Restructuring & Insolvency
Germany

October 2022

In reaction to the energy crisis: Further relief from the obligation to file for insolvency

While the financial burdens of the Covid-19 pandemic in the form of higher debt levels have by no means subsided, the German economy is already facing its next challenge with the current energy crisis. In response to the enormous price increases and fluctuations on the energy and raw materials markets, the German Parliament has passed temporary amendments to the restructuring and insolvency laws. The "*Act on the Temporary Adaptation of Restructuring and Insolvency Law Provisions to Mitigate the Consequences of the Crisis*" (in short: Restructuring and Insolvency Law Crisis Consequences Mitigation Act - "SanInsKG") - which has yet to be promulgated - aims to provide relief for companies that are "in essence healthy" and capable of surviving in the long term, but for which forward-looking liquidity planning is not possible at the moment, or only possible to a limited extent, due to the current price volatility.

In this newsletter, we summarize the particular decisions made by the German Parliament and assess what effects the relief package is likely to have on the restructuring practice.

Overview of the SanInsKG

The SanInsKG directly follows from the Covid-19 insolvency legislation in the form of a renaming of the "COVID-19 Insolvency Suspension Act (COVInsAG)" entered into force on March 1, 2020. The new designation of the law makes it clear that politics want to take a regulatory approach to the current economic "crisis" - initially limited until December 31, 2023. The SanInsKG has its origins in the package of measures adopted by the government/coalition committee on September 3, 2022 to secure an affordable energy supply and strengthen incomes. It comes alongside the primary financial aid still to be implemented (so called "*Doppelwumms*" by the chancellor). As the third relief package, the SanInsKG is primarily intended to ease the obligation to file for insolvency. This relief is to be achieved through the following measures, which will be discussed in more detail below:

- Shortening of the period for the continuation forecast in the case of over-indebtedness pursuant to section 19 (2) sentence 1 of the German Insolvency Code ("**InsO**") from *twelve* to *four months* (for more details see 1.);
- Extension of the maximum periods for filing for insolvency in the event of over-indebtedness pursuant to section 15 a (1) sentence 2 InsO from *six* to *eight weeks* (for more details, see 2.);

Our Expertise
Restructuring & Insolvency

- Shortening of the period for the financial plan in the context of self-administration proceedings pursuant to section 270 a (1) no. 1 InsO and in the context of a restructuring project pursuant to section 50 (2) no. 2 of the Act on the Stabilisation and Restructuring Framework for Businesses ("**StaRUG**") from *six* to *four months* (for more details, see 3.);
- Important: The general suspension of the obligation to file for insolvency that has been discussed in the meantime (as it was once the case during the Corona pandemic) is - for the time being - off the table. The insolvency ground of illiquidity (section 17 InsO) also remains unaffected.

1. Shortening of the forecast period for the over-indebtedness test

The planned amendment to the law does not focus on the insolvency ground of illiquidity, which is most relevant in practice - there will be no changes here. Rather, only the forecast period in the context of over-indebtedness will be adjusted.

a. The two-stage concept of over-indebtedness

Pursuant to section 19 (2) sentence 1 InsO, the insolvency ground of over-indebtedness exists if the debtor's assets no longer cover the existing liabilities (negative equity), unless the continuation of the company in the next *twelve months* is more likely than not (> 50 %) according to the underlying circumstances.

The legislator therefore bases the concept of over-indebtedness on a two-stage examination: only when a positive continuation forecast for the company is denied, an over-indebtedness examination of the equity situation based on liquidation values is to be carried out by comparing assets and liabilities in an over-indebtedness balance sheet. The starting point of every over-indebtedness test is therefore the continuation forecast, in which the equity position of the company concerned is initially ignored (in practice, the equity position is often not easy to determine, so that the focus is placed on the continuation forecast). It is to be examined on the basis of a key date consideration whether for the next *twelve months* there is both a subjective will to continue the business operation and from a planning point of view, an objective possibility to continue as a going concern. On the one hand, this means that the management must be willing to continue the business. On the other hand, there must be a positive revenue and financial plan based on a documented and conclusive business concept, which (in planning terms) leads to surplus income for the company (in other words, the company must be "financed through" for the relevant period). Only if there is a positive solvency forecast according to this (for example on the basis of an IDW S11 expert opinion), a predominant - i.e. more than 50% - probable continuation is guaranteed and a positive continuation forecast is given.

