

COVID-19: CHANGES TO INSOLVENCY AND RESTRUCTURING RELATED REGULATIONS IN GERMANY

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German Finance Alert

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The German federal government is currently preparing new legislation to reduce the economic fallout from the COVID-19 pandemic. This news alert deals with the proposed changes to the insolvency and restructuring related German regulations.

The managers of German corporations are under an obligation to promptly file a petition for the opening of insolvency proceedings if the corporation is illiquid or over-indebted. Compliance with such obligation is enforced by strict civil and criminal law penalties. Also, managers of a German corporation are personally liable for any payments or other assets transfers which have been made after the corporation has become illiquid or over-indebted. As a consequence, there is a concern that the economic consequences of the spread of the SARS CoV-2 virus (COVID-19) will lead to a tsunami of insolvency filings of German corporations. In addition to that, there are currently numerous legal restrictions and obligations for the provision of fresh money to distressed German companies. Some of these restrictions or obligations are enforced by a lender liability towards other creditors.

In response to COVID-19, the German government has now proposed new regulations to prevent the opening of insolvency proceedings over German companies and to facilitate the provision of fresh money and other new financings for German companies. The new regulations will, if implemented, remove virtually all known civil law risks for a restructuring of German companies in an unprecedented "whatever it takes ..." approach.

PREVENTION OF INSOLVENCY PROCEEDINGS

Under the proposed regulation the managers' obligation to file an insolvency petition shall be suspended until 30 September 2020 provided (i) the illiquidity or over-indebtedness (Insolvency) has been caused by COVID-19 and (ii) there are prospects to eliminate its illiquidity in the event of any already existing illiquidity. Because it is always difficult to determine whether the Insolvency of a corporation has been caused by COVID-19 or whether there are prospects of eliminating any existing illiquidity the new regulations provide that (i) the Insolvency of any corporation which was not illiquid on 31 December 2019 is presumed to have been caused by the effects of COVID-19 and (ii) that there are prospects for such corporation to be able to eliminate its existing illiquidity. Thus, the burden of proof is on those who claim that the Insolvency was caused by reasons other than COVID-19,

which is a fairly high hurdle. In addition to the suspension of the Insolvency filing obligation, the managers of a German corporation shall no longer be liable for any payments or other asset transfers, which are made during the suspension period in the ordinary course of business, in particular for payments to maintain or resume the business operations or to implement a restructuring plan.

In the event of a creditor filing for the opening of Insolvency proceedings over a German company, such filing shall only be permissible if the company was already insolvent on 1 March 2020. This restriction shall apply for a period of three months after the new law takes effect (typically the day after its public announcement). As a consequence, during such three months' time period creditors will not be able to enforce their rights by means of an insolvency proceeding.

Under the new legislation, the German government will be authorized to extend each of the above described suspension periods until 31 March 2021.

FACILITATION OF FRESH MONEY AND OTHER NEW FINANCINGS

As a second measure, the proposed legislation provides for the facilitation of fresh money loans for German companies irrespective of whether they are illiquid or otherwise insolvent. In detail:

- Lenders will no longer be exposed to the risk of a lender liability based on delaying the Insolvency filing of the borrower if they grant loans or receive collateral during the suspension period of a German company;
- The repayment on or before 30 September 2023 of a new loan granted during the suspension period and any collateral to secure such loans granted during the suspension period shall no longer be subject to any avoidance or preference claims;
- Shareholder loans shall not be equitably subordinated in the event Insolvency proceedings have been filed on or before 30 September 2023; likewise, the repayment on or before 30 September 2023 of any shareholder loans granted during the suspension period shall no longer be subject to avoidance or preference claims; and
- Avoidance or preference claims shall be excluded for:
 - Any legal acts enabling a counterparty of the German company to secure or satisfy its claims in the manner and at a time to which such counterparty was entitled to;
 - The rendering of any performance in lieu of or on account of the originally owed performance;
 - Payments by a third party upon instructions of the German company;
 - The provision of security other than the originally agreed security, unless such security is more valuable;
 - The reduction of payment terms; or
 - The granting of deferred payment terms,

in each case provided the counterparty was not aware that the German company's restructuring and financing efforts were not suitable to remedy its Insolvency.

Further to the above, there will be even more facilitations for loans granted by the German state-owned Kreditanstalt für Wiederaufbau or its financing partners and for loans granted by other credit institutions in connection with government aid programmes to fight the economic consequences of COVID-19. Such loans and their security shall be exempted from avoidance or preference claims even if they have been granted after the end of the suspension period and irrespective of when the repayment occurs.

The proposed legislation would allow the provision of fresh money to German companies on a fast track basis. Unlike before, it would no longer be necessary to obtain costly and time consuming third-party opinions (e.g. from an accounting firm under the IdW S6 standard of the German organization for certified public accounts) which certify that the borrower is suitable to be restructured and that the contemplated restructuring has a reasonable prospect of being successful if implemented.

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