LEGAL UPDATE
Restructuring/Insolvency Administration
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GÖRG
YOUR BUSINESS LAWYERS

COVInsAG – Act to Mitigate the Consequences of the COVID-19 Pandemic

Insolvency and Restructuring department

It is already foreseeable that the economic consequences of the corona pandemic will reach unprecedented proportions. The economic impact will clearly overshadow the consequences of the financial crisis in 2008/09. The unavoidable consequence would be that the economic impact of the pandemic would expose – essentially healthy – businesses to the duty to file insolvency applications, although legislators want to put into place state aid measures to overcome the pandemic, such as facilitating access to development loans and bank guarantees. In order to ensure that these measures do not come into place too late having regard to the three-week period for filing for insolvency (see § 15a of the German Insolvency Act - InsO), and to prevent a large number of financially stable businesses from being forced into insolvency, the legislator has responded with emergency legislation. On 27 March 2020, the "Act on the Temporary Suspension of the Duty to Apply for Insolvency and to Limit the Liability of Corporate Bodies in the Event of Insolvencies Caused by the COVID-19 Pandemic (COVID-19 Insolvency Suspension Act - "COVInsAG") was passed. The COVInsAG entered into force with retroactive effect as of 1 March 2020.

A. COVInsAG overview

The core of the COVInsAG is the suspension of the duty to file for insolvency provided for in § 1 and (initially) valid until 30 September 2020. The suspension in § 2 is accompanied by regulations on the restriction of payment prohibitions as well as the possibility of an easier supply of liquidity for businesses. The COVInsAG, which only comprises four paragraphs, is supplemented by a regulation to restrict the filing for insolvency by creditors and an authorisation of the German Federal Ministry of Justice to extend the suspension of the obligation to apply for insolvency until 31 March 2021.

B. Suspension of the duty to apply for insolvency (§ 1 COVInsAG)

Under § 1 sentence 1, the duty to apply for insolvency is generally suspended until 30 September 2020. However, this general rule does not apply without limitations: Where grounds for insolvency are not based on the effects of the spread of the pandemic (alternative 1) or where there is no prospect that existing illiquidity can be remedied (alternative 2), the suspension will not apply (§ 1 sentence 2). In addition, where the business was not illiquid on 31 December 2019, a rebuttable presumption is raised under § 1 sentence 3 that neither of these two alternatives applies and that the duty to apply for insolvency is accordingly suspended.

The wording of the provision amounts to a reversal of the burdens of substantiation and proof to the benefit of corporate bodies; the legislator intends this to serve as relief for businesses that are required to apply for insolvency. Those businesses no longer need to prove that the exception applies to them. Instead, other parties seeking to rely on this (typically a later insolvency administrator) must prove that the suspension did not apply to the business on exceptional grounds (i.e. that the pandemic was not the cause or that there was no prospect that illiquidity could be remedied). The “highest standards” will be required here.

Practice note 1
Corporate bodies should continue to review on an ongoing basis whether grounds to apply for insolvency exist and should document that review. Only the duty to file for insolvency has been suspended – the grounds for applying for insolvency have not been stayed. Accordingly, where grounds to file an application are posed, the (reverse) exceptions under sentences 2 and 3 are connected to this on the one hand, as well as other liability risks on the other hand. This applies in particular with respect to the foregoing alternative 2 (no prospect of remedying illiquidity) – where that is found, the duty to apply for insolvency will be re-imposed again. To this extent, a (modified)

continuation forecast having regard to liabilities that will foreseeably become due and payable should potentially be prepared.

Practice note 2
Corporate bodies should take special care to document the liquidity of the business on 31 December 2019, ideally relying here on expert advice. Where no illiquidity existed on 31 December 2019, it is presumed under sentence 3 that the grounds for the insolvency are based on the spread of the pandemic and that there is a prospect of remedying any existing illiquidity.

Practice note 3
Where doubts exist as to whether illiquidity can be remedied, the issue of the standard of review is raised. Planning / forecasting for the determination of the restoration of sustainable liquidity is already positive where there is a "prospect" of restoring liquidity. In our view, this test is lower than the predominant probability required for a continuation forecast. In the forecast, announced and approved "financial assistance" can be taken into account provided that the granting of this is likely. This presumption, however, applies only for businesses that were not illiquid on 31 December 2019 and which have filed (or are filing) corresponding applications for financial assistance. The forecast period should extend at least to 30 September 2020, since a sustainable remedy is needed for any illiquidity that has arisen.

