
COVID-19 PANDEMIC – TEMPORARY SUSPENSION OF OBLIGATION TO FILE FOR INSOLVENCY IN GERMANY

COVID-19 and its impact

The **Covid-19 pandemic** ("Coronavirus") currently spreading in Germany has a massive financial impact in particular in the industrial and service sectors. Small-, mid- and even large-cap companies increasingly come under financial pressure due to the lasting crisis. The **gastronomy sector**, the **travel industry** as well as **retail trade**, but also the manufacturing sector (**plant construction** and **automotive**) are in particular affected. In addition to providing the multi-billion rescue package for Germany, the German Federal Government proposed on 16 March 2020 to **suspend the obligations to file for insolvency** for companies affected by Covid-19 until 30 September 2020. This snapshot is to provide initial guidance on the measures intended by the German Federal Ministry of Justice (*Bundesjustizministerium*; **BMJV**).

Press release by the BMJV

The BMJV announced in a **press release dated 16 March 2020** to suspend the obligations to file for insolvency for affected companies, subject to certain requirements being met, initially until the end of **30 September 2020**. The relevant Act which is currently being drafted is in particular intended to prevent businesses from having to file for insolvency for the reason alone that the processing of applications for public aid and/or financing and restructuring negotiations cannot be completed during the three-week period during which an insolvency filing must be made. According to information provided by the BMJV, the suspension of the obligation to file for insolvency (section 15a of the German Insolvency Code (*Insolvenzordnung*; **InsO**) is subject to the following **requirements**:

- The grounds for the insolvency were **triggered by the effects of the Corona epidemic**.
- The affected business has applied for **public aid** and/or is in **serious financing and restructuring negotiations**.
- There are **well founded prospects of a successful restructuring**.

The BMJV does not distinguish between the mandatory insolvency grounds "illiquidity" (*Zahlungsunfähigkeit*) and "overindebtedness" (*Überschuldung*), so that currently it may be assumed that both insolvency grounds will be covered. In addition, it is not currently apparent that the suspension will be limited to certain economic sectors. Moreover, an **extension of the suspension until 31 March 2021** is intended to be made possible based on an authorisation granted to the BMJV to issue a legal ordinance.

Requirements and initial guidance

The grounds for the insolvency **must have been triggered by the effects of the COVID-19 pandemic**. This obviously includes interruptions of business operations under the recently adopted officially ordered shop closures. This also includes indirect effects such as cancellations of hotel reservations or the interruption of supply chains and even "voluntary" cancellations or restrictions of business operations by affected companies that are, however, reasonable in the light of the pandemic. By contrast, grounds for insolvency which are likely to also have occurred without the COVID-19 pandemic or which already occurred, such as, in particular, business models which have become obsolete as a result of changed market conditions due to digitalisation and technology transfer, do fall not under the scope of application. In many cases, a comparison with the initial financial planning should provide a sufficient initial indication. The

occurrence of the symptoms of the crisis only after the intensification of the pandemic from, e.g., early March, should also be a reason for a presumption to that effect.

In addition, there must be **well founded prospects of a successful restructuring**, because **public aid has been applied for and/or serious financing and restructuring negotiations are being conducted**. Thus, the question arises how the requirements for an entitlement must be evidenced in order to prevent abuse. The following paragraphs are intended to provide some guidance:

As regards the procedural and factual questions, the experience made in connection with the German Reconstruction Aid Act (*Aufbauhilfegesetz*) in the course of the **flood disasters** that occurred in certain areas of Germany in the years 2002, 2013 and 2016 could be used as a basis (InsoAntrG 2016). It must be assumed that the law intended to be proposed by the BMJV will be modelled on the rules developed then, as legislature at that time already saw the need to temporarily suspend the obligations to file for insolvency for companies that had provably been affected by the floods. Serious financing and restructuring negotiations with well founded prospects of a successful restructuring then also had to be conducted as a requirement for suspension.

