Prepacked Plans in Germany

Dr Annerose Tashiro[1], Schultze & Braun, Achern, Germany and London, UK

I. Definition

So-called prepacked plans in a German context are insolvency plans that are planned and created before the debtor files a request for insolvency. Usually, they are submitted together with the petition to open insolvency proceedings.

The German legislative orientated itself by the rules of the Chapter 11 – reorganisation plan as a guideline to form the rules on insolvency plans in German insolvency law. Prepacked plans both in the US and also in Germany are considered as plans that are usually worked out and submitted to the creditors and primarily negotiated before the formal petition for opening of insolvency proceedings. To understand what a prepacked plan means especially in German insolvency law, it is helpful to understand the systematic of an insolvency plan in Germany.

II. Insolvency plan in general

An insolvency plan is a tool to certainly *restructure* the insolvent company. The German Insolvency Code (InsO) grants this possibility only to the administrator and to the debtor. For debtors who plan to reorganise themselves, a prepacked plan is the only controlled way to achieve a calculated outcome.

1. Content

A German insolvency plan contains in any of event two parts. The first part describes the aims and purpose of the plan and the current status of the company in legal and commercial terms. The second part is constitutive - the groups, the distribution conditions, any alteration to any rights or interests, any timing or any other amendment to any creditor's claim are defined and the instruments by which the continuation of the company shall be achieved. The constitutive part may also refer to certain settlements or agreements *voluntarily* entered into with shareholders concerning the capital structure of the debtor-company.

[1] German attorney-at-law and Registered European Lawyer (UK), Head of Cross-Border Restructuring and Insolvency

2. Procedure

The insolvency administrator or the debtor may initiate an insolvency plan. The insolvency administrator can act in two capacities: On one hand as insolvency administrator, on the other hand on behalf of the creditors committee which can instruct the administrator to draft a plan. The court checks the insolvency plan for procedural or formal faults. In case no faults are identified, the court submits the plan to the creditors committee, the administrator and the debtor to make a statement on it. Later, the creditor groups as defined are requested to vote on the plan (see below).

3. Group structures

The author of the plan (debtor or administrator) joins the creditors to form groups. Although the German insolvency law does not stipulate differing priority of insolvency creditors, it shows very few ranking of creditors: creditors with a right to separate satisfaction, the creditors that are not of a lower ranking and the ones of a lower ranking. Within each different "rank" the author of the plan can create groups. In that purpose, he can join creditors of the same economic interest in one group, e.g. those who granted loans or those who delivered goods. Furthermore the InsO also states the possibility to form a group of employees. In insolvency proceedings with many different creditors, forming of groups may be a difficult task. Especially because the author has to consider and to calculate the influence such building of groups will have on the later voting. For example if there are creditors who are known for voting against the plan, it might be advisable to combine them in one group so that the majority of groups consenting is not affected. Forming groups requires a full understanding of those various agendas and interests and also a predicting of the consequent mechanism of possible influences.

4. Voting rights / Necessity of majority

Creditors whose claims or interests are impaired are entitled to vote in their respective groups on the insolvency plan. Unsecured creditors have usually the right to vote because they never get a full settlement of their claim. Creditors with a right to separate satisfaction have this right only if the plan affects their rights, e.g. by delaying their right to foreclose on security.

The plan is accepted if the majority of groups votes for the plan. Whether a group votes for the plan or not depends on the majority within the group. This majority is doubled. It has to be the majority of persons and of the amount of claims that are represented by that group.

Even if the necessary majority is not achieved, it is possible to feign a positive voting of a group. Art. 245 InsO states the premises for that. This so called Prohibition to Obstruct is inspired by the "cram down" of the American bankruptcy law. The creditors in the group must not be treated worse concerned their rights by the plan compared to a regular administration, either winding up or selling the business. Furthermore they have to be participated in a reasonable extent in the economic value devolving on the parties in the plan. As a third presumption the majority of all groups must have backed the plan.

In a next step if a creditor in one group is overruled by the majority in his group, he is entitled to file a petition to refuse the confirmation of the plan, but the premises therefore are very narrow and difficult to prove.

5. Scope of regulation

The plan procedure makes some exclusions: The plan cannot interfere in the rights of creditors with a right to separation (according to Art. 47 InsO the subject of such right to recover or reclaim assets from the administrator' s possession are not part of the estate). Therefore these creditors are not participating in the insolvency plan procedure. However the right to separate satisfaction (those whose claim is secured by the debtor's assets and receive priority payment over unsecured creditors) is not excluded from the plan procedure.

