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Buchalik Brömmekamp

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# The restructuring of the Spezialmaschinenfabrik Wilhelm Rasch under insolvency protection or the "The owner keeps the company"

The very existence of a company comes into question in a corporate crisis. They are a common occurrence and their causes are various and include economic developments, changes in law, the volatility of commodity and currency markets, and internal factors such as leadership errors in management, false acquisitions or unbalanced financing structures. Crisis situations are so exceptional that even a well-positioned management rarely has sufficient experience to handle them. Overcoming crises of this nature presents a company's management with significant challenges. The problems are often times compounded by the aftermath of the world financial and economic crisis, leaving many companies with weakened capital and eroded liquidity. Poor balance sheet ratios have led many banks to lower credit ratings and withhold lending despite the availability of sufficient funds on financial markets. Presently, even minor issues that amplify the crisis, such as increases in competition or seasonal declines in sales, can result in a full-blown liquidity crisis.

During the last major economic crisis in 2009, the legislature contributed greatly to overcoming it through legislative measures, e. g., via extending part time work hours or offering state guarantees. Nevertheless, it was recognized early that the financial and economic crisis in particular would have further consequences. For that reason and to further strengthen the German economy, on 1 March 2012, the legislature took proactive initiative and enacted a new insolvency law. The ESUG (Act to Further Facilitate the Restructuring of Companies) promotes the reorganization of companies in Germany and has the particular feature of allowing reorganization under insolvency protection. The Act is one of a kind and is superior in many respects to the even renowned US Chapter 11. However, despite a number of publications and the successful completion of numerous of proceedings, the new law remains totally unknown or known only in part in many sectors of the German economy. As a consequence, far too few companies have made use of it.

Isolvency under the ESUG offers new strategic options for overcoming a crisis situation to an unprecedented extent to date. This includes the clear message that the company owner and management should continue to hold and direct the company and that the sale or even liquidation of the company is not a primary option. The process under ESUG therefore does not spell the end of the company by liquidation or a so-called asset deal, by which an investor buys the interesting assets, such as customer relationships, machinery and real property from the previous owner, while the administrator liquidates the rest, leaving the former shareholders with an empty shell and a company that no longer exists. The plan insolvency in self-administration presents another outcome with the goal of maintaining the existing owner, i.e., maintaining the company to date. The shareholder structure of the previous company should be left untouched in as much as possible and only the legal entity should be restructured. This occurs by reducing the liabilities side of the balance sheet by removing pre-existing liabilities in whole or in part, while eliminating the causes of the crisis through operative restructuring. Both, balance sheet and operational restructuring, are a part of the so-called insolvency plan, on which the creditors must vote at the end of the process. If they agree to the plan with the majorities required by law, the insolvency plan will often be confirmed by the court at a voting meeting and the proceeding permanently suspended after two to four weeks. This means the insolvency process can entirely be complete within as early as five to seven months.

Since the new law has entered into force, Buchalik Brömmekamp has been successful in permanently maintaining more than fifty companies as going-concerns via plan insolvency in self-administration without the business owners losing their companies. It is exactly this that occurred in the case of Wilhelm Rasch GmbH & Co. KG Spezialmaschinenfabrik. In this case both, a liquidation and a sale of the company, were averted. In 95 percent of the cases we accompany, the business owners retain their shareholder position in full and equity is strengthened significantly. Often equity ratios improve from negative values to seventy percent or more while sufficient liquidity is generated in the process without the need for additional bank loans. On many occasions, we have been even able to significantly reduce the respective company's debt, and significantly or even completely eliminate any owner or management liability existing in this regard.

Professional preparation and implementation is essential to the success of this process, as it contains numerous pitfalls. Properly assessed and executed, insolvency under ESUG offers an outstanding opportunity for the owner to maintain its company and free itself from debt and begin a future anew. The results obtained thereby are often near unbelievable. The references found on www.buchalik-broemmekamp.de confirm this well.

The following articles provide a brief, but essential overview of the potentials offered by the new law. The last article describes the path taken by Wilhelm Rasch GmbH & Co. KG Spezialmaschinenfabrik in its insolvency under self-administration. Further information on the ESUG can be found in the references on pages 10 and 12 of this short presentation. Buchalik Brömmekamp will gladly supply you with the information referred to therein free of charge.

# Authors

**Robert Buchalik**
Attorney at law. Partner of Buchalik Brömmekamp Rechtsanwälte | Steuerberater
Managing partner of Buchalik Brömmekamp Unternehmensberatung GmbH
Specialties: insolvency plan/self-administration, restructuring, reduction of expenses, earnings increase, working capital, financing, M&A, stakeholder management, mediation, interim management, pool administration, trustee solutions
Tel. +49 211-82 89 77 110, robert.buchalik@buchalik-broemmekamp.de

**Dr. Utz Brömmekamp**
Attorney at law. Partner of Buchalik Brömmekamp Rechtsanwälte | Steuerberater
Managing partner of Buchalik Brömmekamp Unternehmensberatung GmbH
Specialties: general civil law, company law, banking law
Tel. +49 211-82 89 77 200, utz.broemmekamp@buchalik-broemmekamp.de

**Dr. Jasper Stahlschmidt**
Attorney at law, specialist lawyer for insolvency law. Partner of Buchalik Brömmekamp Rechtsanwälte | Steuerberater
Specialties: insolvency law, function as a chief restructuring officer in self-administration proceedings, restructuring by insolvency
Tel. +49 211-82 89 77 200, jasper.stahlschmidt@buchalik-broemmekamp.de

# Insolvency as a strategic option

**A reorganization under insolvency protection in self-administration that is carried out as part of an insolvency plan proceeding is not new and has been possible in Germany since the insolvency law was reformed in 1999. However, the new law in force since 01 March 2012 under the name ESUG, simplifies the potential to utilize this manner of reorganization significantly.**

Once the debtor company files for insolvency it is under the protective shield of insolvency law or placed in preliminary self-administration whereby, unlike under the old law, a (preliminary) self-administration proceeding immediately begins. An insolvency administrator is no longer necessary in this proceeding. Its roll is initially assumed by an insolvency monitor monitor, while in contrast under the old law the provisional insolvency administrator was left with control and monitoring functions alone. The insolvency debtor becomes its own insolvency administrator (debtor-in-possession) from the very outset of the proceeding. Because the debtor lacks sufficient legal and business knowledge to execute the insolvency, it will need the accompaniment of an expert during the proceeding so as to ensure its success. The new law also gives creditors a much stronger influence on the course of the proceeding however their involvement is in turn significantly influenced by the debtor in self-administration. Both, the management and the company, are given the opportunity to structure the proceeding with the input of creditors in a legally secure manner and influence the very choice of the administrator, even if this is opposed by the competent court.

