Update Restructuring

October 6, 2020

German insolvency law: COVID-19-suspension of duty to file for insolvency ended on 30 September 2020 for illiquid companies

Over-indebted companies still exempted from filing duty until 31 December 2020
COVID-19-affected companies to benefit from easier access to protective shield proceedings and preventive restructuring schemes/ regimes as from 1 January 2021

Dr. Arnold Büssemaker
Dr. Stefan Proske
Prof. Dr. Georg Streit
Dr. Johan Schneider
David Loszynski

Two German legislative initiatives taken in September 2020 will have an immediate impact on the options available to restructure a business under German law:

***First, effective as of 1 October 2020*, COVID-19 emergency legislation of 27 March 2020 has been modified:** The German legislator modified its COVID-19 emergency legislation which had suspended the legal duty to file for insolvency for all companies, now differentiating illiquid companies from (only) over-indebted companies:

- **for *illiquid*** (*zahlungsunfähige*) **companies,** the **legal duty to file for insolvency** is now reinstated.

- **for over-indebted (*überschuldete*) companies,** the **COVID-19-filing suspension** was **extended to 31 December 2020** (*überschuldet bei drohender Zahlungsunfähigkeit*).

This act is known as the Act for the amendment of the COVID-19 Insolvency Suspension Act (Gesetz zur Änderung des COVID-19 Insolvenzaussetzungsgesetzes) and has entered into effect on 1 October 2020.

***Second*, *effective as of 1 January 2021*, a new preventive and pre-insolvency restructuring scheme will be implemented:** A draft bill of the German government aims at im-

Duty to file for insolvency re-instated for illiquid companies as of 1 October 2020; suspension of filing-duty extended until 31 December 2020 for over-indebted companies

plementing into German law, *as of 1 January 2021*, a new preventive and pre-insolvency restructuring scheme, increasing the options for German distressed businesses to restructure outside of ordinary insolvency proceedings:

- Primarily, the draft bill introduces a **new preventive and pre-insolvency restructuring scheme** (implementing EU Directive 2019/1023 on preventive restructuring frameworks).

New preventive pre-insolvency restructuring scheme introduced as of 1 January 2021 (draft bill published on 19 September 2020

- In addition, and in order to assist companies distressed from the COVID-19 pandemic, the draft bill **temporarily (from 1 January to 31 December 2021) opens up access to self-administrated protective shield proceedings (*Schutzschirmverfahren*) and to the new preventive restructuring scheme even to illiquid companies** (which would normally be excluded from these restructuring options), provided their distress results from the COVID-19 pandemic.

Temporary – from 1 Jan through 31 Dec 2021 - access to
- **self-administration,**
- **protective shield proceedings, and**
- **preventive restructuring schemes**

also to illiquid debtors, provided their illiquidity results from the COVID-19 pandemic.

The draft bill was published on 19 September 2020 as draft **Act for the Further Development of the Restructuring and Insolvency law** Sanierungsfortentwicklungsgesetz – **SanInsFoG**, is in **first draft stage** and is contemplated to become effective on 1 January 2021.

***Practical impact* of these two legislative actions on German distressed businesses and their stakeholders**:

Practical impact on German distressed businesses and their stakeholders:

The practical impact becomes evident before the background of the ongoing COVID-19 pandemic and the emergency legislation passed by the German legislator:

On 27 March 2020, the German legislator had - after a very short legislative process - passed the ***Law on Temporary Suspension of the Duty to File for Insolvency and on the Limitation of Liability of Corporate Bodies in the Event of Insolvency caused by the COVID-19-Pandemic*** (**COVInsAG**).

German COVID-19 emergency legislation of 27 March 2020 bought debtors time to react to imminent insolvency by suspending the duty to file for insolvency between 1 March und 30 September 2020, provided debtors met certain pre-conditions

The main feature of the COVInsAG was to temporarily (from 1 March to 30 September 2020) suspend the duty upon in-

solvent companies to file for the opening of insolvency proceedings, if certain pre-conditions were met. These pre-conditions were that

1) the respective company's insolvency arose only after 1 March 2020,

2) the respective company's insolvency was a result of the COVID-19 Pandemic, and

3) there was reason to expect that an existing illiquidity could be cured by 30 September 2020.

