Update Restructuring

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German insolvency law: From 1 January 2021 new law (SanIns-FoG) temporarily exempts businesses distressed by COVID-19 from regular insolvency regime

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From 1 January 2021, debtors insolvent due to COVID-19 pandemic will benefit from

- **suspension of duty to file for insolvency until 31 January 2021 for companies expecting COVID-19 financial assistance related to November and December 2020 lock-down**
- **easier access to protective shield proceedings and self-administration proceedings,**
- **shorter prognosis period for over-indebtedness test (four months instead of twelve)**

SanInsFoG becomes effective 1 January 2020

The **Act for the Further Development of the Restructuring and Insolvency law** Sanierungs- und Insolvenzrechtsfortentwicklungsgesetz (**SanInsFoG)** of 22 December 2020 concludes a fast-track legislative process of barely three months kicked off by the publication of a draft bill on 19 September 2020. The SanInsFoG will become effective on 1 January 2021.

In a nutshell, the SanInsFoG combines two major long-term insolvency reform projects in one legislative bill and – forced to address the imminent needs of German debtors struggling to recover from the effects of the COVID-19 pandemic – adds short-term temporary measures:

SanInsFoG implements EU Directive 2019/ 1023 on preventive restructuring frameworks into German law

The first insolvency law reform project is the introduction of the new preventive and pre-insolvency restructuring scheme, implementing the EU Directive 2019/1023 on preventive restructuring frameworks. For details, please see our newsletter of 23 September 2020 covering the draft bill and our update covering the bill as it will become effective on 1 January 2021 (to be published shortly).

SanInsFoG renovates regime of self-administration and protective shield proceedings

The second insolvency law reform project is the renovation of the German insolvency law regimes of self-administration (*Eigenverwaltung*) and protective shield proceedings (*Schutzschirmverfahren*). We will provide further detail, and our view as to the practical implications to be expected from this reform, in a separate newsletter (to be published shortly).

SanInsFoG amends CovInsAG (the German COVID-19 emergency law of 27 March 2020) by new temporary relief measures

To meet the imminent needs of German debtors struggling to recover from the effects of the COVID-19 pandemic on their businesses, the legislator included a **new set of temporary measures,** which will technically be implemented by way of **amendment to the COVInsAG** (*COVID-19-Insolvenzaussetzungsgesetz*) of 27 March 2020.

The amendment of the COVInsAG includes the following four key measures, which will temporarily apply from 1 January 2021:

Suspension of insolvency filing duty between 1 and 31 January 2021 for businesses eligible to receive financial assistance in relation to November and December lock-downs.

1) Duty to file for insolvency. Suspension between 1 and 31 January 2021 for businesses eligible to receive public assistance in relation to lock-downs in November and December 2020.

An important feature of German insolvency law is the duty to file for the opening of insolvency proceedings over the assets of a debtor that is either illiquid (*zahlungsunfähig*) or over-indebted (*überschuldet*). This duty is a personal duty incumbent upon each member of the management body of debtors incorporated as a legal person (e.g. *GmbH*, *AG*) or established as limited partnerships (*KG*) with general partner(s) being themselves incorporated as legal persons (rather than natural persons, e.g. *GmbH & Co. KG*) and is sanctioned by personal civil liability and criminal fines.

The COVInsAG had suspended the duty to file for insolvency from 1 March through 30 September 2020 for all debtors whose insolvency had been caused by the COVID-19-pandemic and who had a chance to restore their liquidity by 30

September 2020. This general suspension was the German legislator's attempt to temporarily relieve debtors and their management from the (personal) risks and liabilities related to the uncertainties created by the first wave of the COVID-19-pandemic and the governmental shut-down measures in relation to short-term liquidity forecasts and mid-term going concern prognoses in March 2020. In light of the successful containment of the first wave of the pandemic, the legislator decided in September 2020 to extend the suspension of the filing duty only until 31 December 2020 and to restrict it to debtors, which were over-indebted (but liquid). [See our update of 5 October 2020 for more detail.]

Thus, since 1 October 2020, the legal filing-duty has applied again to all illiquid debtors, including to those whose illiquidity was caused by the COVID-19 pandemic.