## Building blocks of ESUG

The foundation of the new law is based on three elements:

- a substantial strengthening of creditor influence,
- an optimization and less risk-averse structuring of the insolvency plan proceeding and
- a significant strengthening of self-administration.

A reorganization under insolvency protection in self-administration is still a classic insolvency proceeding which is begun by filing an insolvency petition. The competent insolvency court will first decide on whether it looks probable that the proceeding can be successfully executed to the extent required. The competent counselor can predict this with great certainty and prepare a proceeding that is virtually assured of success. This requires however sufficient preparation time and the advisor's comprehensive understanding of the causes of the individual crisis. If communication is strong on the part of the company, the potential that insolvency will be successful can be predicted with the greatest accuracy, thereby enabling all parties to enter into the proceeding with the least risk.

## Insolvency plan governs the debt relief

An insolvency plan is drafted after the proceeding is initiated. This plan conclusively addresses the company's liabilities and is submitted to the creditors for approval. Secured creditor's interests are often satisfied such that they make loans available to the company using the collateral that had existed before. Unsecured creditors lose their interest completely (e. g subordinate creditors such as mezzanine capital lender) or receive only a very low return (other unsecured creditors) on their unsecured claims, which are normally paid to these creditors within up to two years after the proceeding is suspended. The submitted insolvency plan leaves these creditors with no access to their remaining interests. The proceeding will entail that new liabilities, e. g., tax liabilities or the insolvency fund of the Federal Employment Agency will be assumed. These creditors will also receive a very low rate of return on these liabilities. If the plan was to provide even low rates of return for unsecured creditors, it would in fact be rejected, as the creditors in this proceeding are now no longer concerned with receiving a high rate of return, but rather whether or not the company will continue as a going concern. Thus, the Federal Employment Agency has little interest in a high rate of return, but rather it wishes to avoid paying unemployment benefits and wants to maintain as many jobs as possible. Likewise, the employees wish to retain their jobs and likewise have no interest in high repayment of the company's debt; while suppliers are most concerned with keeping their sales channels open and not having to look for new customers. The legislature's real intention is not the widespread perception of insolvency proceedings, whereby insolvency administrators must ensure high returns to best settle creditor's claims. Nor is this the intention of the majority of creditors and the creditors' will controls. The creditors are thus asked to vote on the insolvency plan. Low repayment rates for creditors ensure future liquidity for the company, as the greater the funds flowing to the creditors, the less is available to the company to secure future liquidity.

### The proceeding is intended to ensure the company as a going-concern

The insolvency plan proceeding in self-administration is intended to enable the company to remain a going concern. The structure of the shareholders remains unaffected. The company is neither liquidated, nor sold to a third party, e. g, by means of an asset deal. A third party may acquire shares through a capital contribution, yet this must be approved of and supported by the previous owner. So-called debt-equity swaps in which liabilities are converted into equity almost do not play a role in practice at least for medium-sized companies.

The creditor waivers strengthen equity by considerably reducing liabilities while assets (cash, receivables, inventories) are increased by the influx of normal revenue at significantly lower costs due to the state insolvency fund and unpaid pre-existing liabilities.

The vote on the insolvency plan marks the end of the proceeding. If the creditors approve of the plan with the necessary majorities - which is virtually always the case - the court will suspend the insolvency proceeding shortly thereafter (ca. two to four weeks) and insolvency is ended. Despite the proceeding being over, the company then has up to two years, and in exceptional cases significantly more time than that, to fulfill the plan and pay the amounts held by the unsecured creditors. New loans are normally not required due to the effectsof the proceeding.

### Operative restructuring is essential

The assets must also be restructured alongside the liabilities on the balance sheet, and often times from the very outset of the proceeding. The company can be effectively restored in the market only if long-term reorganization is also operationally ensured. Costs must be reduced, processes improved and new markets created; but the insolvency offers significant relief here as well. Often social security plans cannot be financed outside of insolvency proceeding. In an insolvency proceeding in self-administration the necessary funds are generated, while the social plan costs are reduced to a period of service of a maximum of two and a half months' salary. The maximum notice period for terminating employees is three months, regardless of how long an employee has been with the company. The self-managing insolvency debtor may terminate continuing obligations, such as long-running tenancy or lease contracts, with three months' notice. The landlord or lessor however may not terminate, unless the insolvency debtor has not fulfilled its obligations under the respective tenancy. These options give the debtor-in-possession more opportunities to overcome the crisis at hand which would be unthinkable outside of the insolvency proceedings. Whether or not these options will be used, lies in the decision making power of the previous management and not in the decision of an insolvency administrator.

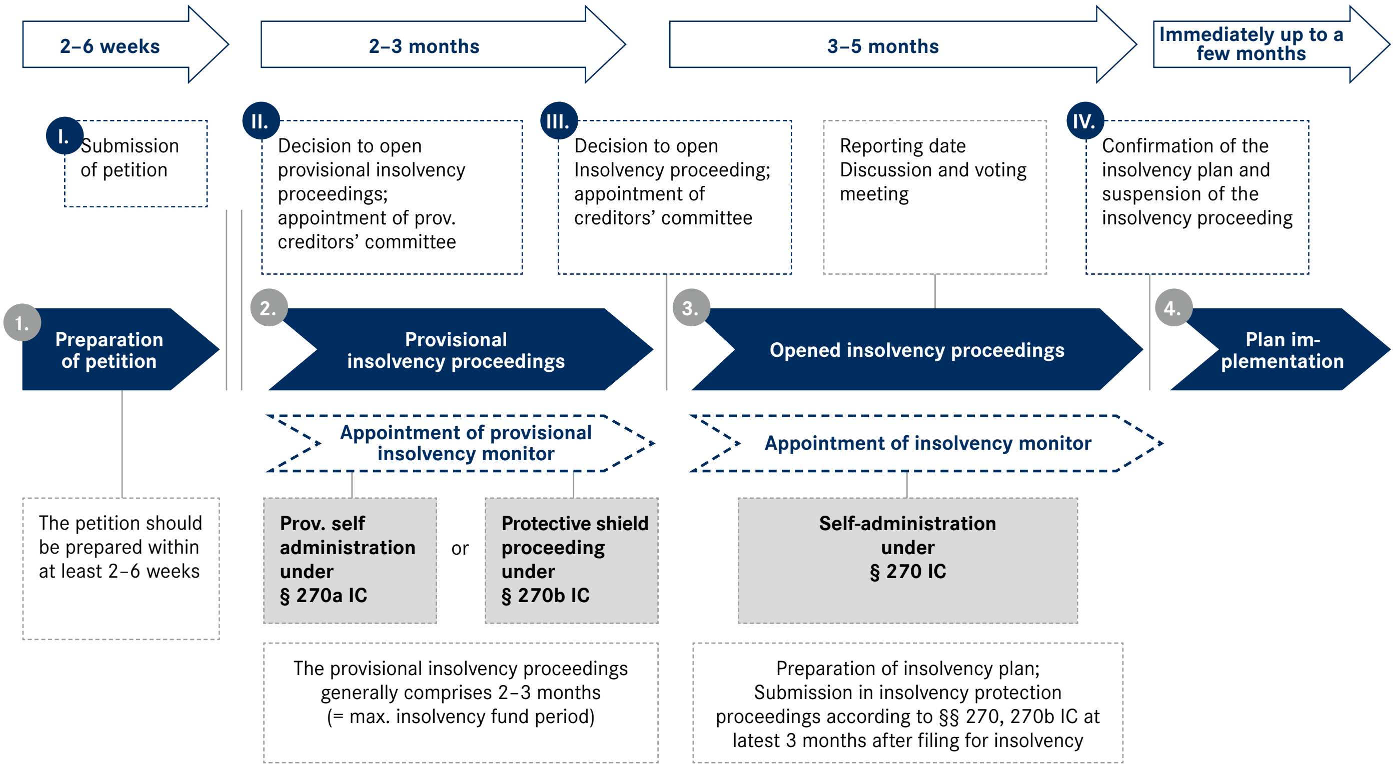
# Protective shield proceedings or provisional self-administration

