

# The Restructuring of a Cross-border Group in German StaRUG Proceedings – Some Takeaways from *Spark Networks SE*

Case note on AG Berlin Charlottenburg, 4.1.2024, NZI 2024, 225

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## I. The financial restructuring of the Spark Networks group

1. The proceedings concerned a plan under the German pre-insolvency restructuring framework StaRUG. The plan aimed at the financial restructuring of a corporate group, whose debt was largely comprised of foreign law-governed debt. More notably, the debtor deliberately selected a StaRUG proceeding although other options were available. The case allowed the court in Berlin to address a few controversial legal questions concerning the new StaRUG legislation. Thus, the decision may be of interest to both local and foreign lawyers.
2. The debtor company, a holding company (Spark Networks SE) with its registered office in Munich and COMI in Berlin, sought to reorganize its capital structure in a public StaRUG process before the Court in Berlin Charlottenburg (restructuring court division). The plan included provisions to restructure

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New York law-governed bonds and intra-group guarantees relating to affiliated companies in the US. The plan also proposed to allow for a fresh equity injection by wiping out old equity. Consequently, the shareholder class rejected the plan while the two creditor classes voted to accept the plan. The Court used cramdown powers under the StaRUG to confirm the restructuring plan.

3. Perhaps the most significant detail of this case is the fact that the parties driving the restructuring process deliberately decided to use the new German restructuring law tools to restructure the financial liabilities of a globally operating corporate group, even though the claims involved were largely governed by foreign law (US law). Furthermore, the shares of the restructuring debtor, an SE in the Munich commercial register and with a Berlin business address, were also listed on the US stock market and the two managing directors of the debtor operated from across the Atlantic. None of these issues prevented the debtor from selecting the “German restructuring route”. More importantly, these significant foreign elements of the case could neither deter the Berlin court<sup>2</sup> nor the US Bankruptcy Court in Delaware<sup>3</sup> from locating the COMI of the debtor in Berlin and thus enabling the application of the StaRUG restructuring instruments.
4. The decision of the Delaware Bankruptcy Court is the first to recognize a “StaRUG proceeding” (without any differentiation between its public or non-public variety) as a foreign insolvency proceeding within the meaning of 11 U.S.C. § 101(23). Since the US court also found that the debtor’s COMI was in Germany, the StaRUG proceedings were recognized as “foreign main proceedings” while recognition as “foreign non-main proceedings” was granted with regards to those US affiliates that were affected by the intra-group debt relief. This precedent must be considered a new cornerstone in US-German restructuring law. The new German pre-insolvency restructuring proceedings enjoy the benefit of a broad concept of “insolvency proceedings” in US Chapter 15 case law. The concept of COMI for main and establishments for non-main proceedings is known to both jurisdictions and thus able to assist in the determination of international jurisdiction for recognition purposes. It should be noted, however, that the Delaware Court only recognised StaRUG proceedings so far. The separate decision regarding the recognition of the StaRUG sanctioned restructuring plan is currently still pending.

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2 AG Berlin Charlottenburg, 4.1.2024 – 36s RES 6525/23, NZI 2024, 197.

3 US Bankruptcy Court Delaware, 14 December 2023 - In re Spark Networks SE, et al.

5. The international aspects of the proceedings were only briefly mentioned in the decision rendered by the Court of Berlin-Charlottenburg since the COMI allocation was already explained earlier in the decision to convene a hearing to vote on the plan that was not published. Hence, the published judgment primarily dealt with the interpretation of StaRUG provisions regarding the conditions for the confirmation of a plan despite its rejection by a shareholder class. The court handled these issues in a convincing way. Five separate matters should be highlighted here.

## II. Restructuring proceedings without prior shareholder resolution

6. From a corporate law perspective, it is noteworthy that the Berlin restructuring court follows its line of case law, according to which restructuring proceedings can also be initiated without a prior resolution by the shareholders. Also a possible breach of information obligations under corporate law is only relevant in the internal affairs between a company's management and shareholders but not a matter of concern for the restructuring court.<sup>4</sup> More importantly, the court does not differentiate between types of companies and simply applies its previous reasoning relating to a GmbH to a SE in the present case. This is relevant because the court seems to deviate from the case law of the Regional Court of Berlin, the competent court of appeal, which, at least for the GmbH, required a shareholder meeting prior to a management's filing for StaRUG proceedings.<sup>5</sup> From an academic perspective, one may disagree with both approaches. It seems preferable to promote an approach that synchronises the management duties in times of distress internally with their competence externally. These duties should be understood in company law with a view to the needs of an efficient restructuring in a potentially escalating crisis. The debate about the justification of such a "shift of duties"<sup>6</sup> has only begun to concern the courts of lower instances in Germany. It might reach the Federal Court (BGH) soon.

