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Remedy for Managing Directors in the Time of COVID-19: Suspension of insolvency filing obligations and limitation of liability risks in Germany

The Federal Ministry of Justice and Consumer Protection (BMJV) now implements, with great commitment and unprecedented speed, what it has generally announced on 16 March 2020:

- The suspension of the obligation to file for insolvency
- The limitation of liability risks for managing directors in an insolvency situation

These measures shall be adopted within less than a week and a half. The aim is to help directors manage the disruptive effects of the COVID-19 pandemic on the liquidity situation of many companies and avert further negative business and economic consequences against the background of the strict German insolvency filing and liability regime in insolvency situations. The BMJV and restructuring experts (including Latham lawyers), have collaborated closely to design these provisions.

Insolvency filing obligations and manager liability

Under German insolvency law, the following insolvency events trigger obligations to file for insolvency:

- **Illiquidity** (sec. 17 German Insolvency Code (InsO)): Illiquidity occurs if a debtor is not able to meet its payment obligations when due. Illiquidity is generally presumed if a debtor has ceased to make payments.
- **Over-indebtedness** (sec. 19 InsO): A debtor is over-indebted if the debtor's assets no longer cover the existing liabilities, unless the going concern of the debtor is predominantly likely (so-called positive going concern prognosis).

If one of these triggers are met, managing directors must file for insolvency without culpable delay and within three weeks at the latest (sec. 15a InsO). **The obligation to file for insolvency for a period of up to three weeks** may only be exhausted as long as the managing directors can assume with sufficient likelihood that the reason for filing for insolvency can be resolved within this period, for example by way of new loans, shareholder contributions, or deferral of due payment obligations. Given the severity of the

economic impact of the COVID-19 pandemic — whether through disruptions on the customer or supplier side or due to factory shutdowns — which cannot even closely be reflected through cost adjustments, many companies will likely now fulfill such insolvency requirements very quickly. At the same time, the promised state funding — whether from KfW or other (federal) state funding institutions — likely cannot be made available within a period of three weeks. The number of companies affected is too large and the provision of funds too complex. Notably the involved funding institutions and banks are themselves limited in their capacity by COVID-19.

In addition to possible liability under civil and criminal law for breaches of **insolvency filing obligations**, managing directors of companies in a situation of illiquidity or over-indebtedness are exposed to considerable **liability risks for payments made**. They are obliged to compensate their companies for payments which are made after it became insolvent or after it was to be considered over-indebted, unless the payments were compatible with the due care of a prudent businessperson (sec. 64 Limited Liabilities Companies Act, sec. 92 Stock Corporation Act). Whether such a payment would have been made by a prudent businessperson or not is often questionable.

Suspension of insolvency filing obligations

The law to mitigate the consequences of the COVID-19 pandemic in civil, insolvency, and criminal procedure law, which is currently being finalized, now provides for a **suspension of the obligation to file for insolvency until 30 September 2020**. The suspension will only not apply if the insolvency is not caused by consequences of the COVID-19 pandemic or if there is no prospect of resolving an existing illiquidity. At the same time, the suspension will apply assuming that (i) the insolvency is caused by effects of the COVID-19 pandemic and (ii) that there are prospects of resolving an existing illiquidity, if the debtor was not insolvent at an earlier testing date. This testing date likely will be 31 December 2019.

To ensure that the legislative purpose of allowing time to negotiate and implement a financing or restructuring solution for debtors cannot be undermined by creditors, the law also provides that insolvency proceedings based on **creditors' insolvency filings** can only be opened if the event of illiquidity or over-indebtedness already existed on 1 March 2020.

The suspension of the obligation to file for insolvency shall take effect **retrospectively from 1 March 2020**. Since it is not yet foreseeable how long the German economy will depend on respective suspensions of the obligation to file for insolvency and creditors' rights to file for insolvency, the BMJV will be authorized by regulation to extend the suspensions until 31 March 2021 if this appears to be necessary due to the continuing demand for available public assistance, ongoing financing difficulties, or other circumstances.

Limitation of manager liability risks

In order to prevent managing directors of COVID-19 affected companies from stopping payments to avoid possible personal liability, which in turn would have a negative impact on creditors' liquidity situations, the suspension of the obligation to file for insolvency is accompanied by considerable limitations of liability risks from **payments in the event of illiquidity or over-indebtedness**. Thus, payments which are made in the ordinary course of business, in particular payments which serve to maintain or resume business operations or to implement a restructuring concept, shall now be deemed to be compatible with the due care of a prudent businessperson to the extent that the obligation to file for insolvency is suspended. The applicability of the liability privilege is therefore subject to the same conditions described above for the suspension of the obligation to file for insolvency. This provision shall also apply retrospectively from

1 March 2020 and then for as long as a debtor is subject to the suspension of its obligation to file for insolvency as described above.

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