**The term protective shield proceeding is often connected with the new insolvency law. Many practitioners still believe that the new insolvency law can only take root and be successful if the respective company is not actually unable to pay. We will set out briefly below the differences between a protective shield proceeding and a normal provisional self-administration and why the shield proceeding is actually less desirable than the provisional self-administration, leaving aside the question of illiquidity.**

The diagram below sets out the course of insolvency proceedings in self-administration:

### In case of self-administration, the company itself prepares an insolvency plan that enables it to continue

**Course of insolvency proceedings in self-administration**




The insolvency proceeding is divided into two parts. The first part, the so-called insolvency initiation proceedings, indicates the period of time between filing of the insolvency petition and the opening of the insolvency proceedings themselves. Usually this period last for two to three month. The duration of this period is largely determined by whether or not wages and salaries have been paid by the time the insolvency position is filed. The Federal Employment Agency regularly pays wages and salaries for three months retroactively from the opening of insolvency proceedings. This occurs regardless of whether the proceeding is one in self-administration or a standard insolvency proceeding.

## Example insolvency fund payment

This can be better understood by way of example: The insolvency petition is filed on 01 February 2015. The Federal Employment Agency will assume wages and salaries for three month retroactively from the opening of the proceedings. If the January wages have not been paid, then the proceedings will open on 01 April, as the Federal Employment Agency will cover the wage and salary payments for March, February and January 2015. If the wages have already been paid in January at the time the company filed for insolvency, then the proceeding will open on 01 May 2015, so as to enable the company to utilize the entire three month insolvency fund period. The insolvency proceedings open directly after the insolvency initiation proceeding. Once the insolvency proceeding has been opened, the company alone is responsible for paying wages and salaries for the period. The opened insolvency proceeding in self-administration ends as a general rule once the insolvency plan is approved. If the creditors approve of the plan with the necessary majorities, the insolvency court will usually confirm the plan in the voting meeting and suspend the proceeding two to four weeks thereafter. The so-called protective shield proceeding (§ 270b Insolvency Act) and provisional self-administration (§ 270a Insolvency) take place exclusively during the period between the filing of the insolvency petition and the opening of the insolvency initiation proceedings. In both types of proceeding there is only an insolvency monitor appointed. This monitor is only given control rights, but does not have the rights of an insolvency administrator (except for the right to appeal/challenge transactions). The self-administering debtor takes the remaining rights of an insolvency administrator and is thus placed in a dual role, one as debtor-in-possession and one as the insolvency administrator.

### Advantages and disadvantages of the proceedings

Both, the protective shield proceeding and provisional self-administration, ends once the insolvency proceeding is opened. Both types of proceedings flow into self-administration. No differences remain once self-administration begins, regardless of which type of self-administration was going on previous. The main difference between the two types of proceedings is that actual insolvency may not be present in the protective shield proceedings. Actual insolvency may however be present in provisional self-administration without anything further being necessary. The debtor has some additional rights in the protective shield proceedings that it would not have in provisional self-administration. This includes the right for the debtor to in principle select an insolvency monitor of its choose and the court must always approve of preferential liabilities that the debtor enters into. However, selecting an insolveny monitor without having gained the support of the court and the main creditors is not recommended. The court would have numerous opportunities to derail the proceeding. Moreover, the debtor's right to enter into debt incumbents would ultimately be just as meaningless, because even in provisional self-administration, this debtor's right is usually only granted on request of the court. The advantage of entering into debt incumbents lies in the fact that, circumstances willing, the supplier can grant faster payment terms because their newly-founded claims are debt incumbents that will be payable before all other claims. There are no other major advantages between the protective shield proceeding and preliminary self-administration. In lay discussion the term "protective shield proceeding" is often preferred, because it sounds much better than provisional self-administration. However, the disadvantages of the protective shield proceedings can be quite severe. Namely, the court must be informed, if the company becomes insolvent during the insolvency opening proceedings. Although this has no direct consequences, the notice will be communicated to the creditors and one cannot preclude that they will react negatively. A protective shield proceeding may only be initiated when insolvency is imminent, but not insolvency itself. A neutral third party must therefore confirm and certify that only the threat of insolvency, and not insolvency itself, exists. This certification process is associated with time and additional costs. Moreover, many legal issues remain unresolved in the protective shield proceedings. The real advantage of the protective shield proceedings lies therefore only in its name and not in any actual advantages, particularly because in provisional self-administration as well, the provisional committee must first provide its unanimous support of the debtor's choice for monitor.

