Milbank

Financial Restructuring Group

Client Alert

Update – Partial Extension of the Suspension of Insolvency Filing Obligations until 31 December 2020

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1. Background: Temporary Modification of the German Insolvency Regime to avoid COVID-19-related Insolvencies in Germany expires on 30 September 2020

As described in our Client Alert "Proposed Legislation to avoid COVID-19-related Insolvencies in Germany" dated 24 March 2020, the German legislator has comprehensively modified the German insolvency regime with effect as of 1 March 2020 to prevent insolvencies of companies which encounter financial difficulties as a result of the COVID-19 pandemic. This modification has been implemented by the Act to temporarily suspend the Obligation to file for Insolvency and to limit Directors' Liability in the Case of Insolvency caused by the COVID-19 Pandemic (*COVID-19-Insolvenzaussetzungsgesetz* – "**COVInsAG**") of 27 March 2020 and has addressed nearly all insolvency-related obligations and restrictions which typically apply to insolvent debtors and which would usually frustrate the affected companies' going concern status and their ability to continue trading by means of:

- suspending the directors' obligation to file for insolvency;
- limiting the creditors' entitlement to file for insolvency in the period from 28 March 2020 until and including 28 June 2020;
- suspending the restrictions on the discharge of pre-existing liabilities;
- privileging new shareholder and third-party financings by means of:
  - suspending the equitable subordination of shareholder loans;
  - excluding lender liability risks in the context of turnaround financings; and
  - limiting the claw-back of repayments of third-party and shareholder financings and the collateralization of third-party financings (but not of shareholder financings).

The existing modification of the German insolvency regime was supposed to expire on 30 September 2020. It included an authorization of the Federal Ministry of Justice and Consumer Protection to extend the aforementioned modification of the German insolvency regime until 31 March 2021 by way of an ordinance without the consent of the German Federal Council (*Bundesrat*) should such an extension be required due to ongoing demand for available public aid, ongoing financing obstacles or other circumstances.

2. Proposed Extension of the Suspension of Insolvency Filing Obligations for over-indebted Debtors until 31 December 2020

The German government now has resolved to extend the aforementioned modification of the German insolvency regime until 31 December 2020, but solely in relation to companies which are over-indebted without at the same time being illiquid. Companies which became over-indebted as a consequence of the SARS-CoV2-Virus (COVID-19) pandemic should have the opportunity to exhaust all potential restructuring and refinancing options until the end of the year without being compelled to file for insolvency.

Companies which are or become illiquid, i.e. unable to honour their payment obligations as they fall due, whether or not as a consequence of the SARS-CoV2-Virus (COVID-19) pandemic, are no longer protected by the modification of the German insolvency regime from 1 October 2020 onwards.

In relation to illiquid companies, all statutory obligations and restrictions which were in effect prior to the modification of the German insolvency regime pursuant to the COVInsAG are applicable again with effect on and from 1 October 2020.

The partial extension of the modification of the German insolvency regime will be implemented by means of a new statute which is expected to be adopted by the German Parliament on 17 September 2020.

3. Practical Implications

With effect on and from 1 October 2020, each managing director (*Geschäftsführer*) has the obligation to file for insolvency without undue delay (*unverzüglich*), but in any event not later than three weeks if the relevant company is or has become illiquid. If the company is currently illiquid or is projected to be illiquid as of 1 October 2020, the directors should already now prepare an insolvency filing to be able to comply with their insolvency filing obligations on and from 1 October 2020.

Directors of companies which became **over-indebted as a consequence of the SARS-CoV2-Virus (COVID-19) pandemic without being illiquid** can continue to make use of the modification of the German insolvency regime until 31 December 2020. Consequently, in each case until and including 31 December 2020,

- the directors of such companies continue to be under no obligation to file for insolvency due to over-indebtedness;
- the restrictions to discharge pre-existing liabilities of such companies continue to be suspended; and
- new shareholder and third-party financings made available to such companies continue to be privileged as described under no. 1 above.

However, the directors of companies which are over-indebted as a consequence of the SARS-CoV2-Virus (COVID-19) pandemic are required to pursue all potential restructuring and refinancing options in order to avoid the occurrence of illiquidity and the persistence of the over-indebtedness from 1 January 2021 onwards. If these efforts no longer seem promising, the directors should prepare for an insolvency filing in order to comply with their insolvency filing obligations on and from 1 January 2021 or, if earlier, upon the occurrence of an illiquidity.

The directors of such over-indebted companies, and of companies which encountered financial difficulties as a consequence of the SARS-CoV2-Virus (COVID-19) pandemic without yet being over-indebted or illiquid, should closely monitor and document the company's liquidity status, in particular by means of a detailed rolling 13 week liquidity forecast, in order to be able to identify the occurrence of any illiquidity and comply with statutory obligations.

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