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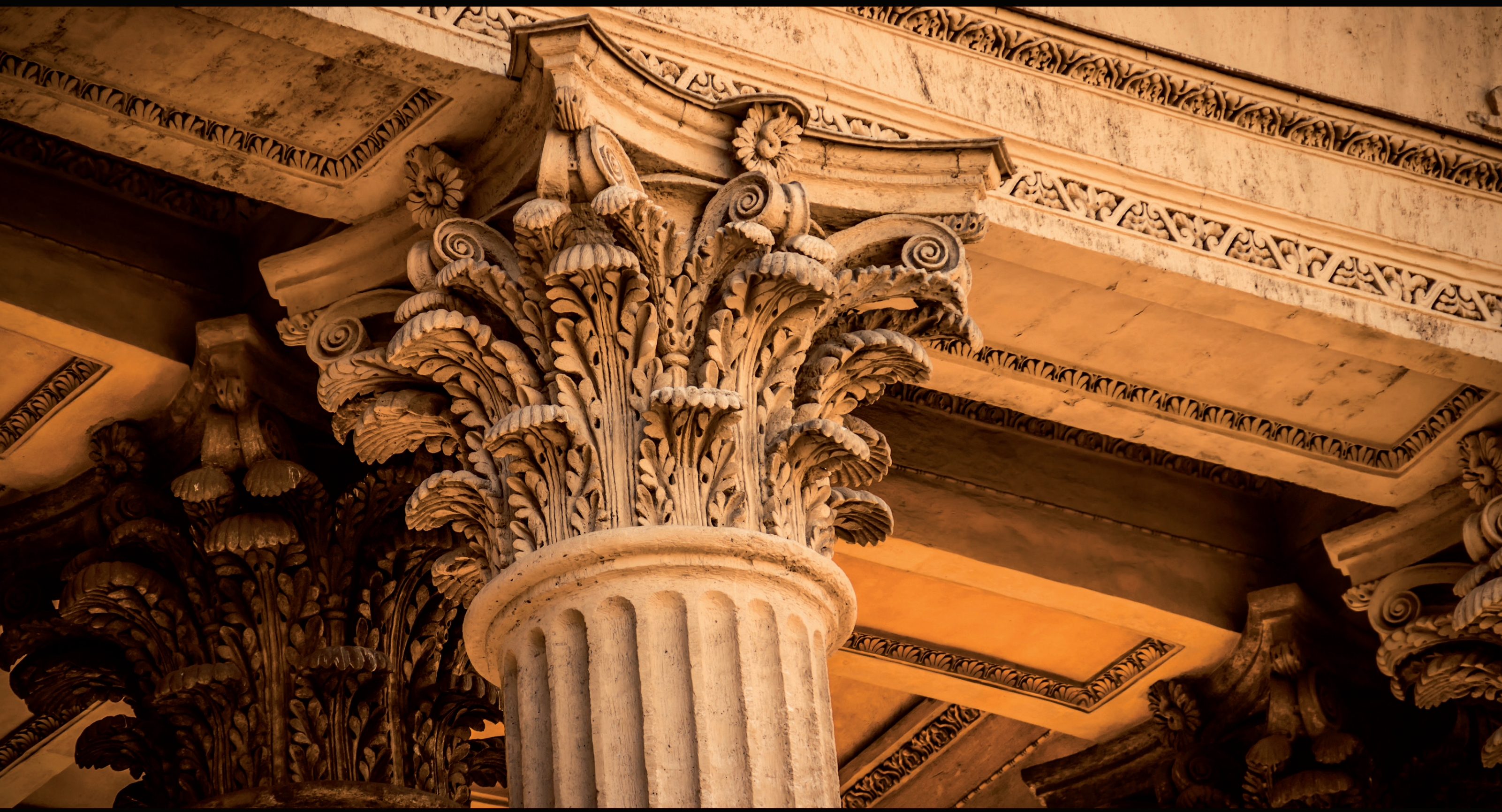

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Restructuring trusts: A viable structure for securing and restructuring financing in Austria

by Dr. Markus Fellner and Dr. Florian Kranebitter, Fellner Wratzfeld & Partner Rechtsanwälte GmbH

For a number of years, the "double-sided restructuring trust" (*doppelseitige Sanierungstreuhand*) has evolved in respect to large as well as mid-size companies as a viable instrument for securing financing and restructuring corporates in their times of crisis. The following article provides an outline of the general legal background and structure, the individual interests of the parties, as well as the potential risks and risk avoidance strategies.

