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Amendment to COVInsAG

Suspension of obligation to file for insolvency on the grounds of over-indebtedness until 31 December 2020 and consequences of suspension

The Federal Government has now submitted its proposed amendments to the Covid-19 Insolvency Suspension Act (*Covid-19-Insolvenzaussetzungsgesetz*; **COVInsAG**) passed in March 2020. While the obligation to file for insolvency in the case of illiquidity will be reinstated with effect as of 1 October 2020, only the obligation to file for insolvency in the case of overindebtedness will remain suspended under the COVInsAG from 1 October 2020 until 31 December 2020.

Should the change of law be adopted in the proposed form, the following will apply:

From 1 October 2020 a board member or managing director of an illiquid company must file for insolvency without undue delay, and in any event no later than three weeks after **illiquidity** occurs, in order to avoid personal or criminal liability. This may mean that action needs to be taken today. On the one hand, the **insolvency application** should be prepared and, if necessary, filed where illiquidity exists – as applicable, by 1 October 2020 at the latest. On the other hand, where no illiquidity exists but indications of illiquidity within the meaning of section 17 of the German Insolvency Code (*Insolvenzordnung*; **InsO**) can be identified – for example, because there are or have already been delays in the payment of amounts due – it might be advisable to prepare **a liquidity status** report at this stage, together with a rolling 13-week **liquidity forecast**, in order to be able to **prove the non-existence of illiquidity** and to create legal certainty for the management and other stakeholders.

The suspension of the obligation to file for insolvency on the grounds of over-indebtedness within the meaning of section 19 InsO until 31 December 2020 continues to be subject to the condition that the **over-indebtedness has been caused by the Covid-19 pandemic**. As before, this will be **assumed (which assumption may be rebutted)** if the company was **solvent as of 31 December 2019**. If the company's management can prove that this was the case, it will be able to invoke the suspension of the obligation to file for insolvency. In order to protect the directors, any rebuttal of this legal assumption must be subject to the "highest standards".

As a result of the temporary suspension of over-indebtedness there is **no** need to exclude the reason for filing for insolvency by establishing a **positive going-concern prognosis for a short period**, i.e. the requirement to submit medium-term financial and liquidity planning which shows that it is more likely than not that the company will be able to pay its liabilities due in the current and the next year. Since the coronavirus crisis continues to entail considerable planning uncertainties, reinstating the requirement of a positive going-concern prognosis as of 1 October

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2020 would have forced companies to gaze into a crystal ball, and could have caused them to file for insolvency prematurely in order to avoid liability risks. (Over-indebted) companies going through a crisis should, however, **use the time until the end of the year** to "take restructuring and refinancing measures, making use of state aid offers and out-of-court negotiations" (see preamble of the draft law).

Important to note, finally, that – as a consequence of over-indebtedness being suspended, if applicable, and the company not being illiquid – the **"new" COVInsAG continues to privilege certain measures** stabilising the company. These consequences are to continue to apply even where companies are not obliged to file for insolvency, and are neither illiquid nor over-indebted (cf. section 2 (4) in conjunction with section 2 (2) COVInsAG, new version). The special rules for loans granted by the KfW and its financing partners or other institutions in the context of state aid programmes also remain in effect, as does the exemption of new loans from liability and avoidance rules even after the suspension period has ended (cf. section 2 (4) in conjunction with section 2 (3) COVInsAG, new version).

The **interplay** between **court practice concerning restructuring loans** on the one hand, which requires a conclusive restructuring concept in order for a financing not to be regarded as *contra bonos mores*, and the **liability and avoidance privilege** on the other hand, which will not apply to illiquid companies from 01 October 2020, raises certain questions. It would therefore seem advisable to not only prepare a liquidity status report in future but, where possible, also a **restructuring concept serving at least as a "roadmap" for overcoming the crisis**.

Consequences of suspension **for non-illiquid companies** until 31 December 2020 (section 2 (4) COVInsAG, new version):

Liability exemption for directors

Insofar as over-indebtedness is suspended as a reason triggering an obligation to file for insolvency and a company is not illiquid, the payment prohibitions under insolvency law will not apply, pursuant to section 2 (2) no. 1 COVInsAG, since **payments made in the ordinary course of business** are deemed to be consistent with the due care of a prudent director. Moreover, tortious liability (section 823 (2) of the German Civil Code (*Bürgerliches Gesetzbuch*) in conjunction with section 15a InsO) for delaying insolvency proceedings or criminal prosecution pursuant to section 15a (4) or (5) of the German Criminal Code (*Strafgesetzbuch*) is also ruled out. We nevertheless recommend preparing a **rolling liquidity forecast**.