A closer look at the legislative history of section 19 InsO reveals that a specific time period to be used for the continuation forecast was not codified in law for a long time. Instead, the forecast was made on the basis of a case-by-case and "medium-term" approach prescribed by the case law of the German Federal Court of Justice. With the entry into force of the Restructuring and Insolvency Law Continuation Act (SanInsFoG) on January 1, 2021, the legislation amended the legal standard of section 19 InsO for the first time since 2008 and included a specific forecast period of *twelve months* for the continuation forecast in the law. However, with the COVID-19 Insolvency Suspension Act (COVInsAG), the legislator, in order to mitigate the consequences of the Corona pandemic for the period from January 1, 2021 to December 31, 2021, almost simultaneously reduced that forecast period to *four months*. According to the presumption of section 4 COVInsAG, however, this shortened forecast period was only to be applied if the debtor's over-indebtedness was <u>causally</u> attributable to the COVID 19 pandemic.

<u>b. Change in the law due to the SanInsKG</u>

Now, approximately two years later, the provision in section 4 (2) no. 1 SanInsKG again limits the forecast period to *<u>four</u> months* - initially until December 31, 2023. The reduction in the forecast period is justified by the current tense situation resulting from the geopolitical conflict between Russia and Ukraine. Due to existing market uncertainties about "*the nature, extent and duration of the crisis situation that has arisen*", as well as the sharp rise in energy and raw material prices at short intervals, it is often not possible for companies to form a reliable continuation forecast for a period of *twelve months*. Due to the uncertain assumptions and the immense civil and criminal liability risk involved, a prudent and conscientious director could therefore find himself in the predicament of having to file for insolvency. This is despite the fact that the company might have a "healthy core" and could continue to exist if the uncertainties and price volatilities were to be disregarded. This would be detrimental to the economy as a whole and should be prevented.

In contrast to section 4 COVInsAG, it is explicitly not necessary for the over-indebtedness of the company to be causally attributable to the (energy) crisis, i.e. in this case the sharp price increases and fluctuations on the energy markets. Consequently, the amendment benefits all economic operators, irrespective of whether they are individually affected, even if the crisis is sometimes caused by other factors. This is justified, in particular, by the fact that it is difficult to define the degree to which a market participant is sufficiently affected without accepting uncertainties of the kind that the shortening of the forecast period is intended to exclude. Thus, more or less all market participants are at least indirectly affected by the energy crisis. Although this is a plausible reason, it will ultimately also benefit companies which, for example, got into the crisis because of a poor business model or mismanagement.

<u>c. Special constellations</u>

The shortening of the forecast period in the over-indebtedness test will logically not apply until the SanInsKG comes into force (which is scheduled for the day following the planned promulgation of the new law at the end of October or beginning of November 2022). However, it is also intended to cover those cases in which (i) over-indebtedness pursuant to section 19 (2) sentence 1 InsO already existed beforehand and (ii) the insolvency application deadline pursuant to section 15 a (1) sentence 2 InsO not yet expired. Consequently, companies that are already over-indebted but for which the (so far) *six-week* maximum period for filing an insolvency petition in the event of over-indebtedness (see 2. above) has not yet expired may also benefit from the new provision. In these cases, too, there is no obligation to file for insolvency. However, it should be noted that this does not apply if the insolvency grounds of illiquidity also exist at the same time.

It should also be noted that the shortening of the forecast period may "*lose some of its practical effectiveness*" even before it expires on December 31, 2023. If it is already clear to the company concerned less than *four months* before the expiry of the SanInsKG that it would be over-indebted immediately after December 31, 2023 and in accordance with the then again applicable concept of over-indebtedness in section

19 InsO, this circumstance can lead to a negative continuation forecast even before December 31, 2023.

Finally, the following constellation must be pointed out: If an over-indebted company is already in insolvency proceedings and the new shorter period would justify a positive continuation forecast, the insolvency application filed by the company itself can be withdrawn. The amendment to the law may therefore have an impact on the past in this respect.

2. Extension of the maximum period for filing for insolvency due to over-indebtedness, section 15 a InsO

In addition to the shortening of the forecast period for over-indebtedness discussed above, the provision of section 4 a SanInsKG extends the maximum period for filing for insolvency due to over-indebtedness, which is subject to civil and criminal liability.

a. The currently applicable (maximum) deadlines for filing for insolvency

Pursuant to section 15 a (1) sentence 1 InsO , the members of the representative body of a legal entity must file an application for insolvency without undue delay if the insolvency is due to illiquidity or over-indebtedness. The application must be filed no later than *three weeks* after the occurrence of illiquidity and *six weeks* after the occurrence of over-indebtedness.