The starting point for restructuring and considering restructuring trusts as a potential instrument to align lenders', shareholders' and the debtor company's interests or at least to find the lowest common denominator among them, is usually when the debtor faces a severe financial crisis and credit institutions or other lenders lose further trust in the skills of the shareholders and the debtor company's management. Even in a situation where lenders' collateral package already includes the shares in the debtor company, enforcement in a debtor's financial crisis will usually generate substantially lower recovery compared to a sale in a structured sales process.

For setting up a restructuring trust, the lenders and the shareholders jointly appoint a restructuring trustee (*Treuhänder*) with the mandate to accept, hold and, if certain criteria are satisfied, to sell or re-transfer the shares in the debtor company. The restructuring trustee becomes the owner of the full rights of the shares (*Vollrechtstreuhand*) and therefore has the power to exercise all rights arising from the shares, including the right to sell the shares.

In the underlying restructuring trust agreement, the lenders and the shareholders agree with the restructuring trustee on general guidelines for the trusteeship, such as certain triggers for initiating the sales process in relation to the shares, milestones and timing, as well as other terms, such as corridors for a minimum purchase price and representations and warranties.

The "double-sided restructuring trust" combines an administrative component, which is the administration of the participation conferred by the shares, and the security component, which covers the potential to realise the value embedded in the shares in case of an event of default or other events defined in the restructuring trust and finance agreements.

Following the execution of the restructuring trust agreement and the transfer of shares, the restructuring trustee is independent from the shareholders and the lenders in administering and executing the predetermined restructuring and sales process. This typically also avoids deadlock situations in restructuring and enforcement scenarios while the usual basic strategic goal of the structure remains to avoid an insolvency scenario (by maintaining or increasing the lenders' financing position) and to allow a structured sales process for the debtor company.

The key element for a restructuring trust agreement is the agreement that the restructuring trustee is not bound by instructions from the lenders and the shareholders (*Weisungsfreiheit*). On the one hand, this is crucial for making the restructuring trust an instrument that continues to be effective even after the opening of insolvency proceedings and, on the other hand, is also vital for risk avoidance.

With respect to the first aspect of the waiver of the right to give instructions, in case of the opening of insolvency proceedings over the assets of a trustor, trusteeships with such trustors generally cease and the object of the trust is returned to the general estate of the

trustor. However, in respect of double-sided or multi-party trusteeships, the Austrian Supreme Court has confirmed that such trusteeships do not automatically cease as a consequence of the opening of insolvency proceedings over the assets of a trustor.

The administrator's right to terminate not completely fulfilled contracts only applies to bi-lateral contracts, which do not include double-sided or multi-party trusteeships. To qualify as a double-sided or multi-party trusteeship in the view of insolvency law, it would be insufficient if the lenders and the shareholders agree to mandate a restructuring trustee. It is particularly essential that the parties agree that the restructuring trustee has an obligation to safeguard the interests of multiple parties (e.g. the lenders, the shareholders of the debtor company and the debtor company itself) and that rights and obligations are irrevocably assigned to the restructuring trustee.

The entering of a restructuring trusteeship and the measures undertaking a restructuring trustee might be voidable pursuant to Austrian insolvency law. Voidance on grounds of intentional discrimination of the creditors (Section 28 Austrian Insolvency Act; *Insolvenzordnung* - IO) would only be possible if the satisfaction of the creditors is delayed or hampered and, in particular, does not apply if the restructuring trusteeship constitutes from the perspective of the debtor company – from an *ex ante* point of view even objectively not correct – a promising restructuring concept.

