

# The first year of StaRUG: A disappointing result?

Olomon Ljumani and Peter Neu report on the high hopes and low acceptance for the new German toolbox



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**Over a year has passed since the EU Directive on Restructuring and Insolvency (EU 2019/1023) was implemented in Germany. With the implementation of the Directive came the adoption of the Stabilisation and Restructuring Framework for Enterprises Act (StaRUG) (Unternehmensstabilisierungs- und restrukturierungsgesetz) by the German legislature on 17 December 2020.**

As reported in the Spring 2021 edition of Eurofenix, the StaRUG was intended to create the basis for the enforcement and implementation of corporate restructurings against the resistance of minority creditors, while avoiding insolvency proceedings. German policymakers made great efforts to implement the law at the beginning of 2021, seven months earlier than necessary, in order to pre-empt the wave of insolvencies that was expected, due to the coronavirus pandemic.

The reason behind this was to give companies affected by the pandemic an additional tool for their restructuring toolbox, in order to allow a more differentiated response to the potential crisis. Expectations of the new law were accordingly high. German politicians even prided themselves on having created a law that was not only in line with the modern approach to restructuring law, but that could also compete with the English Scheme of Arrangement and the Dutch WHOA (*Wet homologatie onderhands akkoord*). One of the aims of the StaRUG was to

counteract so-called forum shopping and to develop Germany into a more attractive place for restructuring. There was even concern, in part, that the courts would be overburdened with the adaptation and the resulting workload.

## Falling short of expectations

To the surprise of the majority of experts, these high expectations have not been met. The StaRUG has not been accepted by practitioners to the degree that was expected when it was implemented. According to the German insolvency trade journal “INDat Report”, there were only 22 applications for StaRUG proceedings in 2021. This figure is based on a survey among restructuring courts located in Germany. Thus, while the Dutch WHOA enjoys great popularity, with an estimated 130 procedures in 2021, the German StaRUG is only of secondary importance. The difference in acceptance levels becomes even clearer when one takes into account that Germany has five times as many inhabitants as the Netherlands. Malicious tongues sarcastically claim that there are now more legal commentaries on the StaRUG than there are procedures.

## Manifold causes for low acceptance and German cautiousness

Possible reasons for the low level of acceptance among practitioners are the subject of much debate among experts. It is difficult to identify a clear reason,

particularly since StaRUG procedures are, by their very nature, not public. However, one reason for the low acceptance probably has to do with the cautiousness for which Germans are known around the world. The StaRUG is new, it is a behemoth of 100 sections and is generally perceived as complicated. Many decision-makers are therefore suspicious of the StaRUG and are worried about making things worse in an already bad economic situation. Such caution is nothing new in Germany.

A very similar reaction was provoked in Germany when the Act to Further Facilitate the Restructuring of Companies (ESUG) (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*) was introduced in 2012. The ESUG was also a law that aimed to innovate and modernise the possibilities for restructuring companies. The changes introduced at that time were as far-reaching as those in the StaRUG. Here too, the reaction in the German industry was initially very restrained. However, the initial hesitation has subsided over time and today the restructuring instruments introduced by the ESUG are part of the daily work in restructuring practice. It seems likely that the acceptance of the StaRUG will increase similarly, once a number of successful StaRUG proceedings have been completed.

## First showcase example

The restructuring proceedings of *eterna Mode Holding GmbH*



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(Eterna) could serve as such an example. Eterna is one of Germany's largest shirt manufacturers, which ran into financial difficulties in the recent past. Eterna's advisors and management decided to file for a StaRUG proceeding in September 2021 and to implement a restructuring plan. The restructuring plan was subsequently confirmed by the restructuring court in October 2021. The central point of the plan was an agreement with Eterna's bondholders, according to which they would receive only 12.5% of their outstanding claim, so that the company's survival could be ensured. Eterna is therefore the first media effective StaRUG procedure in Germany and, so far, it looks like it has been a success.

### Low insolvency figures

Since the beginning of the coronavirus pandemic, a great wave of insolvencies has been expected in Germany. However, such a wave has so far failed to materialise. This is probably due to the fact that the German government generously distributed state subsidies to industries affected by the pandemic and even suspended the obligation to file for insolvency for a certain period of time. With the help of state subsidies, some of which are being paid until summer 2022, many companies hit by the coronavirus pandemic were able to stay afloat. This is also a partial explanation for the low number of proceedings under the StaRUG. This situation is likely to change by late summer 2022, when the last of the government aid programs will expire. It is expected that there will be an increasingly high number of companies whose financial difficulties will become apparent in the near future, due to the expiry of the state subsidies. This means, not only would the number of insolvencies increase, but also the number of companies that could potentially initiate StaRUG proceedings.

### Is the Toolbox too small?

Some experts attribute the restrained acceptance of the StaRUG to the fact that the "toolbox" is not big enough. Criticism focuses primarily on the lack of an option to terminate ongoing contracts. This was a highly controversial issue at the time of the introduction of the StaRUG. Ultimately, however, the voices of legislators who demanded that the right to terminate an existing contract should be reserved only for insolvency proceedings have prevailed.

A further point of criticism is the lack of regulations providing for a "shift of fiduciary duties" of the management. According to such provisions, as of the moment of imminent insolvency, the management of a company would have been obliged to give priority to the interests of the creditors and to act in accordance with these interests as opposed to acting in accordance with the interests of the shareholders. As a result, there is no obligation on the part of the management to initiate restructuring proceedings; it remains merely an option. Admittedly, the StaRUG is therefore more suitable for financial restructurings (i.e. debt restructuring) than it is for restructuring the operating business. As such, the StaRUG certainly does not offer the right restructuring tool for every company.

### Changes would be premature

With regard to the very low number of proceedings, voices have been raised calling for an amendment to the StaRUG. However, this would be premature at this point in time. An overall view of the reasons for the poor acceptance level does not necessarily lead to the conclusion that the law itself has failed. Rather, the business community and consulting practice must be given time to



embrace the new possibilities of the StaRUG. Successful restructurings, such as that of Eterna, will serve as positive examples and will increase the level of acceptance. In addition, the expiry of state subsidies is likely to contribute to long-existing financial imbalances within companies becoming apparent.

Moreover, the success of the StaRUG cannot only be measured by the number of proceedings carried out. It may very well be that the goal of the StaRUG, which is to implement a restructuring against the will of opposing creditors, is achieved even without conducting official proceedings. In many cases, the mere possibility of a StaRUG proceeding is enough to act as a deterrent for opposing creditors. Such creditors tend towards reaching an agreement and making concessions outside the StaRUG procedure in order to avoid it. ■



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