The banks should be enabled, without incurring additional risks, to provide bridge loans as interim financing for the period from the date of filing the application until liquidity assistance is granted by the government. The submission of a meaningful and documented **liquidity planning**, both before and after liquidity assistance is granted by the government, seems to be necessary in any case; still, the requirements should remain practicable. The requirement of a restructuring opinion in line with the general S6 standard, however, should not be stipulated for either means of liquidity, due to time constraints alone.

In addition to the liquidity plans to be submitted, the applicant should prove, or provide evidence with the due care of a prudent businessperson in accordance with the *business judgement rule*, that public aid is applied for or negotiations are being conducted whose prospects of success seem to be promising from an unbiased point of view. Another possibility that could be thought of is for the applicant to submit a third-party confirmation similar to protective shield proceedings (*Schutzschirmverfahren*), confirming that the proposed restructuring has well founded prospects of success or at least is not obviously without any prospects of success at all. If the restructuring efforts are discontinued and no application for aid is filed, no reliance may be placed on suspension (any longer).

If, as was the case in the Reconstruction Aid Act, **the rights of creditors to file an application** are not suspended accordingly, companies may have to face awkward situations of pressure and should therefore continue to actively involve the different stakeholders (banks, suppliers, lessors, etc.), for example by way of letters of intent, standstill agreements or by agreeing terms of payment and delivery.

If suspension of the obligation to file for insolvency is intended to be claimed, it is recommendable for the management to prepare a complete documentation of the requirements for such suspension. This particularly concerns proof of **double causality** (i) of the fact that the filing obligation is *based* on the Covid-19 pandemic and (ii) of the fact that well founded prospects of a successful restructuring exist *due to* financial aid applied for and/or serious financing and restructuring negotiations conducted. If the grounds for insolvency have been provably triggered by developments from 1 March 2020, the privilege should also apply retroactively.

Legal consequences

The **obligation to file for insolvency due to illiquidity or overindebtedness is proposed to be suspended** initially until 30 September 2020 if the requirements for suspension are provably fulfilled. The burden of proof rests with the persons required to file the application, i.e. specifically the managing directors or management board members. Unlike in the case of the German Reconstruction Aid Act at that time, it should be made clear that upon suspension of the obligation to file for insolvency, the **liability risks of managing directors and management board members for payments following (deemed) insolvency of the company** (section 64 of the German Limited Liability Companies Act (*GmbH-Gesetz*; **GmbHG**), sections 92, 93 of the German Stock Corporation Act (*Aktiengesetz*; **AktG**) will also cease to apply an honest manager; this would be consistent and important in practice.

Outlook

The measures announced by the BMJV are an important step towards stabilising the economy. When implementing these measures, it should be ensured, however, in particular in contrast to the German Reconstruction Aid Act, that in addition to the temporary suspension of the obligation to file for insolvency, the liability risks of managing directors and management board members for payments following (deemed) insolvency of the company will also cease to apply (section 64 GmbHG, sections 92, 93 AktG).

On this basis, it would be desirable to (temporarily) suspend the criterion triggering **overindebtedness** pursuant to section 19 of the German Insolvency Code (*Insolvenzordnung*) in its entirety, in order to avoid the liquidity forecast closely associated with the definition of overindebtedness relevant to liability for up to two years (positive going-concern prognosis (*positive Fortführungsprognose*)).

Moreover, in light of the requirements for auditors to issue a **going-concern prognosis** under commercial law (section 252 of the German Commercial Code (*Handelsgesetzbuch*)), it would be desirable to extend suspension until 31 December 2020.

In connection with this very welcome initiative, the legislator should also consider how to deal with the handling of the **tax exemption in relation to restructuring gains** (which may result from such restructuring measures) in the crisis and, if necessary, adopt the practical handling of the availability and granting of such tax exemption accordingly.

In addition to the above provisions and proposals, Directive (EU) 2019/1023 ("**Restructuring Directive**") currently to be implemented by national legislature will reasonably supplement and expand the tools used for reorganising companies outside of insolvencies. An effective and short-term implementation of this directive could make a positive contribution towards stabilising the economy.

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