COVInsAG also reduced exposure of insolvent debtors' management to personal liability when continuing trading and creditors' exposure to claw-back risk when continuing financing the insolvent debtors

Besides suspending the duty to file for insolvency in the above-mentioned conditions, the COVInsAG also contained provisions aimed at reducing liability risks for debtor's management who continue trading and claw-back risks for creditors who continue financing an insolvent company.

The COVInsAG provided for an option to extend the suspension of the filing-duty until 31 March 2021.

Political controversy whether or not to temporarily extend suspension of filing-duty

The question whether or not to temporarily extend the suspension of the filing-duty to 31 December 2020 was vividly debated among politicians and economists as well as insolvency and restructuring experts. Most insolvency practitioners took the position that the initial suspension period which ended on 30 September 2020 was sufficient to help affected debtors adjust to the new conditions. Others argued that the consequences of the COVID-19-pandemic and, above all, the restrictions on public and economic life would continue to be felt beyond 30 September 2020. Since a reliable business (and going concern) planning over the regular period (which spans across the current and the following business year) was still difficult in September 2020, debtors should not be forced to file for insolvency merely due to the lack of a sufficiently reliable going concern prognosis.

German political debate resulted in COVID-19 suspension of filing-duty

- **ending for illiquid debtors on 30 September 2020, while**

The compromise found by the German legislator is to extend the suspension of the filing-duty only for debtors, which are still liquid, but over-indebted (*überschuldet*), e.g. debtors exposed to impending illiquidity (*drohende Zahlungsun-*

fähigkeit) and lacking a sufficiently reliable going concern prognosis.

continuing for over-indebted debtors, which are still liquid until 31 December 2020

Further, the extension of the suspended filing-duty is limited to the period from 1 October to 31 December 2020

As a result of the reinstatement of the filing-duty for illiquid companies as of 1 October 2020, German insolvency practitioners expect a steep increase in insolvency filings by businesses which did not manage to secure financing to stay liquid. This will mainly concern businesses which had already been in distress prior to the pandemic. These businesses often failed to secure the assistance of their banks to help them obtain financing under the huge COVID-19 special credit-programs which KfW, the German state-owned development bank, started rolling out on 23 March 2020.

End of suspension of filing-duty on 31 December 2020 increases pressure on debtors to restructure

By limiting the extended suspension of the filing-duty to a further three months until 31 December 2020 and, at the same time, barring debtors who are already illiquid from access to it, the legislator sends a clear signal to distressed debtors: The legislator is fading out its policy of temporarily tolerating insolvent debtors not filing for insolvency. As from 1 October 2020, illiquid companies are no longer allowed to continue trading. And as from 1 January 2020 also companies over-indebted due to a lack of going concern will – again – be subject to the legal filing-duty, though they may benefit from a slightly relaxed over-indebtedness test if SanInsFoG becomes effective on 1 January 2021 (for this feature of SanInsFoG, see below).

This ‘change of gear’ can be expected to increase the pressure on many debtors to restructure and adapt to the new market environment.

Draft bill of SanInsFoG aims at improving the restructuring tool-box available to German businesses by combining two legislative projects

Before this background, the German legislator sped up the legislative process with regard to two legislative projects aimed at improving the restructuring tool-box currently available to German businesses and combined them into one draft bill published on 19 September 2020 as SanInsFoG:

The first legislative project is the introduction of a **new preventive and pre-insolvency restructuring scheme,** implementing the EU Directive 2019/1023 on preventive restructuring frameworks. For details regarding this German version of a preventive restructuring framework, allowing debtors to restructure pre-insolvency and out of insolvency proceedings, please see our newsletter of 23 September 2020 dedicated to this subject.

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

The second legislative project, which the draft bill intends to implement 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 future newsletter.

SanInsFoG improves regime of self-administration and protective shield proceedings

To meet the imminent needs of German debtors struggling to recover from the effects of the COVID-19 pandemic on their businesses' turnover and performance, the draft SanInsFoG provides for a **new set of temporary measures, which shall be effective only from 1 January to 31 December 2021**.