C. Consequences of the suspension (§ 2 para. 1 nos. 1 to 4 COVInsAG)

It should still remain possible for a business to maintain (and not endanger) its business relationships with contractual partners even where the duty to apply for insolvency is suspended. Please note that the following exceptions apply only where the duty to apply for insolvency is suspended – subject to the exception in para. 2 – and where no reverse exception applies:

Having regard to this (pursuant to para. 1), payments that are made in the ordinary course of business, and in particular those payments that serve the continuation or recommencement of the business or the implementation of a restructuring plan, are deemed to have been made with the due care of a prudent and conscientious manager. Provided that the limits of this are complied with, this irrefutable presumption means that personal liability is excluded for such payments under corporate law payment prohibitions, which continue to apply (§ 64 of the German Limited Liability Companies Act - GmbHG, § 92 of the German Stock Corporation Act - AktG). However, this presumption does not apply as a general rule – it applies only with respect to payments made in the ordinary course of business.

Practice note 4
A manager should be able to prove that a payment was made in the ordinary course of business. As of the date on which material grounds for insolvency are posed, managers and advisors need to document this – policies for categories of payments may help here.

Practice note 5
The COVInsAG does not address any exclusion of credit and inducement fraud, nor does it govern intentional prejudice to creditors (contrary to public policy). In order to avoid own liability risks and criminal offence triggers, just like to date, managers should inform lenders and suppliers of the business' current situation and perspectives. The degree of information that must be provided here needs to be assessed more closely based on individual case circumstances.

In order to encourage shareholders and third parties to provide businesses with additional liquidity during the suspension period (until 30 September 2020), the repayment of loans (including shareholder loans) is exempted from insolvency law claw-back until 30 September 2023. This also applies to collateral provided to secure loans granted by third parties (but not by shareholders) during the suspension period. Lenders should be able to rely on keeping funds that are repaid in the context of overcoming the crisis, and should not be exposed to the risk of claw-back of repayments.

Practice note 6
Loans are protected only where the duty to apply for insolvency is objectively suspended. This means that banks will likely insist on expert opinions on whether the conditions set out in § 1 COVInsAG are met. Tak-

ing account of the planning assumptions set out above, businesses and experts will usually only be able to substantiate that it cannot be determined that there is no likelihood that the support/loans applied will resolve illiquidity.

In pursuit of the aim of making the granting of loans easier, loans and the grant of collateral (pursuant to no. 3) that are made during the suspension period will also not amount to contributions to trading while insolvent (that are contrary to public policy). Once grounds for insolvency have arisen and where there is an unclear forecast situation, the grant of a loan will generally not be regarded as a prohibited bridging or restructuring loan (although limits to this will certainly apply in practice).

In addition, pursuant to no. 4, congruent coverage transactions (i.e. collateral provision / payments that are owed as a contractual obligation) that are undertaken during the suspension period are no longer subject to claw-back under § 130 InsO in a later insolvency proceeding. The legislator has expanded this claw-back protection to cover incongruent coverage transactions under § 131 InsO for these legal transactions that are (exhaustively) set out in § 2 para. 1 no 4. (a) to (e) COVInsAG; these transactions have a financing nature (e.g. the grant of payment relief, payments made to third parties at the instruction of the debtor). That protection, however, will not apply where the contracting party was aware that the debtor's restructuring and financing efforts were not suitable to remedy illiquidity. The purpose of this protection from claw-back is to support the debtor's ability to obtain goods and services from its contractual partners in the best possible manner, and to protect these contractual partners from claw-back risks where these assist with the continuation of the debtor's business. Otherwise, it would be expected that these contractual partners would insist on payment in advance, which would further burden the liquidity of the affected business.

Practice note 7
The exclusion of claw-back and the exclusion of contributing to trading while insolvent (contrary to public policy) also applies to all businesses that are not covered by § 1 COVInsAG, i.e. which are not required to apply for insolvency or where no grounds for insolvency have (yet) occurred with respect to their assets.

D. Creditor applications (§ 3 COVInsAG)

In addition, creditor applications for insolvency are not permitted for three months (until 28 June 2020) provided that grounds for opening insolvency proceedings arose as of 1 March 2020. This is intended to prevent the initiation of insolvency proceedings before state measures can be granted that are suitable to resolve relevant grounds for insolvency.

E. Summary

The legislator has taken courageous steps in passing the COVInsAG and in particular suspending the duty to apply for insolvency. It remains to be seen whether insolvencies on a large scale can be avoided as a result. For businesses that are required to apply for insolvency, it must be comprehensively reviewed on an individual case basis whether the suspension can be (sensibly) used or whether an insolvency application should be selected.

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