

Bond Restructurings in Germany Now Available More Broadly

German Federal Court of Justice decision paves the way for bond restructurings under 2009 Bonds Act.

The German Federal Court of Justice (the Court) recently published its first decision on the reformed German Bond Act (*Schuldverschreibungsgesetz*).¹ Following the Court's decision, a broader range of bonds can now be restructured under the 2009 Bond Act. The decision also allows for bonds issued before August 5, 2009 to opt-in to the Bond Act's powerful restructuring toolkit. The decision provides important guidance on how bond restructurings can be incentivized to obtain sufficient bondholder approval.

Background

In 2009, the German legislature reformed the previous 1899 Bond Act, which had limited practical relevance, mainly due to its limited scope of applicability. The 2009 Bond Act provides for several restructuring tools by majority vote (e.g., debt-to-equity swaps and haircuts) and was intended to apply to a broad range of bonds. The Act contains a provision allowing holders of bonds issued before August 5, 2009 to opt-in to the 2009 Bond Act by majority vote and with consent of the issuer in order to benefit from the restructuring toolkit provided by the 2009 Bond Act (Opt-in).

In 2012, the Higher Regional Court in Frankfurt significantly limited the possibility of an Opt-in by holding that the Opt-in would only be available to bonds that already fell within the scope of the 1899 Bond Act. This meant that holders of bonds from foreign issuers (like dedicated financing subsidiaries of German companies) and of certain types of bonds, such as participation rights (*Genussscheine*), could not take advantage of the Opt-in. The Frankfurt decision negatively impacted several major German restructuring cases, some of which resulted in filings for insolvency proceedings. In other cases, bond restructurings had to be held back or alternatives, such as the UK Scheme of Arrangement, had to be pursued.

In its first ruling on the 2009 Bond Act, the Court overruled the Frankfurt decision and made the Opt-in available to a broader range of bonds as well as to bonds issued prior to August 5, 2009.

The Decision of the Federal Court of Justice

In the case before the Court, the plaintiffs purchased convertible participation rights (*Wandelgenussscheine*) issued in 2006. Upon maturity, the plaintiffs sued the issuer for repayment of the principal amount. The issuer argued that the bondholders had passed a majority vote to opt-in to the 2009 Bond Act, to extend the maturity of the bonds for another four years, and to give only those bondholders who voted in favour of that resolution the right to demand a repurchase of the bonds before maturity in exchange for a waiver of their conversion right.

The plaintiffs succeeded only in part. The Court held that while the Opt-in to the 2009 Bond Act was valid, the vote in question violated the principle of equal treatment of bondholders laid down in the 2009 Bond Act, and was therefore void.

Explicitly disagreeing with the Frankfurt decision, the Court explained that the Opt-in is available for any bond falling within the scope of the 2009 Bond Act that was issued before August 5, 2009.

The Court did not sanction the maturity extension, though, holding that the bond's terms and conditions need to provide equal conditions for all bondholders. This principle was violated as — pursuant to the resolution in question — only bondholders who had voted in favour of the resolution were entitled to demand a repurchase before maturity. The approving bondholders would receive a preferential treatment since the maturity of the bonds would ultimately be at their discretion.

Implications/Takeaways

The Court's decision provides important guidance for the use of the 2009 Bond Act as a restructuring tool.

An Opt-in is now available for all bonds falling within the scope of the 2009 Bonds Act that were issued before August 5, 2009. Consequences are as follows:

- While the bonds need to be issued pursuant to German law, the issuer does not have to be registered in Germany. This point is particularly important for financing subsidiaries, which are oftentimes incorporated in the Netherlands.
- The Opt-in is available irrespective of whether the bond in question fell within the scope of the 1899 Bond Act. The 1899 Bond Act arguably did not apply to certain types of bonds, such as participation rights, convertible notes and derivatives. These types of bonds can now be restructured under the 2009 Bond Act.
- An Opt-in by a majority vote is possible, even if the terms and conditions of the old bond do not already allow for majority decisions.

An Opt-in requires the consent of the issuer and a majority vote of at least 75 percent of the votes cast. Upon a successful Opt-in, the restructuring toolkit of the 2009 Bond Act becomes available to the bondholders. Most importantly, the 2009 Bond Act allows for the holders of the same bond to consent by majority resolution (again, by at least 75 percent of the votes cast) to amendments to the bond's terms and conditions. This enables the bondholders to implement the following, among others:

- Waiver of events of default
- Deferral or reduction or waiver of interest payments
- Deferral or reduction of the principal amount
- Conversion or exchange of the bonds into shares or other securities (debt-to-equity-swaps)

Outlook

The Court's findings with respect to the extension of maturity show that the principle of equal treatment in the 2009 Bonds Act gives rise to ongoing challenges. If the issuer and/or major bondholders make efforts to incentivize bondholder approval to certain proposed resolutions, this principle of equal treatment needs to be considered. Further limitations on providing incentives to certain bondholders stem from the prohibition to "buy" votes in the 2009 Bond Act.

A so-called "Chinese Menu" can be a way out of this dilemma. A "Chinese Menu" can ensure equal treatment of creditors because it provides all creditors with the right to choose between different options. Those options need not be economically attractive to all creditors, though, allowing the issuer and/or major bondholders to thereby create incentives in order to achieve the desired outcome (*i.e.*, a successful restructuring).

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Frank Grell

frank.grell@lw.com
+49.40.4140.30
Hamburg

Jörn Kowalewski

joern.kowalewski@lw.com
+49.40.4140.30
Hamburg

Daniel Splittgerber

daniel.splittgerber@lw.com
+49.40.4140.30
Hamburg

Stephan Schneider

stephan.schneider@lw.com
+49.40.4140.30
Hamburg

You Might Also Be Interested In

Germany's Move to a Restructuring-based Approach to Insolvencies, May 2014
Pre-Packaged Insolvencies on the Rise in Germany? Evaluating the German ESUG, March 2014
Germany's Insolvency Reform Enables Loan-To-Own Strategies, October 2013

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <http://events.lw.com/reaction/subscriptionpage.html> to subscribe to the firm's global client mailings program.

¹ German Federal Court of Justice from 01 July 2014 – II ZR 381/13.