In most instances a voidance because of a gratuitous transaction (Section 29 para 1 Austrian Insolvency Act) will not be applicable since restructuring trusteeships are entered into predominantly in consideration of granting additional funds or the prolongation of existing lines. A voidance pursuant to Section 30 *et seq* of the Austrian Insolvency Act is only possible if the debtor company was already materially insolvent under Austrian insolvency law at the time of the transaction. For this purpose, it should be considered to obtain a positive going concern prognosis before entering into a restructuring trusteeship, because the execution of the restructuring trusteeship as well as individual measures of the restructuring trustee under the restructuring trusteeship may constitute detrimental transactions pursuant to Section 31 para 1 of the Austrian Insolvency Act, provided, however, that this basis for voidance also requires that the risk of the detriment occurring to the creditors was objectively foreseeable.

Therefore, one of the concepts underlying restructuring trusteeships is that fire sales are avoided and structured sales processes in relation to shares or other assets become possible and should *per se* not be considered detrimental.

Apart from insolvency aspects, one additional crucial aspect for granting and restructuring financing are the effects of the Austrian Equity Replacement Act (*Eigenkapitalersatz-Gesetz* – EKEG). This law concerns equity-replacing shareholder transactions and stipulates that loans that are granted by a "shareholder" to its subsidiary in times of a "crisis" of such subsidiary may be qualified to be equity replacing and are blocked from being repaid until the recovery from such a "crisis". The subsidiary is in a "crisis" if it is unable to pay its debts as they fall due (*zahlungsunfähig*), or is over-indebted (*überschuldet*), or where its equity ratio is less than 8% and the fictitious debt repayment term exceeds 15 years and where these financial parameters are evident from the last prepared financial statements or would have been evident if timely prepared or the shareholders knew or should have known thereof.

In respect to the question whether the lenders in their capacity as trustors as well as the restructuring trustee may be considered a "shareholder" within the meaning of the law, Section 7 of the Austrian Equity Replacement Act provides that if a shareholder holds shares as a trustee for a third party, such a third party shall be considered for purposes of the effects of the Austrian Equity Replacement Act a shareholder, unless the trusteeship was disclosed in the credit agreement.

However, whether restructuring trusteeships are qualified as trusteeships within the meaning of Section 7 of the Equity Replacement Act has not been decided yet. Pursuant to Section 5 para 1 cif 3 of the Equity Replacement Act, lenders, even if they are not direct or indirect shareholders of the debtor company,

might be qualified as "shareholders" within the meaning of the Equity Replacement Act if they have a dominant influence on the management. Such influence might arise from the fact of the financing itself; only lender's typical rights, such as information and book-insight rights, are excepted. Pursuant to Section 8 para 1 cif 1 of the Equity Replacement Act those lenders who have the possibility (even if not exercised) to exercise a controlling interest by having the right to give directives to the restructuring trustee to nominate and replace the majority of the members of the management are also included in the "shareholder" definition of the Equity Replacement Act.

Collateral, which has been provided during the crisis by a "shareholder" in addition has the effect that if such collateral secures existing claims of the debtor company, the lenders cannot claim repayment of such claims but rather must first request from the shareholder the repayment (Section 15 *et seq* of the Equity Replacement Act).

Whether the restructuring privilege (*Sanierungsprivileg*) pursuant to Section 13 of the Equity Replacement Act, which provides that the acquisition of shares against the grant of new credit lines is not considered equity replacing, is applicable to restructuring trusteeships has not been decided yet. Therefore, a diligent drafting of the restructuring trust agreement must seek to avoid application of the Equity Replacement Act and detrimental effects on the lenders, by including *inter alia* the aforementioned waiver of the right to provide instructions to the trustee in relation to the shares and the shareholder rights.

