German lawmakers suspend obligation to file for insolvency

HOW HELPFUL IS THE ASSISTANCE IN CASE OF TIGHT LIQUIDITY DUE TO THE CORONA CRISIS?

Executive Summary

- The Bundestag today passed a law temporarily suspending the obligation to file for insolvency for generally healthy companies facing liquidity difficulties due to the corona crisis.
- Creditor petitions are to be suspended for three months.
- At the same time, the law offers incentives to provide companies with new liquidity and to maintain the business relationship.

Comprehensive aid package for distressed businesses

The coronavirus epidemic has disrupted public life but also economies more seriously than we have experienced in decades. In addition to overcoming this acute crisis, however, it will be crucial for the economy to quickly recover once it passes.

Politicians are thus working hard to create measures providing liquidity to companies in order to ensure their operational survival. Over the past few days, the Federal Ministry of Justice has been hectically revising a draft bill suspending the obligation to file for insolvency. The legislative package adopted today offers additional room for manoeuvre during financial restructuring measures, for example by guaranteeing investors that payments will not be contested.
The suspension of the obligation to file for insolvency and management liability exemptions provide legal certainty preventing management bodies from having to file for (precautionary) insolvency to protect themselves. We provided a first overview of the initially even more cautious legislation in our GSK Update of 17 March 2020 This new Update now sheds light on the new rules actually passed by the Bundestag today.

Suspension of the obligation to file for insolvency

The obligation to file for insolvency (Sec. 15a InsO, German Insolvency Code) in the event of illiquidity or over-indebtedness has been suspended until 30 September 2020. The same applies to the corresponding obligation of an association's executive board according to Sec. 42(2) BGB. However, this suspension is subject to two conditions:

- The insolvency must be due to the consequences of the spread of the SARS-CoV-2 virus, and
- There must be prospects of overcoming the present insolvency.

Both conditions can be difficult to prove in individual cases. Therefore, unlike the first draft, the new Act now

contains a **presumption rule to the detriment of the party invoking the obligation to file for insolvency:** If the company was not insolvent on 31 December 2019, it is assumed that both (!) conditions are fulfilled. The legislator emphasizes that the purpose of this rule is to effectively relieve those normally required to file for insolvency of the difficult task of providing proof and prognoses. As the law stipulates the "highest standards" for refuting this presumption, it can really only be refuted in cases where there is absolutely no doubt that the corona pandemic was not the cause of the insolvency.

Suspension of creditor petitions pursuant to Sec. 14 InsO

In principle, creditors, too, can file for insolvency. This right, however, has now been limited for a period of three months to cases where factual insolvency occurred on or before 1 March 2020.

No management liability for payments

The fact that the suspension would have been a blunt instrument unless supplemented with provisions on punishability and liability had been the subject of discussions in the run-up to passing the law. As these liability offense can also become relevant a situation of imminent insolvency, they would still have applied despite the suspension of the obligation to file for insolvency. The legislator therefore did a good deed in solving this problem.

The new law excludes a management team's liability for payments made during a situation of imminent insolvency from constituting an offense. As far as the suspension applies, such payments are deemed to have been made "with the diligence of a prudent and conscientious manager". In such a case, the corresponding facts (Sec. 64(2) GmbHG, Sec. 92(2)(2) AktG, Sec. 130a(2)(2) HGB (in conjunction with Sec. 177a(1) HGB) and Sec. 99(2) GenG) will not be deemed offenses.

Liquidity assistance

A whole set of stipulations within the new law seek to facilitate the supply of liquidity and the continuation of the business relationship through exemptions from the usually present rescission (contesting) and liability risks for the duration of the crisis. The same conditions apply here as for the exemption from the obligation to file for insolvency as well as the comprehensive presumption rule:

Restructuring loans won't be contested

Anyone who grants a loan to an insolvent company must expect that repayments on the loan will later be contested. However, if a new loan was granted during the period of suspension, lenders enjoy liability relief: Repayments up to 30 September 2023, i.e. in the three years following the end of the period of suspension, will not be considered to be disadvantaging the creditors. This eliminates any legal basis for contesting such payments. However, prolongations or a "back and forth" payments are not privileged. The payments must provide additional liquidity.

