even though the absolute number of proceedings conducted in its first two years was low, this does not mean that StaRUG plays no role in everyday restructuring in Germany. Quite the opposite is true. The regulations were mainly applied as a threatening scenario

based on a well-founded comparative calculation that demonstrates the effects on stakeholders in both the insolvency and StaRUG scenarios.

The so-called comparative calculation is therefore the linchpin of the proceedings. The presentation of the economic effects for all stakeholders is of elementary importance to gain acceptance of the project. The consequences of a StaRUG procedure for the affected creditors and shareholders must be transparently and

continued on page 14

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comprehensibly displayed in comparison with other restructuring options.

In the proceedings, the settlement calculation generally serves to enforce group majorities. Thus, the consent of a group under §26 StaRUG can be obtained by proving that the group is not in a worse position or by compensating the group for the loss in value.

The requirements for comparative accounting are explicitly mentioned in §6 StaRUG. This requires the presentation of the effects of the restructuring plan on the prospects of satisfaction of the parties affected by the plan without StaRUG, but with continuation. The legislature thus explicitly refers to the consideration of going concern values and not, as is often seen in practice, of blunt liquidation values.

But how are the going concern values to be determined? The prerequisite for access to StaRUG is

an imminent insolvency, which by definition cannot be eliminated in the course of time by means of classical restructuring. Consequently, it is primarily the effects of a subsequent insolvency that must be considered.

In addition to the approach of traditional company valuation, the presentation of the effects on the individual creditor groups on the basis of a calculated, fictitious insolvency procedure appears to be particularly useful. Success is dependent on the planning of the fictitious proceedings on the basis of plausible assumptions. The liquidity planning of the proceedings, including all insolvency-specific special effects, the P&L and balance sheet of the restructured company, as well as the resulting creditor satisfaction in the case of an asset deal, insolvency plan, or liquidation, must be anticipated.

This places high demands on the validation of the premises and the form of the presentation of scenarios. However, the acceptance of this assessment is likely to be of decisive

importance, especially in contentious cases. This requires independent opinions from an interdisciplinary team of market-accepted specialists with extensive experience in restructuring, financing, and insolvency. Otherwise, there is a risk of prolonging the intended duration of StaRUG, which may subsequently lead to a loss of through-financing and thus to the failure of the project.

Two cases illustrate the use of threats of StaRUG to reach amend and extend agreements with reluctant creditors.

In the first case, the three largest financiers had confidence in the restructuring concept, including the necessary deferrals of repayment. Only the smallest had resisted, so that an agreement based on the collateral pool was not possible. This would have meant a tough restructuring process lasting years, during which the necessary measures could not be tackled. The mere threat of StaRUG convinced this recalcitrant financier to go along with the project, as the process

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would have been easy to carry out.

The second example case was financed mainly through promissory notes. Here, too, about 90% of the creditors agreed to a deferral of repayment, but in the end, it could not be implemented due to obstructing small creditors, and insolvency would have been inevitable. Here, too, an amend and extend solution could be implemented after discussing the settlement values of various scenarios with the uncooperative creditors.

Operational Restructuring

The central goal of restructuring is the operational turnaround of the company. What advantages does the StaRUG procedure offer from the perspective of operational restructuring?

The StaRUG procedure described provides a legal framework for operational restructuring. By dealing harshly with chord breakers in the ranks of lenders, it creates a framework that not only reduces risks but also creates operational room to maneuver

without resistance. The time factor, in particular, plays a decisive role: whereas without a StaRUG process, the operational restructuring process can be blocked or paralyzed by disruptive elements on the lenders' side, the StaRUG process eliminates them. As a result, classic operational measures for a sustainable EBITDA and thus value enhancement can be implemented consistently.

However, StaRUG does not simplify the legal framework for implementing personnel measures or terminating continuing obligations, such as leases. The statutory notice periods and contract terms also apply in a StaRUG procedure.

Thus, the StaRUG procedure creates a clear legal framework and provides time and coherence for implementation of operational restructuring measures. In parallel, the procedure has the advantage that it is not associated with the bad image of insolvency proceedings, because in Germany it is considered

entrepreneurial failure to start an insolvency proceeding. As a result, there is no unrest on either the customer or supplier side, and customer and supplier relationships can be maintained as well.

Conclusion

The state and condition of capital markets will continue to drive the need for amend and extend solutions. For weaker credits and overlevered businesses, the financing situation will remain difficult, requiring borrowers to continue conversations with existing creditors.

StaRUG can and will be a true solution for creditors dealing with obstructive minorities. Whether this is achieved by the mere threat or by the actual implementation of the procedure is ultimately of secondary importance. The importance lies in the fact that solutions are determined at an early stage that support the continued existence of the company and thus ensure the value of the claim. ■