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4 See for a previous decision AG Berlin-Charlottenburg, 31.7.2023 – 36 f RES 1604/23, BeckRS 2023, 24968.

5 See LG Berlin, 31.5.2023 – 100 O 18/23, NZI 2023, 928.

6 See, more recently, Herding/Krafczyk ZRI 2023, 750; also Flöther/Wilke ZRI 2023, 1029.

### III. Strategic behaviour in restructuring negotiations

7. The Berlin court further (correctly) stated that the debtor's management is allowed to pursue a strategic approach when addressing a situation of distress. The directors can initially negotiate a refinancing or restructuring solution confidentially with selected creditors only. The omission to inform other creditors or shareholders immediately does not affect any future StaRUG proceedings that may become necessary once these negotiations fail. With regards to the ability of the court to deny the sanctioning of the plan based on bad faith negotiations (§ 63(5) StaRUG), the court correctly held that the law does not penalize confidential restructuring negotiations but merely prohibits any undue influence during the solicitation of votes, in particular in the form of concealed special agreements with key parties. It requires undue influence parties' vote.<sup>7</sup> Although this comprises an element of good faith, it does neither contain a general prohibition on strategic action in negotiating a plan nor a special requirement for transparency or consideration for the debtor's management. The Berlin restructuring court therefore rightly stated that the debtor is permitted to initially negotiate a planned restructuring with only a few of the parties eventually affected by the plan. Only once the finalized plan is formally submitted, relevant information must be disclosed to all parties affected by the plan (§ 17 (2) sentence 2, § 45 (2) StaRUG) who are guaranteed at least 14 days to process this information (§§ 19, 45 (1) sentence 2 StaRUG). Finally, the Berlin restructuring court was also correct in finding that undue influence is not present where the debtor or a creditor merely change the facts in the case by their behaviour, in particular by deferring claims, in order to influence the facts that are relevant for determining (imminent) insolvency. These actions do not relate to the voting process and are therefore not relevant in the context of § 63(5) StaRUG.

### IV. Court language and venue

8. The cross-border nature of the case called for the relevance of many documents originally written in English. The court's handling of these documents is also notable (and pragmatic). It should be remembered that § 184 GVG (Courts Constitution Act) requires the court to communicate in German. The provision is applicable to all restructuring cases under the StaRUG and exceptions

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7 See MüKo-StaRUG/Jungmann, 1<sup>st</sup> ed. 2023, § 63 para. 149.

are limited. For hearings or other oral communications, § 185 (2) GVG allows for the use of an interpreter to be waived if all parties agree to proceed in English. Written pleadings must always be submitted in German. Evidence can be submitted in the original language.<sup>8</sup> All parties involved are well-advised to correspond with the court bilingually in cases such as this. All submissions should be bilingual, including the restructuring plan.

9. If the venue of proceedings is disputed, it should be noted that § 33 (1) No. 2 StaRUG only provides the debtor with the right to file a motion for referral, not an opposing party affected by the plan. Any motion for referral of a creditor or shareholder may only be taken into account as a factual submission and should be considered when the court assesses the issue of venue as defined in § 35 sentence 2 StaRUG (COMI) unless it is time-barred under general rules of civil procedure.
10. If a creditor's new factual submission raises doubts about the debtor's illustration of the actual circumstances, the court may initiate investigations ex officio. The aim of such investigations is to determine the factual situation at the time when the restructuring notification was received. Subsequent factual developments are irrelevant (*perpetuatio fori*, § 61 (3) No. 2 ZPO (Code on Civil Procedure) as applicable according to § 38 StaRUG).<sup>9</sup> The limited relevance of a late factual submission also derives from these principles. Any intentionally delayed factual submission can be disregarded by the court pursuant to § 283 ZPO if this causes a significant delay. Plan opponents are therefore well-advised to submit relevant facts in due time and, when needed, excuse any delay.

