Authors Dirk Schoene and Mark Price

German Restructuring and Insolvency Law Crisis Consequence Mitigation Act and UK comparisons with CIGA 2020

KEY POINTS

- To extenuate the negative effects for German industry of the tremendous economic challenges it has faced since Spring 2019, German insolvency law has been subject to numerous changes; in particular changes to the obligation on companies to file for insolvency and the respective applicable deadlines.
- The most recent change is the German Restructuring and Insolvency Law Crisis Consequence Mitigation Act (*Sanierungs- und insolvenzrechtliches Krisenfolgenabmilderungsgesetz* ('SanInsKG')). As part of the Europe-wide move towards a minimum standard for restructuring frameworks, in January 2021 Germany has also implemented the Preventative Restructuring Frameworks Directive into German law.
- Introduction of the Corporate Insolvency and Governance Act 2020 (CIGA 2020) and a range of temporary COVID-19 related measures intended to protect companies from collapse have also changed the insolvency landscape in the UK.

OUTLINE OF THE INSOLVENCY REGIME IN GERMANY AND APPLICATION DEADLINE PRE-COVID-19

German insolvency law is based on a no-nonsense insolvency regime, which imposes high personal liability for the management of a company. Under German insolvency law, a managing director of a company is obliged to file for insolvency if the company is either illiquid or over-indebted. Prior to the COVID-19 pandemic, the deadline for filing an insolvency petition was uniformly no more than three weeks from the occurrence of illiquidity or over-indebtedness. Failure to meet this deadline is a crime under German insolvency law and, in addition, leads to personal liability of the management for any payments made after this deadline. Imminent illiquidity does not trigger an obligation to file for insolvency.

Pursuant to s 17 of the German Insolvency Code (*Insolvenzordnung* ('InsO')), a debtor is illiquid if its liquid assets are not sufficient to pay its due liabilities.

According to Sec. 19 para 2 s. 1 InsO, over-indebtedness occurs if the debtor's assets no longer cover its existing liabilities, unless the continuation of the business is predominantly probable according to the business and liquidity plan (so-called positive going concern prognosis (*positive Fortführungsprognose*)). Before COVID-19, the going concern prognosis had to cover a forecast period of up to 24 months (current and next financial year). If the liquidity forecast for this period indicates that the company will always be able to pay its liabilities when due, there is no obligation to file for insolvency.

OUTBREAK OF COVID-19 AND INITIAL LEGAL RESPONSE

Due to the extensive restrictions on social and economic life associated with the pandemic, 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')) came into effect on 27 March 2020. COVInsAG contained a comprehensive suspension of the obligation to file for insolvency until 30 September 2020. The suspension was subject to the condition that the reason for the insolvency was based on the effects of COVID-19 and that there were reasonable expectations that governmental aid measures or serious financing or restructuring negotiations could contribute to help the company through the crisis.

From 1 October 2020 to 31 December 2020, only the obligation to file an insolvency petition due to over-indebtedness was suspended.

REGULATIONS FROM 1 JANUARY 2021 UNTIL 31 DECEMBER 2021

On 1 January 2021, s 4 COVInsAG came into force, as part of the Act on the Further Development of Restructuring and Insolvency Law (*Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts* ('SanInsFoG')). The forecast period for the going concern prognosis in the case of over-indebtedness was temporarily shortened to four months to take into account the increased uncertainty regarding further economic development, in particular the ongoing supply chain crisis. This shortened forecast period was set from 1 January 2021 until 31 December 2021. The reduction of the forecast period was conditional on the debtor's over-indebtedness being caused by the COVID-19 pandemic. Another measure of the SanInsFoG was to extend the deadline for filing for insolvency, in the event of over-indebtedness, from three to six weeks.

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Dirk Schoene is a partner in Dentons' Berlin office with strong experience advising companies on successful restructuring in protective shield proceedings ('*Schutzschirmverfahren*') and debtor-in-possession proceedings ('*Eigenverwaltungsverfahren*') with a focus on restructuring by an insolvency plan. He regularly advises banks and other institutional investors on securities and potential investors in the M&A process regarding the acquisition of insolvent companies. Email: dirk.schoene@dentons.com

THE GERMAN RESTRUCTURING AND INSOLVENCY LAW CRISIS CONSEQUENCE MITIGATION ACT

The combined effects of the COVID-19 pandemic and the war in Ukraine continue to pose immense challenges for companies in Germany. The rapid rise in energy, gas and commodities prices and the ongoing supply chain crisis are causing tremendous uncertainty among entrepreneurs. This uncertainty is amplified when it comes to economic planning in particular. However, such planning is indispensable for companies and imposed on them by the law through the obligation to file for insolvency due to over-indebtedness.

The going-concern-prognosis can only be based on uncertain assumptions in view of current price volatilities and uncertainties that will continue to exist for the foreseeable future regarding the nature, extent and duration of the state of crisis that has occurred. Consequently, managers of companies are exposed to liability and the risk of criminal offences that can only be avoided safely by filing for insolvency, as comprehensive and secure planning is a prerequisite to producing a positive going concern.

German legislators recognised this problem and to alleviate the consequences, the German Restructuring and Insolvency Law Crisis Consequence Mitigation Act ('SanInsKG') was passed on 9 November 2022. Its goal is to protect companies that are essentially healthy and capable of surviving in the long term.