Also shareholder rights are not part of the scope of the insolvency plan. The InsO presumes that shareholders are not party to the procedure and may neither be integrated in a group nor even vote. To reorganise a company in its structure or to reshape the company's financing or equity base, shareholders must voluntarily commit to the goals of the plan and make any necessary shareholder's resolution outside of the scope of the plan. Such voluntarily achieved agreement can be made an attachment to the plan which can refer to it to include its effects indirectly. However, no shareholder can be forced to give his consent to any such – necessary measures (besides any possible duty to vote in favour of the "company's future" arising out of the argument of good faith).

Furthermore the plan cannot interfere in collective labour agreements.

III. Use of prepacked plans in Germany

Back to the prepacked plans, it can be said that these are very useful tools if handled properly. It replaces to some extent an extrajudicial restructuring. This form of restructuring is however rather uncertain because there is no judicial framework that governs out-of-court restructuring as such. A prepacked-plan is only effective and useful, if insolvency proceedings are formally opened later on.

The initiative for a prepacked plan is mainly coming from the companies, sometimes also from the main creditors. The prepacked plan is a tool by which the company can make a concept to rescue its business in a crises considerably far before the formal commencement of the proceedings. Structuring a prepacked plan needs full overview and control of the situation facing an upcoming and planned filing for insolvency. There are no further aspects to the content of a prepacked plan compared to the one drafted after opening of a case. However, the debtor filing for insolvency submits his petition together the prepacked plan.

IV. Advantages of prepacked plans

Especially credit institutes are usually afraid of driving a debtor into insolvency because the recoverage in insolvency will be very little. Therefore, opening proceedings together with an already agreed-upon insolvency plan can help to keep them on board with an outlook of a prepared and calculated conduct. Insolvency plan procedures started after commencement take longer so that the restructuring could be endangered if the company runs out of liquidity to carry on with its business. The provisional administrator better uses the time period of the opening procedure to prepare the plan where the labour authority funds the wages (up to three months prior opening) by which usually companies achieve a significant break in their way down the crisis and the provisional administrator maintains some liquidity to operate. However, it is also advantageous to prepare a prepacked plan since the whole procedure takes less time if the plan is ready and filed with the petition for opening of insolvency proceedings – the effectiveness is its unique selling point.

Furthermore, the outcome of the voting on the insolvency plan is more predictable when agreed prior to filing because of the co-operation of debtor and creditors.

One can easily see, that the prepacked plan is the most effective tool to restructure a company. Especially if the prepacked plan is combined with the request for a form of "self-administration" inspired by the idea of a "debtor in possession" where the management of the company remains in full power and place, only watched by a supervisor as opposed to the usual and regular appointment of an administrator. Such petition for self-administration should be filed together with the petition to open proceedings and the prepacked plan. This results from the fact that the company as "debtor in possession" can manage its assets and rescue plan for itself. The management (also possibly under implementation of a CRO or the like) of the debtor stays - as long as appropriate – in full control of the restructuring process using the prior structured and agreed prepack-plan. Furthermore there are fewer costs for the estate if administration is not ordered.

Finally, once a prepack-plan is filed and even if administration is ordered, it is unlikely that the administrator can counter the prepacked plan with another insolvency plan, since German insolvency law provides not for the opportunity to choose between multiple plans or vote on several plans. Voting can only be conducted for one plan.

VII. Facts on insolvency plans

In Germany there are still a few proceedings with an insolvency plan and even fewer proceedings with a prepacked plan, but the number of proceedings with a plan is increasing steadily, though. In 2006 20,369 corporate insolvencies were opened, out of them, in 257 cases an insolvency plan was filed. The number of business insolvencies filed with a plan has changed from 47 in 1999 to 257 in 2006, thus the number increase by more than 500 %.

VIII. Conclusion

Prepacked plans are a very useful tool in restructuring of companies because the procedure of restructuring is faster and more effective than in normal insolvency plan procedure, especially in combination with a "debtor in possession". The plan can, however, not force any shareholder to give up any rights or interests.

In Germany it is not yet very often used but as seen before, the numbers of insolvency proceedings with a plan are increasing and its publicity and effects are improving.