Securities won't be contested

Securities provided to safeguard a loan granted during the period of suspension, also won't be considered to be disadvantaging the creditors, thus also excluding contesting at a later point.

Shareholder loans ranked higher

Shareholder loans and claims "deriving from legal transactions corresponding in economic terms to such a loan" also enjoy this privilege. However, the collateralisation of shareholder loans is not protected. In addition, such shareholder loans are moved up in rank compared to other creditor loans (Sections 39 (1)(5), 44a InsO). However, if a lower rank has been agreed upon by contract, this preserves the lower rank in insolvency proceedings.

Restructuring loans are not contrary to public policy

In restructuring situations, there is always great uncertainty as to whether granting a loan can be regarded as a contribution to delaying insolvency proceedings that is "contrary to public policy" (*sittenwidrig,* Sections 138,

826 BGB). For the lender the categorisation of a loan has fatal consequences. However, the new law privileges new loans during the suspension period as "not contrary to public policy". This also applies to novations and prolongations.

Other restructuring measures that won't be contested

Contracts that are executed in a manner other than initially agreed upon (so-called "incongruent coverage") are subject to particular risks of being contested. In particular, an incongruent performance leads to the loss of the cash transaction privilege (Sec. 142 InsO). The new law now declares such acts to be non-contestable with one restriction: The creditor must not have known that the debtor's restructuring and financing efforts were not suitable to remedy the insolvency.
The following are explicitly excluded from being subsequently contested:

- Services in lieu of or on account of performance,
- Payments by a third party as instructed by the debtor,
- Providing a security other than originally agreed, unless it is more valuable,
- Shortening of terms of payment and
- Granting easier means of payment.

Other companies not filing for insolvency

Additionally, the legislator now also extends the above financing relief to companies that are not currently in a financial crisis. It is not necessary for a company to be insolvent today in order to fall within the scope of the law. In this way, the law creates legal certainty by ruling out later delimitation issues today.

Entry into force and possibility of extension

The insolvency-related part of the legislative package will enter into force retroactively from 1 March 2020. The legislator grants the Ministry of Justice the right to extend the suspension of the obligation to file for insolvency and the suspension of creditor petitions by means of statutory order until 31 March 2021 at the latest, if this appears necessary. The legislator does not strictly link this extension to the duration of the medical crisis, but rather to a "continued demand for available public aid, persistent financing difficulties or other circumstances".

Our assessment

The legislator has responded to the crisis with a comprehensive package of measures. Relieving managers of liability and punishability risks is a decisive element in this process. Otherwise, in view of the current uncertainties, managers would have had to choose the "safeer" way of filing for insolvency in order to avoid liability problems.

In addition, the law offers financing and business partners a comprehensive shield against potential risks. The legislators clearly demonstrate their intention: ensuring the survival of affected companies. Anyone providing liquidity support for this purpose should not suffer any disadvantage as a result later on.

You are welcome to contact us to find out which (preventive) options you could take. But most of all: Stay healthy!

Your GSK Restructuring team

Raoul Kreide
Lawyer, business economist (BA), mediator
raoul.kreide@gsk.de

Andreas Dimmling
Lawyer, business lawyer (University of Bayreuth)
andreas.dimmling@gsk.de

Jana Wollenzin
Lawyer
jana.wollenzin@gsk.de

Sandra Krepler, LL.M. (Trinity College Dublin)
Lawyer
sandra.krepler@gsk.de

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www.gsk.de

GSK Stockmann

BERLIN
Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

HEIDELBERG
Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

FRANKFURT / M.
Taunusanlage 21
60325 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

MUNICH
Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

HAMBURG
Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG
GSK Stockmann SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 271802-00
F +352 271802-11
luxembourg@gsk-lux.com