Exemption of new loans from avoidance and liability rules

Where a new loan is granted (whether as cash or trade credit) and collateral provided during the suspension period, section 2 (1) no. 3 COVInsAG qualifies this **granting of credit,** and **corresponding collateral are not *contra bonos mores***, which means that in such cases lenders will enjoy an exemption from the usual lenders' liability risk. In addition, section 2 (1) no. 2 COVInsAG specifies that any repayment of such loans during the suspension period and the provision of collateral to secure such loans is deemed **not to be prejudicial to creditors** and is thus exempted from insolvency avoidance pursuant to sections 129 *et seq.* InsO.

Insofar as suspension applies, there is no need to arrange for a restructuring opinion (IDW S6) to mitigate lenders' liability risks. But **defining the exact scope of the privilege may be difficult**: Since court practice concerning restructuring loans looks already at companies being in a financial crisis, i.e. before the occurrence of illiquidity, and illiquid companies do not enjoy the liability and avoidance privilege, it is advisable to not only prepare a rolling **13-week liquidity forecast** but, where possible, also a conclusive **restructuring concept serving at least as a "roadmap" through the crisis** in order to prevent any appearance of selfish motives. While the exemption from avoidance pursuant to section 2 (1) no. 2 COVInsAG applies only to new loans, and thus not, for instance, to renewals, novations or other types of back-and-forth payments, finance providers may also

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invoke the liability exemption pursuant to section 2 (1) no. 3 COVInsAG if no new funds are provided for example in the case of a renewal or deferral. In view of the fact that the exemption is limited to new loans, negotiating and implementing the new **financing structures**, especially financings mixing "old and new money", remains **a challenge**.

Shareholder exemption

Insofar as suspension applies, the **exemption for shareholder loans** introduced by the COVInsAG also continues to be valid: these loans (but not any collateral provided to secure them) are not deemed to be prejudicial to creditors; they may thus not be contested under section 135 InsO and are deemed to be unsubordinated, so that fresh money provided by a shareholder during the suspension period will rank equally in the insolvency proceedings (here, too, renewals, novations and other types of back-and-forth payments will not suffice).

Coverage exemption

Insolvency avoidance on the grounds of congruent and certain incongruent coverage actions pursuant to sections 129 *et seq.* InsO also remains ruled out where the suspension rules apply. If, for example, a company punctually pays instalments due under an instalment payment agreement, any payments made in good faith are not to be reclaimable in subsequent insolvency proceedings by way of insolvency avoidance (section 2 (1) no. 4 sentence 1 COVInsAG).

IN BRIEF

From 1 October 2020 onwards, illiquid companies must once again file for insolvency without undue delay, and no later than within three weeks. In case of doubt, a liquidity status report should be prepared now and, for companies undergoing financial crisis, a rolling 13-week liquidity forecast should be prepared in the interests of legal certainty.

For non-illiquid companies, i.e. companies that are over-indebted but also companies that are neither over-indebted nor illiquid (!), the legislature continues to offer temporary stability during the period of suspension of the obligation to file for insolvency on the grounds of over-indebtedness until the end of 2020:

- Directors are not obliged to issue a positive going-concern prognosis in order to avoid having to file for insolvency on the grounds of over-indebtedness, and payment prohibitions under insolvency law will not apply to them even in a potential situation of over-indebtedness.
- Lenders may grant new loans to companies and may have collateral provided without having to fear liability or avoidance risks. In particular, the requirement to obtain a restructuring opinion generally remains suspended.
- Shareholders may grant shareholder loans without having to fear avoidance or liability risks.

But beware: In addition to the familiar challenges related to mixed financing structures ("new/old money") owing to the limitation of the various exemptions, it is advisable to prepare not only a rolling liquidity forecast but, where possible, also a restructuring concept serving at least as a "roadmap" through the crisis, because some uncertainties remain as to the exact scope of application of the various exemptions in the run-up to a potential illiquidity situation (= crisis).

From 1 January 2021 – under the current rules – a positive going-concern prognosis will again be important in order to avoid over-indebtedness, and the requirements for restructuring loans will again apply in full. Companies should thus use the time in order to develop at least the basic structures for a conclusive restructuring or refinancing concept.

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