### Both proceedings are insolvency proceedings

Both, the protective shield proceeding and provisional self-administration, are insolvency opening proceedings. In both cases, a petition to open insolvency proceedings is necessary. Thus, it would be dangerous as part of a protective shield proceeding to communicate that the case at hand will not likely involve an insolvency initiation proceeding, but rather an independent reorganization proceeding. The insolvency monitor will ask the creditors to submit their claims at latest by the opening of insolvency proceedings and before the start of the actual self-administration proceeding, as it would do it in any normal insolvency proceeding. If there was told in advance that the provisional self-administration is not a kind of insolvency opening proceeding, most of the creditors might be irritated. Exactly the information, that the provisional self-administration represents of course an insolvency opening proceeding, will e given to the creditors by the insolvency monitor. The protective shield proceeding ends upon the opening of the insolvency proceedings - as well as the provisional self-administration - and both flow directly into standard self-administration. Virtually no difference exists between the two types of proceedings from this time forward. The aim originally intended by the legislature of creating an independent reorganization proceeding via the protective shield proceeding was therefore not achieved in the least. Practice dictates that the protective shield proceedings should be used only in the most exceptional cases. In any case, it can be stated that if the respective company is already insolvent, the only path to insolvency protection is provisional self-administration. Moreover, even provisional self-administration has no serious drawbacks when compared to the protective shield proceedings, but to the contrary, offers significant rewards.

# Effects of the self-administration proceeding on the company's liquidity and balance sheet

**Some features of German insolvency law are intrinsic in a manner not found in any other insolvency regulation. These features are made even stronger by self-administration such that the results are often incredible.**

Corporate insolvencies are usually conditioned by the fact that the company is illiquid, meaning that it can no longer met its current financial obligations. The Federal Employment Agency takes over wages and salaries for three months retroactively from the opening of the proceeding in both, a self-administration proceeding and a standard insolvency proceeding. This can mean a cash surplus totaling 450 TEUR for a company of fifty employees with a gross monthly payroll, including social security contributions of approx. 150 TEUR. Larger companies may expect a cash benefit that is correspondingly much higher. As a rule of thumb, one can expect a gross payroll per employee of around 3000 euros per month and 9000 thus euros for the entire insolvency fund period.

Moreover, sales tax liabilities do not have to be discharged to the tax authority for the entire period from the filing of the insolvency petition to the opening of the insolvencies proceedings themselves. This totals the difference between the sales tax that the company has in fact charged and the amount that the company has otherwise invoiced and collected. This is only available however in self-administration and not as part of the standard insolvency proceedings. All liabilities that are unsecured and still exist at the time the petition was filed, are deemed to non-preferential insolvency liabilities. Only a portion or rate will be paid on these liabilities in the future. This rate rarely exceeds twenty percent, meaning that there is a significant benefit to liquidity, which is however only noticeable as the liabilities ultimately come due. However, no interest or repayments are made during the proceeding to the banks, and only goods/services are paid that have been delivered after the petition to open insolvency proceedings was filed.

Significant liquidity is moreover formed in the company, because these payments are not made while revenue proceeds are received, whereby we mention here only the most important sources. The savvy advisor still knows of numerous other possibilities to generate liquidity during the proceeding. Consulting fees and court costs diminish this. However, if planned and structured reasonably by the advisor, these costs usually amount to only one-third of the total benefit to liquidity, such that the enterprise retains significant liquidity and additional bank loans for crisis management are normally unnecessary.

### Accumulation of liquidity

Something very similar takes place on the asset side. Because existing liabilities are not being serviced, that is, only a fraction of the unsecured claims are being paid and subordinate liabilities are completely eliminated (like e. g, mezzanine debt which is not serviced at all in the insolvency proceeding), a very substantial restructuring gain is recorded. This strengthens the company's equity significantly.

This is, because the plan insolvency in self-administration preserves the original legal entity, thus the company. Therefore the company is not broken up and its assets are not sold to a third party via an asset deal. The result is that the asset side of the balance sheet during the proceedings remains mostly unchanged, while the liability side is strengthened by the fact that the significant waivers of creditors have greatly reduced total liabilities and thereby led directly to an increase in equity. It is not uncommon for this proceeding to bring about improvements to the equity ratio of seventy percent or more.

The resulting restructuring-related profit is tax-free with respect to both trade and income tax. This must however be clarified in advance through a binding exchange of information with the Municipality competent for trade tax and the tax authority where the company resides which is competent for corporat e tax, if the matter involves a corporation, or in cases of a partnership the tax authority competent for income tax. However, damaging errors can be made with respect to issuing this binding information. Without professional advisory support, a significant danger exists that taxes will increase to such an extent that the reorganization will itself fail.

## Impact on the liabilities side

The following chart summarizes the impact of a balance sheet restructuring:

### Plan insolvency preserves the original legal entity. The liabilities newly regulated

Impact of the restructuring plan on the liabilities side

| **Balance Sheet** | | | | | |
|---|---|---|---|---|---|
| **Equity and liabilities** | Before restructuring plan | | After restructuring plan | | |
| **in TEUR** | **TEUR** | **%** | **TEUR** | **%** | |
| **A. Equity capital** | **4,135** | **18.7** | **12,290** | **70.4** | 1. |
| I. Subscribed capital | 9,000 | 40.7 | 9,000 | 51.5 | |
| II. Net income/loss | –4,865 | –22.0 | 3,290 | 18.8 | |
| **B. Mezzanie** | **530** | **2.8** | **0** | **0** | 2. |
| **C. Provisions** | **1,967** | **8.9** | **249** | **1.4** | |
| I. Pension Provisions | 1,643 | 7.4 | 164 | 0.9 | 3. |
| II. Other Provisions | 324 | 1.5 | 85 | 0.5 | 4. |
| **D. Liabilities** | **15,497** | **70.0** | **4,923** | **28.2** | |
| I. Liabilities against bank | 3,166 | 14.3 | 3,100 | 17.8 | 5. |
| Thereof secured bank liabilities | 3,166 | | 3,100 | | |
| II. Trade receivables | 4,714 | 25.1 | 1,429 | 8.2 | |
| Thereof secured suppliers | 1,064 | 5.7 | 1,064 | 6.1 | 6. |
| Thereof unsecured suppliers | 3,650 | 19.4 | 365 | 2.1 | 7. |
| III. Receivables against bond creditor | 7,331 | 33.1 | 366 | 2.1 | |
| Thereof unsecured bond creditor | 7,331 | | 366 | | 8. |
| IV. Other liabilities | | | | | |
| Liabilities against Federal Employment Agency | 286 | 1.3 | 28 | 0.2 | 9. |
| **Total Equity and liabilities** | **22,129** | **100.0** | **17,462** | **100,0** | |

The waivers of the unsecured creditors strengthen equity while they receive only a low return during the insolvency plan proceeding

The secured bank suffer generally no disadvanteges during the insolvency plan proceeding

The secured suppliers suffer generally no disadvantages during the insolvency plan proceeding

