

CORONAVIRUS RESOURCE CENTER

COVID-19: Temporary Changes to German Insolvency Law

March 31, 2020

To mitigate the significant economic consequences of the COVID-19 pandemic and the resulting shutdowns and contact ban implemented in Germany, the German Parliament (*Bundestag*) passed the Federal Act to Mitigate the Impact of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedural Law (COVID-19 Mitigation Act—“CMA”) on March 25, 2020. The required approval by the German Federal Council (*Bundesrat*) has been adopted on March 27, 2020.

This Update provides a brief overview over the key provisions of this CMA as it pertains to German insolvency law.

Suspension of the obligation to file for insolvency. Most notably, the CMA provides for the suspension of the obligation to file for insolvency until September 30, 2020.

Under normal circumstances, legal entities in Germany are required to file for insolvency within three weeks of the onset of their illiquidity or over-indebtedness. Failure to do so can result in criminal and civil liability of the company’s management. In order to provide companies which were severely impacted by the COVID-19 pandemic with the time and opportunity to avert an impending insolvency, e.g. by availing themselves of government assistance in the form of financing and restructuring agreements, the CMA provides for a suspension of such filing obligations until September 30, 2020. During this period, (factually) insolvent companies may continue to operate, effect payments and undertake reorganization and refinancing efforts.

The suspension does not apply to companies whose insolvency was not caused by the pandemic or companies which have no prospect of eliminating their illiquidity or over-indebtedness during the suspension period. However, the CMA presumes in favor of the

businesses that the insolvency was caused by the pandemic and that illiquidity can be remedied if the company was not yet insolvent as of December 31, 2019.

The provision applies retroactively from March 1, 2020 to cover companies which were affected by the pandemic early and, if required, the CMA contains an option to extend the suspension period up until March 31, 2021.

Payments remain permissible. The CMA further provides that the management of companies which qualify for a suspension of insolvency filing may continue to effect payments during the suspension period as long as such payments are made to maintain or resume business operations or to implement a restructuring plan. The management must apply the standard of care of a prudent and diligent manager. This provision has been adopted as response to concerns that the payments made during the suspension period by (factually) insolvent companies may result in personal liability of the management of such companies. Under German corporate law, the management is personally liable if it effects payments while the company is in the state of insolvency.

Mitigation of clawback and lender's liability risk. Another key element of the CMA aiming at improving the ability of the affected companies to access debt financing is the limitation of the clawback and lender's liability risk in connection with financing provided during the suspension period. Under German insolvency law, providing financing to companies that are, or are at risk to become, insolvent can expose the creditors to the risk of lender's liability or of a clawback. Under the CMA, financing provided to the affected companies during the suspension period, as well as collateral granted in connection with such financing, is expressly exempted from such rules. Such financing may be repaid until September 30, 2023 without the creditors having to face the risk of a clawback. The CMA, however, provides that a creditor may still face the risk of a clawback if such creditor is positively aware that the reorganization and refinancing efforts of the (factually) insolvent company are ineffective or unsuitable. The burden of proof in this case lies with the contesting party.

Privileged treatment of shareholder loans and suspension of equitable subordination. In order to also incentivize the shareholders to provide shareholder loans, such privileged treatment has been extended to shareholder loans granted during the suspension period. However, as opposed to third party financing, collateral provided in connection with shareholder loans does not benefit from such privileged treatment. Moreover, the CMA provides for a suspension of the "equitable subordination" under German insolvency law according to which shareholder loans are subordinated by law to the claims of any other creditors. Thus, shareholder loans granted during the suspension period will be treated as *pari passu* with the claims of other creditors in the case that the company becomes insolvent prior to September 30, 2023. Contractual subordination of shareholder loans is, however, not affected by the new legislation.

Limitation of ability of creditors to file for insolvency. The CMA also limits the ability of the creditors of a (factually) insolvent company to file for the commencement of insolvency proceedings for a period of three months, starting March 1, 2020.

However, this limitation only applies if the company was not yet insolvent as of March 01, 2020. It also does not apply to filings by the German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) or other competent supervisory authorities.

The CMA also authorizes the Federal Ministry of Justice and Consumer Protection to extend such limitation until 31 March 2021.

* * *

For more information regarding the coronavirus, please visit our [Coronavirus Resource Center](#).

Please do not hesitate to contact us with any questions.

FRANKFURT



Dr. Thomas Schürle
tschuerle@debevoise.com



Klaudius Heda
kheda@debevoise.com



Philipp von Holst
pvonholst@debevoise.com



Christina Heil
cheil@debevoise.com