The SanInsKG, as the legal response to the current ongoing crisis, focuses on reducing planning periods. Therefore, the forecast period needed for a positive going concern prognosis according to Sec. 19 para 2 s. 1 InsO is again reduced from 12 to four months. Managing directors will find it easier to provide and substantiate a positive prognosis of their company's ability to continue as a going concern. In addition, if a company has to file for insolvency and would like to manage the proceedings by way of debtor-in-possession proceedings, the planning periods for financial plans in such filing are reduced from 12 or six months to four months respectively.

Finally, the maximum time limit for insolvency filings based on over-indebtedness has been increased from six to eight weeks. Companies now have two more weeks to either remedy the over-indebtedness or prepare for the initiation of proceedings.

The obligation to file for insolvency within the deadline of maximum three weeks in the case of illiquidity has remained unchanged.

In contrast to previous measures, the SanInsKG refrained from tying the scope of application of the described measured to a causality requirement that relates the forecast uncertainties back to developments on the energy markets. Lawmakers assume that, in principle, all players in the German economy are at least indirectly affected by the prevailing conditions.

These changes are relevant from a liability perspective, as the question of whether the management of a company has filed for insolvency within the time limit set out in Sec. 15a para 1 InsO and whether a criminal offence has been committed is regularly examined based on the going concern prognosis.

Although the measures offer a relief, the duty to plan for the medium to long term must not be disregarded, as SanInsKG does not alter the ongoing monitoring and remediation obligation, under Sec. 1 of the German Corporate Stabilisation and Restructuring Act (*Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen* ('StaRUG')).

CONCLUSION, IMPACT AND RESPONSE TO THE CHANGES, UK COMPARISONS

The measures taken in the SanInsKG are similar to those permanent and temporary insolvency measures introduced in the UK by CIGA 2020 during 2021 as a response to the COVID-19 pandemic. However, the German insolvency law changes are arguably more far reaching as they represent a fundamental change to the way a company assesses and reacts to its own financial difficulties.

The changes have received a mixed response in Germany. Some claim the new laws reflect only the acute fear of those in power of an insolvency wave, rather than preparing for an increasing number of crises in the future. Whilst others claim that the relevance of these measures will remain at a minimum and should be seen as a populist signal, rather than actual legislative change.

In the UK, the temporary measures that supported businesses during the pandemic (such as suspension of wrongful trading, prohibition on winding up petitions, relief from forfeiture for rent arrears and protection from eviction) have now ended and although they were arguably effective in achieving their intended outcome whilst in force, the latest figures from the UK Insolvency Service show a sharp rise in corporate insolvencies. Arguably, this indicates that the temporary measures did little more than delay the inevitable for certain businesses, but perhaps the current economic pressures at both micro and macro levels (led by the energy crisis, the Russia-Ukraine war, supply chain woes, Brexit and global instability) mean we are simply in a very challenging period and the world as we knew it has changed.

Like Germany, the UK, via CIGA 2020, has recognised that the insolvency legislation status quo was not fit for purpose. Consequently, the UK's insolvency landscape has been changed by a number of permanent measures. Notably, the introduction of the Restructuring Plan provided the UK with a new insolvency process aimed at company rescue. Like a scheme of arrangement and requiring court sanction, it enables more debts to be restructured and will support the injection of new rescue finance. Crucially, it allows dissenting classes of creditors to be bound, provided they are no worse off than in a more traditional insolvency procedure. CIGA 2020 also introduced the new Moratorium process, which provides companies with breathing space from creditor action (initially only for 20 business days, but extendable). It is proposed by directors of the distressed company who remain in control but the process is overseen by a monitor, who is a regulated insolvency practitioner. Additionally, CIGA 2020 introduced a permanent suspension of

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Mark Price is a senior associate in Dentons' London Restructuring and Insolvency team. He focuses on a range of contentious insolvency work (including commercial litigation), advising office holders, directors and investors on receiverships, administration, liquidation and cross-border issues. Mark's experience extends to managing complex domestic and international corporate insolvencies and restructurings, high-profile commercial disputes and investigations. Email: mark.price@dentons.com

termination clauses for suppliers of goods and services, preventing suppliers to a company in an insolvency procedure or under a moratorium from relying on contractual terms to stop supply, terminate or vary contract terms/increase prices provided they are paid, whilst causing them no financial hardship. CIGA 2020 has demonstrated a pragmatic response from the UK legislature, albeit its true impact is still being assessed and will be tested by the rise in insolvencies.

Europe-wide a raft of changes to insolvency law are being made in response to not only the COVID-19 crisis but as a result of the Preventative Restructuring Frameworks Directive approved by the European Parliament and the Council on 20 June 2019. The Restructuring Directive sought to introduce a minimum standard among EU Member States for preventive restructuring frameworks available to debtors in financial difficulty and to provide measures to increase the efficiency of restructuring procedures. These latest changes in Germany are a further and welcome response to the changing landscape of insolvency law in Europe. ■

Further reading

- Lexis PSL Restructuring & Insolvency; International restructuring and insolvency; Getting the Deal Through (and country guides); Restructuring and insolvency – Germany – Q&A guide
- Lexis Library; Howard, Warner & Beatty Restructuring Law & Practice > Chapter 15 Restructuring plan as a restructuring tool > C Jurisdiction and extra-territorial recognition > Jurisdictional roadblocks and EU recognition of the Plan post-Brexit > Germany
- How easy is it to enforce English judgments in the EU post-Brexit? A look at the procedures in Italy, Germany and Spain (2021) 5 JIBFL 354