The unsecured creditors (unsecured suppliers, unsecured bond creditor) receive a return

1. From EUR 4,135 million before the balance sheet restructuring, equity will increase through balance sheet measures to EUR 12,290 million. The equity ratio increases from 18.7 to 70.4 percent.
2. Mezzanine capital is deemed subordinated capital. The mezzanine creditor is completely eliminated.
3. Only 10 percent of the pension provisions remain and these are assumed by the company as existing remaining provisions. The pension guarantee fund (PSV) assumes the remaining 90 percent thereof. This means the insured employees suffer no disadvantages, as the PSV will pay the secured pensions in the future.
4. 85 thousand euros remain from the other provisions, and the rest is waived.
5. Bank liabilities are secured by fixed assets and current assets and thus remain unchanged with respect to collateral. Because no payments are made, the liquidity is preserved.
6. The suppliers with interests secured by a right of retention (remainder) are fully satisfied.
7. The unsecured suppliers are serviced with 365 TEUR and must forgo 90 percent of their claims.
8. The unsecured bondholders are serviced with 366 TEUR and must forgo 95 percent of their claims.
9. The Federal Employment Agency has accrued a claim of 286 TEUR during the proceedings and receives only 10 percent thereof (28 TEUR). It waives its claim to the rest.

As the unsecured creditors have been convinced in advance that they would receive significantly less, if the company was liquidated, they are willing to accept waiving such significant amount of their claims.

The proceeding ends leaving the company with a cash outlook and a balance sheet that significantly strengthens the company and presents new impetus for success in the future.

# The importance of early involvement of customers and suppliers in self-administered plan insolvency

**Insolvency is still a stigma and too rarely seen as an opportunity to many business owners. The Act to Further Facilitate the Restructuring of Companies (ESUG) of 1 March 2012 is the legislature's attempt to motivate companies to consider filing for insolvency early-on. The legislator provides the company based on the plan insolvency by self-administration options to retain the company while a liquidation or disposal of assets trough an asset deal can be prevented. Although the process can be structured to be almost legally watertight, almost always the same concerns are expressed in initial meeting with business owners. Concerns of a loss of reputation often block these companies from taking the legally required, first steps. Most affected parties not only lack the requisite knowledge of the potentials offered by self-administered plan insolvency, they also lack an understanding of the risks involved with insolvency.**

A business owner, who is informed about the possibilities offered by self-administered plan insolvency in an initial meeting, usually expresses following concerns:

1. Suppliers will jump ship as they will lose money in the process. If we do not receive resources, we cannot function.
2. Customers will no longer be loyal to the company, as their confidence in the company will wane due to the insolvency. Without customers, the company will generate no sales.

However, both concerns are completely unfounded and do not materialize as we can show by a variety of examples.

Suppliers almost always have an interest in continuing to supply the company, as otherwise they are left to look for new sales channels. This entails a large expense and is often associated with a considerable loss in yield. Of course, the suppliers lose money in an on-going insolvency proceeding. This is of course unpleasant and does not immediately strengthen trust. If, however, the supplier can be convinced by evidence that the company, reorganized under the plan, will have sufficient liquidity to pay the supplier invoices properly in the future, and moreover has an equity ratio that is no longer negative, but rather clearly moving in a positive direction thereby ensuring that the company will be a safe and solvent customer in the future, the supplier can also be easily convinced that the company will continue to accept future deliveries. Usually for the first few weeks of insolvency, the company will have to pay for the supplier's good and services in advance. Normally, as the proceedings progress and the suppliers' confidence in the customer's solvency increases, the supplier will gradually alter the payment terms, considering that the advance payment procedure is an extremely laborious process. In any event the supplier has no interest in creating new sales channels, because here he is in competition with third parties and must often accept worse payment terms, because initially competition only exists with respect to price. Moreover, sometimes even prelisting fees must be paid, which is a common practice in retail. In any case, suppliers do not find having to create new customers in this manner an attractive option. If the supplier does not do it that way, however, the loss of its customers may have even more harmful effects than a mere one-off, non-recurring loss. It is even conceivable that this would force the very supplier into a crisis that could only be resolved through restructuring measures of its own. A plan-reorganized company with strengthened liquidity and reduced debt is therefore significantly more attractive to the supplier than a new customer.

If the supplier cannot be convinced in the exceptional circumstance, the company can still switch to other suppliers. After all, why would a new supplier refuse to deliver if advance payment were being offered? This of course is a point which applies equally to the affected supplier-creditor, because he can observe without risk whether his client actually develops as has been predicted.

Customer behavior can be analyzed similarly. Likewise the customer will not assess the insolvency negatively, but rather possibly consider an indicator for entrepreneurial performance, if he gets explained the methodology by which the crisis will be overcome by company's management. Our experience shows that the insolvency in self-administrator does not garner negative reactions from customers, but rather is greeted with positive encouragement. In general, the proceeding is still unknown to the customer, and for that reason it is also recommended, just as with respect to the suppliers, to explaine the proceeding with the help of the competent advisory using a projected balance sheet and projected profit and loss statements. This will clarify to the client the professionalism with what the debtor is approaching the proceeding. The customer's confidence regarding to the company's future will be significantly strengthened thereby. Sometimes it makes sense to bring the customers into confidence even days before the actual petition will be? filed. This is particularly true if the customer is somewhat dependent on the potential insolvency debtor. This may be the case e. g. with ongoing projects or when the customer receives important components from its supplier, which cannot be obtained elsewhere in the short term. This dependence is regulary found in the automotive industry. The manufacturer always returns to specially tested parts. This is compulsivery necessary as shown impressively by constantly occurring recalls, which costs of which often run into billions for the manufacturers.

Against this background, the customer is often prepared to take liquidity support measures in light of the impending insolvency. This most likely occurs through reducing the payment terms. This behaviour can also give substantial additional liquidity to the company in advance of filing the petition. Moreover, it is not infrequent that the esteemed customer itself is one of the causes of the insolvency risk, because the profit margins that are generated through the customer are not sufficient to cover costs. If the insolvency debtor can make this transparent, the customer may even be willing to accept some of the loss. This requires, however, that the customer has to get involved closely and early throughout the whole proceeding, including possibly an involvement as a guest in the creditors' committee during the entire proceeding. The decisivety criterias for the customer are the advisor's competence and the evidence of the advisor about success, and possibly also about industry specific knowledge.

Moreover, it is advisable to determine when on is preparing for the proceeding which, how and when particular customers and suppliers will be informed. Sometimes a simple letter, in which the proceeding is explained, is enough, but sometimes a personal visit is necessary. This requires a kind of information strategy that should be developed before the proceedings commence. The major customers and suppliers should not learn from the press about the proceeding, but rather receive a confidence-building advance on information.

