Marcel Barth

'Current Developments in Germany'

Selected changes in insolvency law

Germany's Covid-19 Insolvency Act contains far-reaching temporary changes to the country's insolvency law. Sections 1 and 2 of the act regulate the requirements for suspending the obligation to file for insolvency and the subsequent consequences. Section 3 limits insolvency proceedings filed by a creditor between 28 March and 28 June 2020 to cases where the reason for opening was present on 1 March. Notably, the Federal Ministry of Justice is authorized to extend some of the act's provisions until 31 March 2021.

Suspending the obligation to file for insolvency

Until 30 September 2020, the Covid-19 Insolvency Act suspends the obligation to file for insolvency if the legal entity is insolvent or over-indebted. However, this does not apply if the reason for insolvency does not stem from the consequences of the pandemic or if there is no prospect of eliminating an existing inability to settle debts. Since the law does not define these grounds of exclusion, the wording will remain subject to further judicial interpretation.

If the company was not insolvent on 31 December 2019 it is assumed that the pandemic was the basis of the insolvency and that there is a prospect of eliminating inability to pay its debts. These presumptions are rebuttable. Yet, a rebuttal may only be considered in cases where there can be no doubt that the Covid-19 pandemic was not the cause for the insolvency and that the elimination of an insolvency could not be successful.

Consequences of suspending the obligation to file for insolvency

The Covid-19 Insolvency Act provides for certain consequences associated with the suspension of the obligation to file for insolvency. During the crisis, affected companies are supposed to have the opportunity to stay in business and eliminate their insolvency. The following regulations mostly apply to companies not subject to insolvency application too – such as traders and limited partnerships with a natural person as general partner – and solvent companies who find themselves into serious economic difficulties due to the pandemic.

> **a)** By way of a legislative fiction, the Covid-19 Insolvency Act states that payments made in the ordinary course of business are deemed compatible with the diligence of a prudent and conscientious business owner. It specifically mentions payments to maintain or resume business operations or to implement a reorganisation. Therefore, the personal liability risks for representative bodies in companies affected by insolvency have been reduced. According to the draft legislation, representative bodies are expected to "be able to take the necessary measures to continue the company in the ordinary course of business". This includes not only "measures to maintain or resume business operations, but also measures in the course of the reorientation of the business within the framework of a restructuring".
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> **b)** Additionally, the new act aims at ensuring that companies affected by the crisis continue to receive the funds they need. However, the repayment of loans granted during until 30 September 2020 and collateralization during the same period are not considered

disadvantageous to creditors. In this respect, trade credits and other forms of performance on target are also regarded as loans. Since the new regulation pursues to provide the affected companies with fresh money, novation or prolongation and similar situations are not covered.

c) The act indicates that granting loans and collateral during the suspension period is not to be regarded as an immoral contribution to the delay in filing for insolvency. In fact, lenders are to be protected against the risk that such credit be classed as immoral. Unlike in the case of repayment relief, this also covers prolongations and novations.

d.) Finally, during the suspension period, the act exempts so-called congruent cover – such as payment and collateral – and certain incongruent cover – like payment instead of performance or payments by a third party on the instruction of the debtor – from a future insolvency challenge. This intends to prevent landlords, lessors or suppliers from quickly terminating a contractual relationship with a company in crisis. They will not have to fear repaying received payments in case a company's restructuring efforts fail.

Many companies' crises are not down to their business models as such but are rather triggered by uncontrollable external circumstances. If not for these measures, this would be further aggravated, making a future restructuring much more difficult.

Assessment and outlook

In the current crisis, German legislators seem to be on the right track. The temporary suspension of strict requirements in company and insolvency law makes it far easier for many companies to manoeuvre through the crisis.

The temporary restrictions in insolvency law will contribute to preventing insolvencies and help healthy companies who ran into difficulties as a result of the pandemic. They offer other market participants an incentive to support these companies too. The measures taken constitute an important element in supporting and maintaining the German economy. Without them, an economic recovery after the pandemic would likely be much more difficult.