## V. Valuation

11. The core of the dispute in this case can be traced back to competing valuations. This applies both to the enterprise value in the plan scenario and to the enterprise values in relevant alternative scenarios without a plan. These difficulties arise from the fact that the business operations of the debtor could have potentially continued in one or more scenarios. Consequently, the plan distributes not merely the burden of the restructuring but the entitlement to future cash flow and profits of the business. This upside is not easily valued due to legal and technical difficulties.

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<sup>8</sup> See MüKoZPO/Pabst, 6<sup>th</sup> ed. 2022, GVG § 184 para. 9.

<sup>9</sup> See BeckOK StaRUG/Kramer § 35 para. 4.

## a) Distributional fairness

12. The legal difficulty already arrives in the form of a doctrinal debate about what a restructuring process actually achieves.
13. One prominent line of thinking argues that every court-based restructuring process (both within insolvency and pre-insolvency) is merely an instrument for the (collective) enforcement of claims and thus a subset of an insolvency proceedings that is subject to the principles of insolvency law.<sup>10</sup> This idea characterizes German legislation in particular.<sup>11</sup> Following this approach, it is the creditors who decide (1) whether the business operation continues by waiving their rights to liquidate the debtor's assets and (2) to decide who will claim the future benefits of such continuation. This absolute power rests normatively on the determination of insolvency, which, on its own, shall provide ownership-like rights to creditors – in insolvency liquidations and restructurings alike. This line of arguments is difficult to maintain where restructuring proceedings are available prior to a state of insolvency. Overall, it is not able to normatively explain the full variety of modern restructuring procedures; a workout-based approach seems preferable.<sup>12</sup>
14. Even more, the narrow normative justification of creditor superiority led into trouble whenever a plan did not only intend to enforce creditor superiority against the shareholders (“cram-down” situations). While cram-down cases were in the focus of the German law reform in 2012 (ESUG reform), absolute priority appeared problematic in cases in which creditor classes, not shareholders opposed the plan (“cram-up”). In cases in which it made good business sense for existing shareholders to participate in the benefits of a restructuring, a strict priority of all creditor classes provides even the most junior creditors with vetoing powers in plan negotiations. Flexibility is key.

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10 See, for instance, Mokal, ‘What is an Insolvency Proceeding? Gategroup Lands in a Gated Community’ (2022) 31(3) *International Insolvency Review* 418, 425-429.

11 See the explanatory text to the StaRUG legislation, BT-Drs. 19/24181, at 85-86, 90.

12 For a detailed analysis see Casey, ‘Chapter 11’s Renegotiation Framework and the Purpose of Corporate Bankruptcy’, 120 *Colum. L. Rev.* 1709 (2020); Madaus, ‘Insolvency law through the lens of a contract theory of restructuring’, in Ghio, Wood, Gant (eds.), *Re-examining Insolvency Law and Theory Perspectives for the 21st Century*, Elgar, 2023, 229, 233-242; Singer, *Vorinsolvenzlicher Restrukturierungsrahmen*, 2022, at 146 ff.

15. In Germany a first step towards a more flexible priority rule was taken in 2021 with the SanInsFoG law reform introducing the StaRUG and more flexible rules to the insolvency plan under the Insolvency Code (InsO). Both plan proceedings since feature a “new value exception” and a limited “sweat equity contribution” in their cramdown tests (§§ 27 (1) no. 2, 28 (2) no. 1 StaRUG; § 245 (2) sentence 1 no. 2 and sentence 2 InsO). This reform was not yet driven by a new doctrinal idea. The German legislator instead insisted on expanding insolvency principles to the StaRUG process. Hence, the normative question remains clearly answered for German lawyers. The (collective body of) creditors are to decide alone if and how to continue the debtor’s business and how to distribute the future cash flow even if the debtor is not even imminently but merely prospectively insolvent (on a two year forecast). In the insolvency plan and StaRUG proceedings alike, this creditor superiority sees shareholder protection reduced to the mere constitutional guarantee of the present value of their shares (Article 14 of the German Constitution).<sup>13</sup> Hence the focus of the discussion must shift to the matter of valuation.