In summary, it can be stated that as a rule the concerns that were expressed initially vanish "in the air" and information from customers and suppliers can be seen as an opportunity to create an even stronger bond and increase confidence in the proceeding. Many company owners who have successfully executed such proceedings can attest to this.

**Restructuring under insolvency protection instead of liquidation by insolvency**


The authors Robert Buchalik, Dr. Utz Brömmekamp and Prof. Dr. Ralf-Peter Oepen describe the conditions of restructuring opinions under insolvency protection within a self-administration in a short form. They also show the effects on the result, liquidity and balance sheet and give numerous practical tips.

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**Imprint**
Buchalik Brömmekamp
Rechtsanwälte | Steuerberater
Prinzenallee 15
40549 Düsseldorf
Tel. +49 211-82 89 77 200
www.buchalik-broemmekamp.de

Westendstraße 16 – 22
60325 Frankfurt/Main
Tel. +49 69-24 75 215 0

**Editors**
Markus Haase, Bettina Fey, Femke Boyens

# Promptly file the insolvency petition or risk liability for the delay

**Insolvency always presupposes an insolvency petition. The same applies to an insolvency plan proceeding in self-administration. Generally the debtor does not have the discretion to decide, if and when it will file for insolvency. German insolvency law recognizes three grounds to petition for insolvency: insolvency, over-indebtedness and imminent insolvency.**

If compelling reasons exist to petition for insolvency, the debtor must file a petition. Only in instances of the so-called imminent insolvency, does the debtor have discretion to file the petition. However, the debtor must file for insolvency no later than when the company becomes actually insolvent. When applying insolvency law in German insolvency practice, the only reason for insolvency that plays a real role is insolvency. The other reasonfor insolvency, the over-indebtedness, has no significant role, when the company has received positive forecast to continue as a going-concern. This positive forecast can be certified by a third party, such as an advisor. If such a prognosis exists, over-indebtedness being defined as a preponderance of liabilities over assets after the release of undisclosed reserves, is no longer relevant in practice, because as a response to the banking crisis the legislature reacted to the over-indebtedness of many banks by enacting the Financial Market Stabilization Act. Many banks were over-indebted due to the high demand to devalue the so-called "toxic debts" on their books and were thus obliged to file for insolvency. In order to prevent this and an resulting economic collapse, the concept of over-indebtedness was attenuated greatly. Accordingly, only if the company cannot be permanently continued or when it is not predominantly likely that the company will continue as a going concern, does its over-indebtedness oblige the debtor to petition insolvency.

### Ground for insolvency: Illiquidity

To be distinguished from the grounds for insolvency due to the illiquidity. Here the bodies of a legal entity or a GmbH & Co. KG always have a criminally penalizable duty to file for insolvency without undue delay no later than three weeks after the onset of illiquidity. The three-week period is intended to give the bodies the opportunity to perform reorganization measures to remove the grounds for insolvency in a sustainable manner. However, this cannot be seriously expected, and thus the petition must be filed promptly well before expiry of the three-week period. A ground for insolvency and the attendant duty to file is normally determined by means of a so-called insolvency status, the results of which must be resilient to challenge – not in the least for reasons of liability.

The ground to compel filing of insolvency is present, when the debtor is not capable of meeting its payment obligations as they come due. According to the Federal Court of Justice's leading decision on the matter from 2005, this is in any event the case, if within a spectrum of three weeks the debtor cannot meet at least ten percent of its total liabilities, provided that as an exception it cannot be expected with a probability bordering on certainty that the liquidity gap will be completely or almost completely eliminated soon thereafter and it is reasonable to expect the creditors to wait based on the particular circumstances of the individual case. It is very difficult for a layman to determine if and when this is the case. The debtor should thus use the assistance of experts. If the debtor fails to file for insolvency, despite a ground of insolvency being present, the bodies of the debtor become criminally liable. This might also have grave implications on future career opportunities of the responsible agent and can lead to personal civil liability risks for the company organs that are obliged to file a petition.

### Filing for insolvency early provides better room for maneuvering

The insolvency grounds of imminent insolvency are present, when it is expected that the debtor will not be able to meet its existent payment obligations. The earlier an insolvency petition is made, the greater is the company's room for maneuvering. If, at the time the petition is filed, sufficient liquidity still exists, the most pressing advance payments that become due simultaneous to the filing may be settled. The advantages of an insolvency proceeding, e. g., the non-payment of wages and liabilities or portions of sales tax, take effect only after a considerable time. In contrast, the suppliers for new orders almost always demand immediate payment before delivery. Submission of an insolvency petition early is therefore a guarantee of success for an effective reorganization through insolvency. For this reason, companies should make much greater use of imminent insolvency as a ground for filing insolvency by e. g. demonstrating in a liquidity plan that the duty to petition insolvency will come into effect in a few days, weeks or months. This is sufficient enough to enter the insolvency proceedings. Self-administration, which does not flow into a protective shield proceeding, is however also possible without imminent insolvency as its basis, but also in the event of actual insolvency. Nevertheless, it makes sense not to wait until the company has in fact become insolvent, because if the company is in fact insolvent, the options for action become significantly reduced.

### Reward for early application

The ESUG created incentives to file for insolvency early. The sooner the petition is made, the more cash the company will have available, and in turn the greater are the chances of success for a reorganization under insolvency protection. It may sound surprising, but the legislator wanted to reward companies that decide to petition insolvency early by providing imminent insolvency as grounds to compel filing. The legislature clearly intended for the new law to make insolvency a strategic option.

### Case study: Spezialmaschinenfabrik Wilhelm Rasch

Through innovative product development, Rasch has become world market leader in the field of wrapping hollow chocolate figures. However, due to the global financial crisis, the company got into financial trouble. Thus, the partners decided to initiate reorganization via an insolvency plan proceeding in self-administration, together with Buchalik Brömmekamp. From today's point- of view, this was the best management decision, as the protective shield proceeding enabled Rasch to become competitive again. The insolvency plan was unanimously accepted by the creditors at the creditors' meeting on 10th February 2014, so that the insolvency proceedings could be terminated already on 14th April 2014, allowing the previous owners to continue to run the company. We would like to thank the involved lawyers and advisors from Buchalik Brömmekamp wholeheartedly for their fast, effective and expert work and advice. With the help of Dr. Michael Lojowsky as the restructuring manager and the assistance of numerous other advisors in all parts of the company, it was possible to successfully implement the respective measures in the departments.