The thrust of the second wave of the COVID-19 pandemic caused the German states to take new lock-down measures, starting with a limited / "soft" lock-down in November 2020, which was extended to a general / "hard" lock-down of virtually all areas of non-essential public life in December 2020, which is expected to last at least until 10 January 2021 while the political discussion for a further extension of the hard lock-down has already started. These lock-down measures were accompanied by new financial assistance programs established by the German government and aimed at assisting businesses suffering from the economic consequences of the lock-down measures, so called *November- und Dezemberhilfen (*November and December assistance).

However, in practice, administrating public financial assistance at a national scale always comes with a time-lag from the initiation of the public assistance programs, to the day the IT-systems allow the first assistance-applications by applicants, to the day of the communication of assistance-decisions to the applicants and to the day of the actual payment to applications.

In order to prevent debtors from falling insolvent while waiting on public assistance in relation to the November and December lock-down, the German legislator decided to suspend the insolvency filing duty for the period starting 1 November 2020 to 31 January 2021 for those debtors, who either

(i) applied for public financial assistance between 1 November and 31 December 2020, or

(ii) did not apply for public financial assistance between 1 November and 31 December 2020 due to legal or other reasons while being eligible to receive public financial assistance under the terms of the respective programs,

unless, in each case, the respective debtor has no reasonable expectation to receive the assistance applied for or the debtor's insolvency would not be remedied by the grant of the assistance.

2) <u>Protective shield proceedings</u>. Access to protective shield proceedings for debtors insolvent due to the COVID-19 pandemic even when illiquid:

Between 1 January to 31 December 2021 even illiquid debtors can access protective shield proceedings (*Schutzschirmverfahren*), if their insolvency is caused by the COVID-19 pandemic

Protective shield proceedings are a derivative form of self-administration proceedings and provide the debtor with even more control over the restructuring process, inter alia by allowing it to prepare an insolvency plan and select the custodian (*Sachwalter*) to be appointed by the court to safeguard the creditors' interests. For this reason, access to protective shield proceedings is normally restricted to debtors, which are still liquid when filing.

Between 1 January and 31 December 2021 debtors which are illiquid (*zahlungsunfähig*) due to the COVID-19 pandemic are, in deviation from the general rule, allowed access to protective shield proceedings (*Schutzschirmverfahren*). The legislative rationale for temporarily relaxing access to protective shield proceedings is that in the exceptional circumstances of the COVID-19 pandemic a debtor's illiquidity is no reliable indicator for an improper crisis management by the debtor, which would – in normal circumstances – disqualify the debtor for access to protective shield proceedings, which essentially rely on the debtor's ability to continue managing its business through insolvency in the best interest of the creditors.

Debtor's insolvency is deemed "caused by the COVID-19 pandemic", if debtor meets three requirements

In order to benefit from this temporary exemption, the debtor needs to submit an expert's opinion confirming that it meets the following three requirements (in which event the law deems the debtor's insolvency as "*caused by the COVID-19 pandemic"*):

(i) the debtor was not illiquid nor over-indebted on 31 December 2019,

(ii) the debtor generated a profit from its ordinary business activity (*gewöhnliche Geschäftstätigkeit*) in the period of the last financial year completed prior to 1 January 2020, and

(iii) the debtor's turnover from ordinary business activity in calendar year 2020 decreased by more than 30 per cent compared to the prior year.

While the first requirement was already part of the COVInsAG on 27 March 2020, the amendment now adds the second and the third requirements in an attempt to better tailor the criteria for the exemptions to those debtors whose distress mainly results from the COVID-19 pandemic. In practice, these requirements may prove difficult to meet for a good number of debtors affected by the COVID-19 pandemic.

However, even if the expert's confirmation does not or not completely confirm that the above-mentioned requirements are met, the legislator allows the debtor access to protective shield proceedings if "*it follows from*" the expert's opinion that due to particularities inherent to the debtor or its industry or resulting from other circumstances the debtor's insolvency is caused by the COVID-19 pandemic.

If the insolvency court has allowed the debtor access to protective shield proceedings on the basis of these temporary rules, the insolvency court can, if it subsequently becomes aware that the debtor's insolvency is not caused by the

COVID-19 pandemic, immediately terminate the protective shield proceedings for this reason and convert the proceedings into regular administration proceedings by appointing a (prelim-nary) insolvency administrator replacing the (preliminary) custodian (*vorläufiger Sachwalter*) initially appointed.