## b) How to value a firm?

16. The German legislator did not specify a valuation method. While a certain value of a right is guaranteed to creditors or shareholders in a number of provisions in the StaRUG, the InsO or other laws (such as §§ 305 and 327a AktG (Public Companies Act) or § 728 (1) BGB (Civil Code)), the technical details of a valuation remain obscure. It is no surprise, therefore, that the practice of business valuations has always been characterized by a variety of competing methods with a variety of soft factors (for example, in relation to the projected future cash flow or the capitalization rate).<sup>14</sup> A clear value of a firm only exists in textbooks (“Assume a company is worth 100”) but not in reality. This commonly acknowledged fact<sup>15</sup> is pinpointed by a phrase attributed to Peter F. Coogan: “A reorganization valuation is a guess compounded by an estimate”.<sup>16</sup> This situation invites all parties, most prominently a plan-proposing debtor, to select the method that is most in line with their interests.

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13 See the explanatory text to the StaRUG legislation, BT-Drs. 19/24181, at 113.

14 See, for instance, Kiem/Caumanns, Kaufpreisregeln beim Unternehmenskauf, 3<sup>rd</sup> ed. 2023, § 1.

15 See even Baird, ‘Priority Matters’, U. Penn. L. Rev. 786, 788 n.6 (2017).

16 See Coogan, ‘Confirmation of a Plan Under the Bankruptcy Code’, 32 Case W. Res. L. Rev. 301, 313 n.62 (1982).

17. Unfortunately, there is no real alternative. A valuation by means of a “real market test” is not able to provide more reliable numbers in a restructuring context because an efficient market hardly ever exists in the real world.<sup>17</sup> Again all that is left is the idea that parties are able to agree on a value during plan negotiations. Valuation reports are indispensable for this exercise. Where, as in this case, some parties refuse to fall in line with the valuation agreed to by the supporters of the plan, they remain entitled to present their valuation to the court. The court must be aware that this dispute is, at its core, not a dispute about mathematical precision but about forecasts.
18. The provisions of the StaRUG address these limitations by focusing on rules on the burden of proof. The primary burden of proof lies with the debtor (see § 6 (1) StaRUG), who must present several valuations in the descriptive part of the plan. The court is allowed to accept these valuations when confirming the plan (§ 63 StaRUG) unless a plan opponent presents separate valuations that would see them worse off than in the scenario without a plan (§ 64 StaRUG). Faced with competing valuations, it is for the restructuring court to decide which valuation should be adopted. In this case, the Berlin court followed the valuation of the debtor.
19. To complicate matters even more, it should be remembered that the valuation report must cover a variety of scenarios individually. When considering whether a plan opponent is worse-off under the plan, the valuation must compare (i) the value allocated in the plan at the moment it becomes effective (ii) with the hypothetical value that the plan opponent would accrue in the most likely scenario without the plan (and thus without the contributions by other stakeholders provided for in the plan). The (rebuttable) statutory presumption of § 6 (2) sentence 2 StaRUG only applies to the latter. Further, as the Berlin-Charlottenburg district court correctly points out, the question of whether other parties affected by the plan receive value under the plan to an extent that exceeds the full amount of their claims (§ 27 (1) no. 1 and (2) no. 1 StaRUG) is a separate issue that requires a separate analysis. Here, only the value allocated by the plan to other creditors affected by the plan may be assessed. As the restructuring scenario is relevant, all contributions under the plan must be considered.

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17 See MüKo-StaRUG/Herweg § 27 para. 45.



### c) **Distributional fairness revisited?**

20. If value is allocated by the plan in the form of shares in the restructured company, the valuation needs to assess the restructured firm. The fact that a plan creditor who receives shares might potentially benefit from the future share price and dividends – or the company’s future cash flow – for an unlimited period of time may not lead to the conclusion that creditors receive excessive or even infinite value in the firm. The Berlin restructuring court rightly argues that the aforementioned normative understanding that any restructuring process is an insolvency process, which certainly guided the German legislator, justifies the allocation of all decision powers to the creditors. They might well liquidate the company. Restructuring proceedings would therefore include a day of reckoning for both creditors and other stakeholders in the company that would fix the value of their entitlements. Such an approach may be seen as unfair in normative terms or as part of a policy debate. Other solutions are conceivable.<sup>18</sup> However, these considerations are not yet part of the German law as enacted today.

## **IV. Conclusion**

21. StaRUG proceedings have become efficient means of financial restructurings. The emerging case law in Germany as well as recognition in foreign jurisdictions like the United States further support the predictable use of StaRUG restructuring plans in the international restructuring market. Progress is being made by the day.

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<sup>18</sup> See the Final Report of the ABI Commission, 2014, 208 ff., 218 ff. Also see again Baird, ‘Priority Matters’, U. Penn. L. Rev. 786, 806 (2017).