Due to the professional support, no irritation amongst customers and suppliers occurred. All of them continued their co-operation with the company; neither there were any losses on the customer side nor any supply shortages. We mostly achieved this result because of your highly professional handling of the "self-administration" proceedings and thus could eliminate our resentments regarding an insolvency proceeding.

Moreover, we are very happy that Buchalik Brömmekamp was so convinced of the plan and the company's future prospects that, in agreement with the existing shareholders, the consultancy decided to invest in company shares through a capital increase and strengthen the company's management and operational units. We find Buchalik Brömmekamp a highly competent partner for our future operations, stressed by Robert Buchalik having become an essential part of our Managing Board.

We feel that this new start by self-administration was the right step towards a successful future.

Tina Gerfer
Managing Director

# The provisional creditors' committee: Strengthening creditor participation

**The course for a company in insolvency is placed on the correct or incorrect path already within the first 10 to 14 days. Due to this, the new law has given the debtor and creditors the opportunity to influence key strategic decisions from the first day of the proceeding.**

Prerequisites for such "controlling participation" are that the company is under professional advisory in at least the last phase of the crisis, is encouraging a dialogue with its key creditors, and is convinced that it will take a mutual path towards restructuring the company under the protection of insolvency law. In contrast, and rightly so, companies that surprise their creditors with an insolvency petition should not have these options of controlling the proceeding available to them. These new possibilities are a meant to be a "reward" from the legislature that simultaneously provided incentives for businesses to move into the protection of insolvency law in a timely manner. The key control instrument at this early stage is a representative, provisional creditors' committee. In passing the law, the legislature also intended to ensure that from day one the insolvency court can integrate the knowledge of the creditors regarding the debtor company in its decision.

## Committee Members

Each insolvency proceeding is influenced by different group interests. The process should prevent – as the legislature intended - the law of the stronger, i.e., the secured creditors, from prevailing over the legitimate interests of general insolvency creditors in the insolvency proceedings, because all group interests must be expressed through the representative nature of the members of the provisional creditors' committee. The legitimacy of the creditors' early-controlling influence follows directly from the representativeness of the committee members. For this reason, a provisional creditors' committee that is proposed in the initiation proceeding should consist of at least five members. The members should not overlap and must clearly reflect the groups of the banking industry, the secured creditors, the institutional creditors, the unsecured creditors and representatives of workers' interests. If simultaneous to a petition from the debtor, the creditors propose a provisional creditors' committee, in which the five classes of creditors are clearly and discretely represented, the court must be appoint this group as the provisional creditors' committee. At the same time this ensures that from day one of the proceeding the creditors may influence the on-going structuring, appointment of the preliminary insolvency administrator, performance of reorganization options and how to open the proceedings in the fastest manner possible without any issue emerging that could potentially delay the proceeding.

The rights of the provisional creditors' committee, in particular in a self-administration proceeding are very wide reaching. The following are particularly noteworthy:

- Participation in all important decisions in the initiation proceeding, e. g., naming of the insolvency monitor, continuation of self-administration or termination of a protective shield proceeding.
- The insolvency court is bound by the unanimous proposal from the provisional creditors' committee, in which the provisional insolvency monitor administrator (§ 56a, Para. 2 Insolvency Code (IC)) is named or the professional or personal requirements (§ 56a, Para. 1 IC). By means of a unanimous decision, the provisional committee of creditors may deselect a provisional insolvency monitor that has been previously appointed by the insolvency court.
- Support or rejection of self-administration (§ 270, Para. 3 IC); the insolvency court is bound by an unanimous decision of the provisional creditors' committee to order self-administration in a proceeding that has already been opened. This is true even if it is obvious that self-administration would be detrimental to the creditors.
- Consent to all transactions of a particular importance as set out in § 160 IC.

## The "Can Should Must Committee"

Once one understands the new possibilities for creditor participation by virtue of the provisional creditors' committee and recognizes the central importance of setting the proper judicial course, then three different legal options must be distinguished.

It is important to note that the creditors, and not the court, have the right to propose suitable persons for the committee. If the creditors do not make use of this right, the court may appoint these members.

Any insolvency petition must include all the appendices required in § 13 IC. If any of these appendices is lacking or incomplete, the petition is deemed inadmissible. The necessary appendices are very complex, thus making professional preparation in the few weeks directly before filing essential.

### The "Can or Discretionary Committee"

Although it was previously disputed as to whether the law even permits a provisional creditors' committee to be appointed in as early as the initiation proceeding, this is now a permitted provisional measure under § 21, Para. 2, Sent. 1 no. 1a IC and may be ordered by the court ex officio at any point in the proceeding. A special feature hereto is that non-creditors or third-party experts may not be represented in a provisional creditors' committee as they lack the necessary relationship to operations, however parties that become creditors upon the very opening of the proceeding may be members of the committee. This includes not only the Pension Indemnity Fund (PSV) and the Federal Employment Agency, but also all creditors holding undisputed or legally enforceable claims. The representation of workers' interests should also be permitted via a union active in the company.

### The "Should or Petition Committee"

Even if a company does not reach the threshold values for a "must committee" (sales of approx. EUR 10 million, total assets of approx. EUR 5 million, 50 employees), the court should establish a provisional creditors' committee pursuant to § 22a Para. 2 IC, if this is requested by the debtor, any creditor or a preliminary administrator that has already been named. This means that in effect a provisional creditors' committee can be utilized in every corporate insolvency to thereby bring in creditor participation. This petition must be granted, if the court receives a proposal stating the composition of the provisional creditors' committee, the consent declaration of each proposed representative is attached to the petition, and no reasons for excluding them exist (§ 22a, Para. 3 IC). If such a committee petition is filed directly with the insolvency petition, the court may not hesitate in appointing the committee. However, here as well, the principle requiring discrete representation of each group must be respected, meaning that the interests must be balanced within the committee of five members.

### The "Must or Compulsory Committee"

If the company meets the thresholds in § 22a, Para. 1 IC (sales of approx. EUR 10 million, total assets of approx. EUR 5 million, 50 employees) and it has not yet suspended operations by the filing date, the court is required by law to appoint the provisional creditors' committee, if a properly composed committee is proposed with the complete insolvency petition and the consent declarations of the nominees are attached. Because such an appointment by the judiciary may take considerable time, a petition containing a proposal of suitable persons should always be filed with the insolvency petition.
If the court initially refrains from establishing a provisional creditors' committee and immediately appoints a provisional administrator without a hearing, it must convene the hearing of the committee promptly, so that as applicable the latter may make use of its substitution right to substitute and unanimously elect another administrator at the committee's first meeting (§ 56a, Para. 3 IC).