From the lenders' point of view, particular caution is required when structuring double-benefit trusts in view of the potential liability risks associated with them, in particular those arising from the case law on *de facto* management (*faktische Geschäftsführung*) and liability for delay in applying for insolvency proceedings (*Insolvenzverschleppung*).

The *de facto* managing director (*faktischer Geschäftsführer*) is a person managing the company without, however, having been formally appointed to the management body of the company. The interests of parties to a restructuring agreement, in particular the interest of lenders, often includes a limitation of certain rights conferred to the debtor company's management. This may give rise to liability for lenders, if the lenders exercise their rights to issue instructions indirectly via the restructuring trustee or matters within the scope of authority of the management of the company. While outside the crisis of a company, individual directives by lenders generally do not create liabilities, the standards for potential liabilities in a crisis are much stricter.

In a crisis, individual actions, in particular the implementation of restructuring actions by the restructuring trustee upon instructions of the lenders, may give rise to liability. It has to be clarified that even persons who are not shareholders may act as *de facto* managing directors and therefore instructions to the trustee through financing banks may potentially give rise to liability.

In respect to the question if only persons or even corporate bodies can act as *de facto* managing directors, the Federal Court of Justice of Germany stated that this is only possible in respect to natural persons. In Austria, such opinion would probably not be assumed by the Supreme Court, when taking similar decisions by the court into account. For instance, the Supreme Court has established legal precedant that in respect to partnerships, corporate bodies can act as managing directors; a distinction would hardly be understandable for lenders.

Liability for delay in applying for insolvency proceedings arises if the managing director fails to comply with his obligation to apply for insolvency proceedings once the criteria for insolvency are met. The Supreme Court has already decided that a *de facto* managing director has such an obligation in accordance with Austrian corporate law and he has to at least instruct the management to apply for the opening of an insolvency proceeding. In case of a restructuring trusteeship structure, the lenders (assuming that they are *de facto* managing directors) would have to apply for insolvency proceedings themselves or they would have to influence the trustee (as shareholder) and/or the managing directors to do so. The damage, which is to be compensated if the delay in applying for

insolvency proceedings occurs, consists of the operational loss that has arisen due to the absence of or late applying for insolvency proceedings.

Furthermore, the Austrian Criminal Code (*Strafgesetzbuch*) also contains provisions on insolvency proceedings. The most important provisions are (i) grossly negligent interference with creditors' interests; (ii) fraudulent intervention with a creditor's claim; (iii) preferential treatment of creditors; and (iv) withholding of social security payments.

About fwp

Fellner Wratzfeld & Partner Rechtsanwälte GmbH (fwp) is one of Austria's top business law firms, both at a national and international level. fwp employs approximately 70 lawyers and over 120 employees in total. fwp successfully applies a dual consultancy approach, relying on both legal expertise and well-founded business know-how. Our major fields of specialisation include, among others, reorganisation and restructuring, banking & finance, corporate law, M&A, capital market law, real estate and construction law, infrastructure and public procurement law, litigation and arbitration as well as competition and antitrust law. As a member of the international law firm network *TerraLex* and the *Association of European Lawyers*, fwp can rely on an international referral network in more than 110 countries.

The insolvency law & restructuring team led by Markus Fellner and Florian Kranebitter advises clients in all areas of reorganisation and restructuring as well as with respect to national and cross-border insolvency law issues and includes the most prominent cases ever related to the Austrian market, such as the insolvency of the world-wide active ALPINE group or Steinhoff-Group. fwp's work in this area is also boosted by the team members' high degree of economic understanding and therefore also includes numerous successful transactions in relation to distressed assets including their reorganisation and their return to profitability.

Authors:
Dr. Markus Fellner, Partner
Dr. Florian Kranebitter, LL.M., Partner
Fellner Wratzfeld & Partner
Rechtsanwälte GmbH
Schottenring 12
A-1010 Vienna
Austria
Tel: +43 1 537 70 311
Email: markus.fellner@fwp.at
florian.kranebitter@fwp.at
Website: www.fwp.at