New temporary measures

- **apply during calendar year 2021, and**
- **aim at helping distressed debtors impacted by COVID-19 avoid insolvency filing and restructure under preventive restructuring framework**

The first new temporary measure allows even illiquid debtors to access the German pre-insolvency preventive restructuring frame-work and the self-administrated insolvency proceedings (even in the variant of protective shield proceedings):

Between 1 January and 31 December 2021 debtors which are illiquid (*zahlungsunfähig*) are exempted from the legal provisions barring illiquid debtors from access to

- the new pre-insolvency preventive restructuring framework,
- the insolvency proceedings in self-administration (*Eigenverwaltung*), which permit the debtor to stay in control of its business while restructuring its debt by way of an insolvency plan, and

Between 1 January to 31 December 2021 even illiquid debtors can access

- **the new preventive restructuring framework, and**
- **the insolvency proceedings in self-administration, including by way of protective shield proceedings**

- the protective shield proceedings (*Schutzschirmverfahren*), a derivative form of self-administration proceedings accessible only to liquid debtors, but providing the debtor with even more control over the restructuring process, inter alia by allowing it to select the custodian (*Sachwalter*) to be appointed by the court to safeguard the creditors' interests,

provided in each case that the debtor submits an expert's opinion, confirming that it meets the above-mentioned criteria.

The legislative rationale of temporarily relaxing access to these restructuring proceedings is that in the exceptional circumstances of the COVID-19 pandemic the debtor's illiquidity is no reliable indicator for an improper crisis management, which would normally disqualify the debtor for access to this type of proceedings, as each of them relies on the debtor's ability to continue managing its business through insolvency in the best interest of the creditors.

Between 1 January to 31 December 2021 prognosis period for over-indebtedness-test is reduced to four months

The second temporary measure reduces the prognosis period for the determination of the debtor's going concern, **which is one element of the test for the debtor's over-indebtedness, to just four months**. This significant reduction responds to many practitioners' observation that, with the COVID-19 pandemic still spreading and negatively impacting almost every sector of the economy across the world, a reliable going concern prognosis is currently impossible, as current law requires a prognosis period stretching across the current and the following business year (i.e. up to 24 months).

This significant reduction of the prognosis period may help turning an otherwise negative going concern into a positive going concern and allow the debtor to prevent an insolvency-filing duty for over-indebted. In conjunction with the facilitated access to the new preventive restructuring framework, temporarily even allowing illiquid debtors to restructure pre-insolvency, the German legislator provides the tools allowing at least those debtors (only) impacted by the COVID-19 pan-

demic to avoid the German insolvency courts.

Access to these two new temporary measures is subject to the debtor fulfilling all of the following requirements:

- the debtor was not illiquid as per 31 December 2019,

- 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

- the debtor's turnover from ordinary business activity in calendar year 2020 decreased by more than 40 per cent.

While the first requirement was already introduced by COVInsAG on 27 March 2020, the draft bill 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.

New temporary measures are subject to higher access-hurdles, tailored to reserve access to debtors evidently impacted by COVID-19 pandemic

Your contact

Lawyer
Dr. Arnold Büssemaker
T +49 89 540 31-150
F +49 89 540 31-550
a.buessemaker@heuking.com

Lawyer
Dr. Stefan Proske
T +49 30 88 00 97-15
F +49 30 88 00 97-99
s.proske@heuking.de

Lawyer
Prof. Dr. Georg Streit
T +49 89 540 31-227
F +49 89 540 31-527
g.streit@heuking.de

Lawyer
Dr. Johan Schneider
T +49 40 355280-30
F +49 40 355280-80
j.schneider@heuking.de

Lawyer
David Loszynski
T +49 40 355280-66
F +49 40 355280-80
d.loszynski@heuking.de

Update Restructuring
☐ subscribe (free, without obligation, cancelable at all times)
☐ unsubscribe
Fax-response to: +49 40 355280-80
E-Mail-response to c.burmester@heuking.de

Information on how Heuking Kühn Lüer Wojtek handles your personal data, the purposes for processing your data, the legal basis for processing, and on your rights can be found at www.heuking.de.

Subscription and contact

Name: .....

.....

Email-Adress: .....

.....

Your Adress: .....

.....