If you want to restructure in Germany, look to the 2009 Bond Act

The ESUG insolvency law introduced two years ago gave Germany a truly effective alternative to liquidation. But it is still an insolvency law. Local practitioners and legislators bitterly regret the absence of an equivalent to the increasingly popular English Scheme of Arrangement as a restructuring tool.

On the other hand, practitioners are coming to realise that another piece of legislation may have provided them with similar tools; Germany's 2009 Bond Act.

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Over the last 18-24 months the number of bond restructurings in Germany has surged. It was therefore timely when the German government introduced a new Bond Act ("Schuldverschreibungsgesetz") in 2009 to replace the existing law dating back to 1899.

Initially, large scale restructurings such as Q-Cells and Pfleiderer tried to deploy this Act in order to restructure their outstanding bonds.

Over the past 12-18 months however, a large number of midcap bonds (so called "Mittelstandsanleihen") have had to engage in restructuring talks with their bond creditors. Overall, the Act has now become a key restructuring tool for German restructuring professionals.

The major change in the new Bond Act revolved around modifications to the terms and conditions of the bond.

Under the old Bond Act and without unanimous consent, no change to the principal or face value ("haircut") was possible, nor was any change permitted to be made to the security interest. This meant that a financial restructuring outside an insolvency proceeding was near impossible, or necessitated a COMI shift, as was the case in Deutsche Nickel in 2004.

Under the 2009 Bond Act, the indenture may be modified by a majority resolution of creditors if and to the extent the indenture provides for such modification.

Whilst the bar has been set relatively high with a 75 per cent majority in terms of outstanding nominal value voting in favour, the quorum of 50 per cent in the first creditors meeting and only 25 per cent in the second creditors meeting effectively reduces the threshold to 18.75 per cent for an out of court restructuring.

> Thus, the new Bond Act offers an efficient out-of-court implementation route similar to the UK Scheme of Arrangement for bond creditors

The 2009 Bond Act also introduced an instrument called "Common Representative", elected by bondholders.

The Common Representative, typically drawn from a professional restructuring firm, negotiates with other restructuring stakeholders and, within certain restrictions, is able to make decisions legally binding the totality of the bondholders he represents.

In-court bond restructurings are subject to the German insolvency code that supersedes any provisions in the 2009 Bond Act in case of the conflict of law.

Bond Act restructurings of non-German companies

In 2011/2012 the Bond Act hit the headlines due to the debate on the applicability of the act to bonds issued prior to 2009 by non-German companies but issued under German law.

The higher regional court (Oberlandesgericht) Frankfurt decided in March 2012 in the Pfleiderer AG case that the so-called "opt-in" would be not applicable to such companies. Pfleiderer AG had issued a bond out of a Dutch Pfleiderer Finance BV.

As a consequence, no collective action could be taken and Pfleiderer management had no option but to file for insolvency.

The management of Q-Cells AG, which also had issued a bond by a non-German finance company followed suit.

However, the case not only had implications on these two companies.

The practise of issuing bonds for tax and other reasons out of a foreign, e.g. Dutch subsidiary, guaranteed by the German parent company was a commonly used financing model and had implications for the potential restructurings of further German companies, the convertible bond of IVG being the most recent example.

However, in July 2014, the German Federal Court of Justice ("Bundesgerichtshof") reversed the decision by the higher regional court in Frankfurt and decided that the opt-in provision in the 2009 Bond Act would indeed be applicable to all bonds issued under German law.

> Whilst this decision comes too late for the creditors in Pfleiderer and Q-Cells, it has provided implementation certainty for upcoming bond restructurings issued by non-German companies.

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SolarWorld and the Common Representative

The benefits of the 2009 Bond Act became very evident in the successful out-of-court restructuring of SolarWorld AG, which in spring 2013 invited bondholders to elect their Common Representatives for its two outstanding bonds.

Following their election, the Common Representatives were able to present the restructuring concept to bondholders who subsequently voted in favour of the concept. However, a further, and often underestimated, role of the Common Representative is its role in the implementation phase.

The collective action clause provides the elected Common Representative with the authority to approve changes to the bond documentation and other legal documents that are required during the course of a financial restructuring (e.g. restructuring agreement, intercreditor agreement, etc.) on behalf of all bondholders. Without this clause, the restructuring of liquid instruments would be impossible.

> The restructuring of SolarWorld AG and 3W Power SA, the latter a Luxembourg registered issuer, are prime cases of successful out-of-court restructurings.

Furthermore, standards long established in the loan market have been successfully introduced into the German midcap bond market. For example, the Common Representative of the bondholders in MT-Energie negotiated a 1 per cent waiver fee in return for not terminating the bond following a breach of a minimum equity ratio covenant, an absolute novelty in the midcap bond market, although widely used in loan restructurings.

Without a Common Representative, acting on behalf of all bondholders and being one port of call for the company and the other term loan holders, this would not have been possible.

Still areas to work on

Despite all the positive feedback the 2009 Bond Act has received, there are still some areas that require further education of issuers or potentially further legislation.

Firstly, whilst the above mentioned decision by the German federal court to allow the applicability of the law for German law governed bonds issued by foreign entities, there are many cases of German companies issuing bonds under foreign law.

This principally applies to high-yield bonds issued under New York law but the case of Scholz AG, which had issued a bond under Austrian law and had to undergo a restructuring earlier this year, further highlights this factor.

> International investors are becoming more and more familiar with the German bond legislation and the benefits it offers bondholders in a restructuring.

Whether or not a trend toward issuing new high yield bonds under German law by non-German issuers or, in fact a change of law for existing bonds (analogue to the change of law of its loan documentation in the case of Apcoa) would emerge, remains to be seen.

Secondly, bonds have had little or no financial maintenance covenants traditionally, and the Common Representative is therefore only asked relatively late in the process to join the restructuring discussions.

They often find themselves presented with a proposal negotiated between other lender groups and the company. Then, little room for manoeuvre for their clients remains. Bondholders however do have the right to call for a bondholder meeting and vote for a Common Representative if they own in excess of 5 per cent of the issued bond capital.

This lever has thus far not often been used in Germany, SiC Processing being one of the cases, but the benefits are clear: an elected Common Representative has, at the very minimum, information rights towards the company; he can act as a sounding board for restructuring proposals for the company and as a messenger for restructuring concepts brought forward by individual bondholders.

> In order to do this, a good Common Representative needs to appreciate the requirements of all bondholders, including par investors, both institutional and retail, as well as yield investors and distressed investors.
>
> The Representative also needs to be able to understand the financial impact of restructuring proposals and be prepared to take decisions on behalf of the bondholders.

5.4 billion euro of bonds need refinancing

Since the introduction of the 2009 Bond Act, investors have become significantly more comfortable with the German bond law.

This is most important as 5.4 billion euro of German midcap bonds will have to be refinanced by 2018. Some of the issuers will be able to refinance their bonds at par with relative ease, but others will struggle and therefore will have to restructure the bonds before or whilst entering into refinancing negotiations.

The 2009 Bond Act has thankfully provided a modern, restructuring-friendly legal basis for these discussions and has shown that, with expert advice, it can offer the framework for a smooth restructuring process.