3) <u>Self-administration proceedings</u>. Easier access for debtors insolvent due to the COVID-19 pandemic:

Between 1 January to 31 December 2021 debtors benefit from easier access to insolvency proceedings in self-administration (*Eigenverwaltung*) if their insolvency is caused by the COVID-19 pandemic

One key element of SanInsFoG is the renovation of the self-administration proceedings introduced into German law as part of the ESUG law-reform in 2012. The new rules aim at rendering access to self-administration more predictable for debtors and, at the same time, better protecting the interests of creditors from debtors going into self-administration without the necessary preparation and advice. Under the new rules, filing for self-administration will require debtors to submit, among others,

(i) a financial planning for the first six months of proceedings,

(ii) a restructuring concept,

(iii) a description of the status of the debtor's negotiations with creditors, shareholders and other parties impacted by the contemplated restructuring measures,

(iv) a description of the debtor's expertise in complying with the requirements in insolvency proceedings, and

(v) a comparison of the costs expected in self-administration versus ordinary administration.

In practice, the new hurdles for self-administration proceedings applying from 1 January 2021 will require debtors to more solidly prepare their self-administration proceedings, involving professional advisors at an earlier stage.

However, requiring such a solid early-stage preparation in the currently prevailing COVID-19 pandemic environment, would likely prove too high a hurdle for many debtors. Therefore, the amendment to COVInsAG exempts those debtors from the new hurdles to self-administration which file for self-administration in the period from 1 January through 31 December 2021, provided their insolvency *is caused by the COVID-19 pandemic*.

The debtors may bring evidence that their insolvency *is caused by the COVID-19 pandemic* by two alternative means:

(i) The debtor submits an expert's opinion confirming that the debtor meets the three legal requirements (see item 2) above); note that the relaxed access to self-administration is also granted if the expert's confirmation does not or not completely confirm that all of the above-mentioned requirements are met, provided that "*it follows from*" the expert's opinion that due to particularities inherent to the debtor or its industry or resulting from other circumstances the debtor's insolvency is caused by the COVID-19 pandemic.

(ii) Instead of submitting an expert's opinion, the debtor itself confirms in the filing document that it has no liabilities which had already been due and payable (and were uncontested) on 31 December 2019.

If the insolvency court has allowed access to (preliminary) self-administration proceedings on the basis of these temporary rules, the insolvency court can, if it subsequently becomes aware that the debtor's insolvency is not caused by the COVID-19 pandemic, convert self-administration proceedings into regular administration proceedings by appointing an insolvency administrator replacing the custodian (*Sachwalter*) initially appointed.

4) <u>Over-indebtedness test</u>. Companies impacted by the COVID-19 pandemic benefit from more lenient over-indebtedness test:

Between 1 January to 31 December 2021, the going concern prognosis period for over-indebtedness-tests is reduced to four months (from twelve) if the over-indebtedness is caused by COVID-19

Another element of insolvency reform implemented by SanInsFoG is to provide a clear legislative guideline for the test of a company's going concern prognosis, which – if positive – exempts a company from the duty to file for insolvency because of over-indebtedness. Under current practice, the going-concern test spans across the prognosis period of the current and the subsequent business year (i.e. up to 24 months), whereas the new rules will limit the prognosis period to the next 12 months. This will practically mean that the company's management can ignore – for purposes of the over-indebtedness test – all uncertainties, which it expects to occur later than 12 months in the future.

For debtors impacted by COVID-19, the going-concern prognosis period is further reduced to only four months (from 12) during the period from 1 January through 31 December 2021. This significant reduction responds to the observation of many practitioners that, with the COVID-19 pandemic still spreading and negatively impacting almost every sector of the economy across large parts of the world, a reliable going concern prognosis over the next 12 months is currently impossible.

This significant reduction of the prognosis period may help turning an otherwise negative going concern into a positive going concern. This may allow debtors distressed by the impact of the COVID-19 pandemic to make use of the new preventive restructuring framework to restructure *outside of* insolvency proceedings, where a restructuring *in* insolvency proceedings would likely destroy too much value.

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