

# COVID-19: PRESSURE POINTS: SUSPENSION OF THE INSOLVENCY APPLICATION OBLIGATION (GERMANY)

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Legal Briefings

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## SELF-APPLICATION

### *Basic principle*

In the case of either (i) (imminent) illiquidity, i.e. the debtor is unable to pay its debts when they become due (*Zahlungsunfähigkeit*), or (ii) over-indebtedness, i.e. a debtor's assets do not cover all its liabilities (*Überschuldung*) ("**Insolvency Maturity**") of a corporate entity, the members of its board are obliged to apply for the opening of insolvency proceedings without undue delay (*ohne schuldhaftes Zögern*) but at the latest three weeks after the Insolvency Maturity has occurred, Section 15a of the German Insolvency Act (*Insolvenzordnung*, "**InsO**").

The current draft of the COVID-19 Insolvency Suspension Act (*COVID-19-Insolvenzaussetzungsgesetz*, "**COVInsAG-E**"), which has passed the German Bundestag on 25 March, stipulates with retroactive effect as of **1 March 2020** that this obligation to apply for insolvency proceedings will be suspended until **30 September 2020** ("**Suspension Period**"), Section 1 COVInsAG-E. The Suspension Period shall be extendable by legislative decree without the consent of the German Federal Council (*Bundesrat*) at maximum until 31 March 2021, Section 4 COVInsAG-E.

This applies in principle to all cases of Insolvency Maturity, unless

- i. the Insolvency Maturity is not due to the consequences of the spread of the COVID-19 pandemic; or

- ii. there is no prospect of recovery from the illiquidity.

### ***Rebuttable presumption***

A rebuttable presumption (*widerlegliche Vermutung*) applies that the Insolvency Maturity is due to the COVID-19 pandemic and that there is a prospect of successful recovery from illiquidity if the debtor was not illiquid on 31 December 2019. The legislator apparently does not take into account a possible over-indebtedness. In our opinion, the existence of an over-indebtedness on 31 December 2019 would therefore not be harmful for the application of such rebuttable presumption.

According to the draft bill's explanation, the aim is *"to ensure that the current uncertainties and difficulties regarding the proof of causality and the predictability of further developments are in no way at the expense of the applicant"*. The presumption should only be considered rebutted if *"there can be no doubt that the COVID-19 pandemic was not the cause of the Insolvency Maturity and that the elimination of an occurred Insolvency Maturity could not be successful"*. In this respect, *"the highest requirements must be met"*.

### ***Reversal of the burden of proof***

Regardless of this rebuttable presumption, it is not the potential applicant but the person claiming the existence of an obligation to apply for insolvency proceedings who must demonstrate and prove that insolvency has not been caused by the COVID-19 pandemic or that there is no prospect of successful recovery from illiquidity. In our view, this should hardly be possible (proof of a negative fact) and should deliberately relieve the potential applicants.

## **ACCOMPANYING MEASURES**

Also with retroactive effect as of **1 March 2020**, the draft bill links the suspension of the obligation to file for insolvency to further legal consequences which are designed to make it easier to continue the company and to eliminate the insolvency situation:

- Enabling emergency operation, *Section 2 (1) No. 1 COVInsAG-E*

In order to ensure an emergency operation of the companies concerned, payments made in the ordinary course of business are considered compatible with the care of a prudent and diligent manager (*Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters*). This provision is intended to suspend payment prohibitions under current law that apply when insolvency proceedings have been initiated and to protect the concerned managers from personal liability. It applies in particular to those payments which serve to maintain or resume business operations or to implement a restructuring concept.

- *Relief in respect of restructuring loans, Section 2 (1) No. 2 and 3 COVInsAG-E*

In order to facilitate the granting of restructuring loans, repayments of new loans granted, and collateral provided, in the Suspension Period are not considered to be detrimental to creditors until **30 September 2023**. By virtue of the law, granting of loans and providing collateral during the Suspension Period is also not considered as an unethical (*sittenwidrige*) contribution to the delay of insolvency proceedings. This also applies to the repayment (but not the collateralization) of shareholder loans. Under current law, the granting of loans to companies in need of restructuring is subject to strict conditions and is associated with considerable risks under liability and rescission law.

- *Rescission protection for business partners, Section 2 (1) No. 4 COVInsAG-E*

Legal certainty is also to be created for business partners of companies that make use of the provisions of COVInsAG-E. For this reason, certain legal acts vis-à-vis business partners are not contestable. This concerns, for example, fee payments to suppliers, landlords or lessors. The rescission protection will only not apply if the business partner was aware that the debtor's restructuring and financing efforts have not been suitable to eliminate the occurred insolvency. Under current law, the business partners would, by contrast, have had to fear that they would have to repay payments received if the restructuring failed.

The relief in respect of **restructuring loans** (*Section 2 (1) No. 2 and 3 COVInsAG-E*) and the **rescission protection for business partners** (*Section 2 (1) Nr. 4 COVInsAG-E*) also apply to companies that are not subject to an insolvency application obligation (e.g. retail traders and limited partnerships having an individual as general partner) as well as to debtors that are neither illiquid nor over-indebted, *Section 2 (2) COVInsAG-E*.

In addition, the relief in respect of **restructuring loans** (Section 2 (1) No. 2 and 3 COVInsAG-E) also applies to loans granted by the KfW and its financing partners or by other institutions in the course of state aid programs granted on the occasion of the COVID-19 pandemic even if such loan is granted or collateralized after the expiration of the Suspension Period (i.e. beyond **30 September 2020**) and without time limitation with regard to their repayment (i.e. beyond **30 September 2023**), Section 2 (3) COVInsAG-E.

## THIRD PARTY APPLICATIONS

In addition to the debtor himself, a creditor may also file an insolvency application. In principle, this applies if the creditor substantiates both his claims and the Insolvency Maturity, most of the time the debtor's illiquidity, and has a legal interest in the opening of the insolvency proceedings, Section 14 (1) InsO. If such third party applications are filed within a period of three months after COVInsAG enters into force, insolvency proceedings shall only be opened if the reasons for the insolvency had already existed on 1 March 2020, Section 3 COVInsAG-E.

For more information on the German Government's response click [here](#).

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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