The recent controversial restructuring of Leoni AG and the filing of Varta AG raise important issues for the German restructuring regime StaRUG and highlight important differences with the English Part 26A Restructuring Plan

I. Background

On January 1, 2021, Germany implemented the German Act on the Stabilisation and Restructuring Framework for Businesses (StaRUG), a new out-of-court restructuring regime. This system aimed to provide a viable alternative to traditional insolvency proceedings for companies looking to restructure their debts. Despite initial praise, during the restructurings of real estate groups Adler and Signa, financial creditors continued to prefer the established UK Scheme of Arrangement or the new English Restructuring Plan . However, companies such as Eterna Mode GmbH, Softline AG, Leoni AG, and Varta AG opted for StaRUG as a genuine alternative.

In 2023, the StaRUG restructuring of German automotive supplier Leoni AG sparked resistance from its shareholders. They contested the cram-down provisions in the plan, resulting in a complete loss of their equity, with only the major shareholder maintaining the right to subscribe to new shares and reinvest in the company to recover their initial investment.

Similarly, the case of Varta AG, filed in July 2024, draws significant media attention due to the controversy surrounding its StaRUG restructuring. The move is perceived as a pre-arranged plan to transfer the company to its largest customer and majority shareholder without compensation for other shareholders and with a considerable reduction in the creditors' claims.

Now, the StaRUG is viewed by some as a disguised takeover law, which does not require shareholder approval and allows majority shareholders, potentially in coordination with a new investor, to buy out existing shareholders without providing compensation.

II. The main challenges of the StaRUG

There were two main challenges: Does the management have to seek 75 % shareholder approval for filing the restructuring petition to the insolvency court? And can the restructuring plan provide for the exclusion of the shareholders' subscription right?

There are conflicting court decisions regarding the management's filing authorities. It is often argued that in the case of a company with limited liability ("GmbH"), as opposed to a stock corporation ("AG"), the management should seek shareholders' consent as shareholders are generally entitled to instruct the management. There seems to be a consensus that shareholder approval is not required if the company would be cash flow and/or balance sheet insolvent without the contemplated restructuring under the StaRUG regime. However, the balance sheet/going concern test is highly complex. It is essentially a cash flow prognosis test, meaning a company is considered balance sheet solvent if there is a sufficient likelihood that they will remain cash flow solvent for the next 12 months, with certainty in the case when third-party funding

is required to cover such a 12-month period. Shareholders may often argue that a StaRUG filing was not required to avoid cash flow and/or balance sheet insolvency.

In the cases of Leoni AG and presumably Varta AG, the restructuring plan includes the elimination of all existing share capital and the subscription of newly issued share capital by the majority shareholder and/or a new investor, while excluding the subscription rights of the other existing shareholders. Without the StaRUG regime, such capital measures would require a 75% majority vote of the voting shareholders. According to the cram-down provisions in the StaRUG, a restructuring plan can be approved by the majority of the stakeholder groups. As a result, financial creditors, with the majority shareholder, could overrule the group of dissenting shareholders. There is a view that a subscription right for shareholders under the German Stock Corporation Act (AktG) continues to exist even in a restructuring under the StaRUG, despite the fact that it may be excluded from the restructuring plan. However, where the interest of the debtor are sufficient to justify the exclusion of the subscription right, (which must be established by evidence as to the reasons) the right could be excluded. However, this would not be the case if the subscription right remains with one shareholder. In that case, the insolvency court must dismiss the restructuring plan, and further, shareholders may have damage claims against the management board and be entitled to a mandatory offer (Pflichtangebot) under the Securities Trading Act (WpÜG).

III. Contrast with a UK Restructuring Plan

A UK Restructuring Plan (unlike a UK Scheme of Arrangement) allows for a cramdown of one or more classes of creditors or shareholders even if they vote against the Plan. There is no need to obtain shareholder approval for the company to commence a Plan – it merely has to be in "financial difficulties". That does not require a balance sheet/going concern test.

Further, the legislation allows equity rights to be adjusted and new equity rights to be created without the approval of the shareholders. There has been one case where the court approved a Restructuring Plan of a non-UK Company to issue new equity to creditors giving them control as part of the restructuring. Once certain English jurisdictional hurdles were met, all the court needed was evidence that this would work under the law of the place of the Company's jurisdiction. Under the plan a power of attorney was created which the court was told would mean that the new issue could meet the local law requirements.

If there is clearly no value in the equity, then the court can order that shareholders do not even get to vote on the Restructuring Plan.

IV. Legal remedies against the takeover in the restructuring plan

Stakeholders impacted by the restructuring plan may file a complaint to have the effects of the restructuring plan suspended. The approval of the restructuring plan depends on a comparative calculation, which determines whether shareholders and creditors would be in a better position commercially with or without the restructuring plan. It is argued that without the StaRUG regime, the company would have to enter insolvency proceedings – so, the shareholders and creditors would not be disadvantaged.

However, there is a lot of debate around this comparative calculation, specifically whether liquidation or going concern valuation should be used, especially if the German insolvency process is similar to a US Chapter 11, involving a debtor in possession process resulting in a going concern asset sale. Additionally, strict German insolvency rules allow for the claw back of payments made to shareholders and financial/trade creditors if they are made during a financial crisis, with claw back periods of up to 10 years. When making this comparative calculation, we must also consider potential damage claims against management and other parties. The German Federal Court has established the concept of deepening insolvency, which could lead to a tort claim against management, lenders, customers, and other parties who delayed filing for insolvency. Management could also face damage claims for failing to engage in early dialogue with stakeholders to offer the opportunity to further invest and minimize their losses.

V. Legal Remedies to challenge a UK Restructuring Plan

As in Germany, stakeholders whose interests are being crammed down can object to the court on the basis that they are receiving a worse outcome than they would have obtained under when the law calls the "Relevant Alternative". That is the position which the stakeholder would have been in if the Restructuring Plans were not approved. Often the Relevant Alternative is taken to be an insolvency process and in most cases that results in the shareholders having no economic value. Accordingly, unless they can show that there is real value in the equity, which would accrue in the most likely alternative case, then the shareholders may find the English courts do not provide them with significant protection.

VI. Conclusion

The controversy surrounding the case of Leoni AG and the public debate about the recent StaRUG filing of Varta AG highlights the challenges that German out-of-court restructurings present for both equity and debt holders. There is still no clear guidance on how stakeholders will be affected. If the StaRUG is used as, what is being considered by many, a means of disguised takeover. But this uncertainty may leave existing shareholders in a stronger position than if the Company were to seek to use a UK Restructuring Plan and the question of which jurisdiction's laws to use to effect a restructuring will generally be a decision for the Company.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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