### Conclusion:

The provisional creditors' committee gives creditors and debtors a means to influence all key issues relating to a reorganization under insolvency protection. However, without professional preparation, these rights will bring about nothing. If the insolvency debtor has the (provisional) creditors' committee on its side, it can likewise influence all measures that direct the insolvency. The provisional creditors' committee and its support offer a further instrument to ensure legally certain structuring of plan insolvency in self-administration.

# The restructuring of Wilhelm Rasch Spezialmaschinenfabrik under insolvency protection

**The Wilhelm Rasch Spezialmaschinenfabrik GmbH & Co. KG specializes in producing special packaging machines for the packaging of confectionery products. Through innovative product development, Wilhelm Rasch has established itself as the undisputed world leader in the hollow figure winding market segment. Rasch products are characterized by innovative solutions, high quality and well-above average durability. The financial and economic crisis left a profound impact on the balance sheet and the profits of the company.**

Despite slightly positive results directly after the crisis, liquid assets were not sufficient to make necessary future investments to the extent required; the shareholders were not willing to assume higher debt as bank liabilities were already presenting the prospect of significant, related personal liability for the shareholders. At the end of September 2013, the Managing Director, Bettina Gerfer, decided to restructuring through an insolvency plan proceeding in self-administration. The insolvency proceeding was suspended after just seven months. The company was operatively restructured making equity clearly positive and earnings potentials were excellent. Fully free of debt, with no bank liabilities and sufficient liquidity without the need for new third party financing, a new start into the future had begun. Convinced by the excellent products and the highly motivated team, Buchalik Brömmekamp decided not only to continue to accompany the company, but also decided to participate in the company as a partner and strengthen its management.

Previously, the income crisis had severely impacted the liquidity position of the company. Revenue in 2009 was down as compared with the previous year by more than 30 percent. Cost structures could not be adjusted quickly enough to handle the reduction in revenue. Moreover, subdued sales activities, exceedingly high production costs and insufficient data processing for corporate management due to the absence of well-functioning ERP system provided additional causes of the crisis.

## Restructuring by means of insolvency plan

In order to overcome these clearly recognizable weaknesses, financial resources for new investments in a new ERP system and production optimization were particularly required. Moreover, sales had to be urgently strengthened in order to eliminate the weaknesses found in that department and most primarily generate the funding for the investments needed. Financial requests made of banks were rejected due to the difficult economic circumstances. As the liquidity situation came to a head and insolvency became imminent, Bettina Gerfer decided to initiate restructuring via an insolvency plan proceeding in self-administration, together with Buchalik Brömmekamp.

Initially, the ultimate goal was to maintain production and thereby the company's ability to deliver in an effort to maintain customer trust. Insolvency fund pre-financing had been secured even before the company filed for insolvency in self-administration, such that the salaries that were pre-financed by a bank brought in by Buchalik Brömmekamp could already be paid by the time self-administration was ordered.

## Comprehensive analysis of causes

First, a comprehensive root cause analysis was performed with respect to all areas of the company and the key operational weaknesses were identified:

- A strategy was already in place which could not be implemented adequately however due to the lack of a functioning ERP system and a corresponding breakeven analysis for appraisal of the individual divisions.
- The calculation was based for the most part on estimates. Implementation of a detailed preliminary and post calculation at first began in 2013.
- Orders could not be carried out on time or below cost due to a lack of figures for operational control and a lack of assigned responsibilities.
- Sales activities were insufficient.
- The vertical range of production, old machinery and an unfavorable flow of material were identified as key cost drivers.

A comprehensive restructuring plan was prepared together with the company management based on this root-cause analysis giving special attention to the following areas:

- Analysis of the sales organization,

- Analysis of production processes and planning,
- Analysis of purchase-related data and procurement volume
- Assessment of working capital in terms of existing cash potentials,
- Restructuring of the organization,
- Adaptation of the ERP system and allocation of costs to each cause and
- Adjustment of cost accounting.

## Measures in the proceeding

Accompanying measures were taken, in order to optimally steer the self-administration proceeding:

- Addition to the management by a chief restructuring officer from the firm Buchalik Brömmekamp,
- Implementation of a reporting system in the form of a so-called daily report, incl. key figures for corporate management (sales, orders, account balances, etc.),
- Drafting of short term liquidity planning,
- Adaptation of business operations to requirements specific to insolvency and
- Regular communication with the participating stakeholders regarding to the progress of the proceeding.

## Creditors were convinced by the restructuring plan

A comprehensive restructuring plan was already available by start of December 2013 as the insolvency proceedings began. The plan found wide acceptance and was agreed upon with the insolvency monitor, creditors' committee, works council and the main customers. The identified restructuring measures were implemented with diligent urgency and meanwhile have almost been completed. The self-administration and continuity in the management caused no irritation amongst customers. Quite to the contrary, the customers remained loyal to the company during the proceeding. Declines in orders were not recorded. Moreover, suppliers were and continue to be available to the company without restriction, and supply shortages or delivery delays have not occurred to date.

The sales staff was reinforced with Christian Biermann, who, together with Bettina Gerfer and Christian Wichmann, has established a strong sales team. The production department was realigned and optimized with the assistance of necessary investments. The experienced and competent production manager, Udo Martin, was hired. The introduction of a new ERP system is currently being moved forward by the proven strengths of Holger Plaumann and René Holdenried and will be completed in the near future; the tools necessary for commercial management are available again. The engineering team led by Axel Störmer was terminated to allow the team to concentrate more intently on core competencies.

## Company is capable of competing on the market once again

Equity was completely exhausted by the time insolvency was filed and is again sufficiently positive due to a high tax-free recapitalisation gain, which after deduction of restructuring expenses is well over EUR 1 million. The insolvency fund from the Federal Employment Agency and the non-payment of social security contributions and sales tax burdens during the preliminary insolvency proceedings provided the company with substantial cash means with which all bank liabilities were reduced, and the company's liquidity strengthened, so as to enable the necessary investments to be made.

The insolvency plan that was derived from the restructuring plan was unanimously adopted by the creditors at the creditors' meeting on 10 February 2014. This meant that the insolvency proceedings could be suspended on as early as 14 April 2014 allowing the previous owner to continue to lead the company. Buchalik Brömmekamp was so convinced by the plan and future prospects of the company that the consultancy decided in agreement with the existing shareholders to assume company shares through a capital increase and strengthen the management and operational units of the company. Today, employees of Buchalik Brömmekamp are comprehensively involved in process optimization, and Robert Buchalik has become a Managing Director, alongside Bettina Gerfer.