

Germany: Act suspending obligations to file for insolvency proceedings and reducing liability for managing directors

In response to the COVID-10 pandemic, the German legislator enacted a new law to suspend the mandatory obligations to file for insolvency proceedings and to mitigate liability risks for managing directors and creditors. According to the "*Act to Mitigate the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedural Law*", the obligation to file for insolvency proceedings is suspended on a temporary basis for companies facing an insolvency due to the COVID-19 pandemic. The new law also mitigates the risks of managing directors as well as creditors and other business partners in connection with financial distress. The new law was enacted on Friday, 27 March 2020, with the regulations regarding insolvencies having retroactive effect as of 1 March 2020.

1. Suspension of Obligations to File for Insolvency Proceedings

The obligation to file for the opening of insolvency proceedings pursuant to Section 15a of the German Insolvency Code (*Insolvenzordnung*, **InsO**) and Section 42 para. 2 of the German Civil Code (*Bürgerliches Gesetzbuch*, **BGB**) are **suspended until 30 September 2020**. The suspension does not apply if:

- the insolvency was not caused by the consequences of the COVID-19 pandemic, or
- there is no prospect of resolving the insolvency.

In case the debtor was not (yet) illiquid (i. e. cash-flow insolvent) by 31 December 2019, it is **legally presumed** that the insolvency was caused by the consequences of the COVID-19 pandemic and that it can be resolved. The suspension can be **extended** by ordinance **until 31 March 2021**.

To protect companies from untimely creditor petitions, insolvency proceedings are not to be opened upon a creditor petition if the debtor was not yet insolvent on 1 March 2020. The limitation on the consequences of creditor petitions applies to petitions filed between 28 March 2020 and 28 June 2020.

2. Liability Protection of Managing Directors

As long as the obligation to file for insolvency proceedings is suspended, managing directors are not liable for failure to file for insolvency or a delayed filing. Furthermore, a broad exemption from liability applies to payments made by the debtor during a



financial crisis. Managing directors and board members shall not become liable for a violation of the statutory payment prohibitions pursuant to Section 64 sentence 1 of the German Limited Liability Companies Act (**GmbHG**) or Section 92 para. 2 of the German Stock Corporations Act (**AktG**) when making payments in the ordinary course of business. Such payments shall be deemed "compatible with the diligence of a prudent and conscientious manager". This provision is intended to facilitate payments which serve to maintain or resume business operations or to implement a restructuring concept.

Please note: The bill does not provide for a comprehensive exemption from liability. For example, liability of managing directors on the basis of criminal law regulations (e.g. fraud or embezzlement) is not *per se* excluded.

3. Protection of Lenders

The financing of businesses is facilitated by the following regulations:

- During the suspension period, the **granting of new loans** and the taking of security will not be regarded as aiding or facilitating the delay in filing for insolvency contrary to public policy pursuant to Section 826 BGB. Thus, the provision mitigates the risk of lenders becoming liable for providing financing in a distressed situation without exercising proper care. This means that restructuring loans can be provided without the lender being exposed to a liability risk that would be almost incalculable in the current situation.
- **Any redemption** of new loans **is exempted from claw-back**, provided that the redemption occurs by 30 September 2023. The taking of security for new loans is also exempted from claw-back and avoidance.
- The abovementioned provisions also apply to the **granting and repayment of new shareholder loans** (and legal acts that are economically equivalent to them). Section 39 para. 1 no. 5 and Section 44a InsO ordering the subordination of shareholder loans do not apply in insolvency proceedings opened before 30 September 2023. However, the provisions shall not apply to the taking of security for shareholder loans.

The regulations apply irrespective of whether the borrower is insolvent or not. Therefore, the protection of loans to companies is comprehensive, regardless of how much the borrower is affected by the COVID-19 pandemic. The time restrictions on granting, collateralization and repayment do not apply to financing provided under government assistance programs in response to the COVID-19 pandemic.

4. Protection of Creditors from Claw-Back and Avoidance Actions

Legal acts performed during the suspension period by which a creditor was granted a security or satisfaction in a kind or at a date the creditor was entitled to (congruent coverage pursuant to Section 130 InsO) **are exempted from claw-back and avoidance** in subsequent insolvency proceedings. As an exception to the rule, claw-back and avoidance shall remain possible if the creditor was positively aware that the debtor's restructuring and financing efforts were not suitable for remedying an insolvency that was already present at the time of performance or provision of security. The following legal acts are also exempted from claw-back and avoidance:

- performance rendered *in lieu* or on account of the contractually owed performance;
- payments by a third party upon the instruction of the debtor;
- the provision of other security than originally agreed upon (unless the provided security is more valuable);
- the shortening of payment terms; and
- the granting of payment relief.

The provisions for protection against claw-back actions apply regardless of whether the debtor has an obligation to file for insolvency or whether he has become illiquid or over-indebted as a result of the COVID-19 pandemic.

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