Since the SanInsFoG came into force on January 1, 2021, a different maximum period applies to over-indebtedness compared to the insolvency grounds of illiquidity. The maximum period of *three weeks* previously also applicable to over-indebtedness was extended to *six weeks* at that time in order to "*enable the debtor to bring ongoing restructuring efforts to a successful conclusion on an extraordinary basis or, if necessary, to prepare a restructuring in a proper and conscientious manner within the preventive restructuring framework or on the basis of a self-administration procedure*" (German Parliament printed matter 19/24191, p. 193).

b. Change in the law due to the SanInsKG

In line with this objective and in response to the energy crisis, the maximum period for over-indebtedness is now to be increased from *six* to *eight weeks* under the SanInsKG - initially until December 31, 2023. As in the SanInsFoG, the maximum period for filing an application due to illiquidity remains unaffected.

In addition, the principle of section 15 a InsO remains unchanged, namely that the maximum periods may not be exhausted if it is already clear at an earlier point in time that the illiquidity or over-indebtedness cannot be expected to be eliminated in the long term. If it is apparent that restructuring efforts have no prospect of success, the insolvency application must be filed without culpable hesitation, i.e. without delay - otherwise the management faces severe sanctions. In cases of doubt, managing directors should seek appropriate legal advice in practice.

3. Shortening of the planning period for self-administration and the StaRUG proceedings

a. Financial plan with respect to self-administration and StaRUG

Insolvency proceedings in self-administration are fully-fledged insolvency proceedings in which the debtor's management remains in office under the supervision of a so-called insolvency custodian and does not - as in the regular proceedings - lose the power of administration and disposal over the insolvency estate, i.e. this is regularly transferred to an insolvency administrator. With the SanInsFoG, the legislator increased the requirements for the self-administration procedure as of January 1, 2021 and introduced the requirement of a comprehensive and detailed "self-administration plan", which according to section 270 a (1) no. 1 InsO requires, among other things, a financial plan (i.e. through-financing) for *six months*. If this financial plan cannot be submitted, the application for self-administration can only be complied with, if the implementation of the project is in the interest of the creditors pursuant to section 270 b (2) InsO.

Similarly, such a financial plan is also required in the context of a pre-insolvency restructuring pursuant to the StaRUG and its section 50 (2) no. 2 StaRUG. If such a financial plan, covering a period of *six months*, is not submitted, a stabilization order pursuant to section 51 StaRUG cannot be obtained.

According to both provisions, a financial plan must be submitted which covers the period of (so far) *six months* and contains a well-founded description of the sources of financing by which the continuation of ordinary business operations (and the coverage of the costs of the proceedings during this period) is to be ensured.

b. Change in the law due to the SanInsKG

In the context of self-administration proceedings pursuant to section 270 a (1) no. 1 InsO and in connection with a restructuring project pursuant to section 50 (2) no. 2 StaRUG, the debtor shall benefit from a reduction of the planning period from *six* to *four months*.

Conclusion/Outlook

The amendments adopted by the German Parliament are to be welcomed in principle. The readjustment of the planning and forecast periods in insolvency law are an appropriate response to the current tense market situation. From the point of view of creditor protection, the extension of the maximum period for filing an application in particular seems justifiable in view of the external market circumstances and also appropriate in view of the high level of complexity involved in drawing up a continuation forecast.

However, the SanInsKG also harbors risks. The aim of the law is to enable companies that are "in essence healthy" to continue operating. However, due to the lack of a causality requirement, it cannot be ruled out that "unhealthy" and unprofitable businesses will benefit at the same time and join the already presumably large number of "zombie companies". This would not only have negative consequences for competition, but would also lead to a (further) postponement of insolvencies. This fear is diminished by the fact that the insolvency ground of over-indebtedness, which is rarely (solely) relevant in this respect, is affected and the existing rules on filing for insolvency remain in force with regard to illiquidity.

The proposed legislation does, however, open up tendencies in the direction of a further artificial postponement of an emerging wave of insolvencies which, in view of the economic situation, can only be delayed but probably not stopped.

For further questions don't hesitate to contact our experts:

Joachim Ponseck, MBA, Lic en droit
joachim.ponseck@bakermckenzie.com

Prof. Dr. Artur M. Swierczok, LL.M., MSt.
artur.swierczok@bakermckenzie.com

Tim Hosgör, LL.B.
tim.hosgoer@bakermckenzie.com

Baker McKenzie Rechtsanwaltsgesellschaft mbH von Rechtsanwälten und Steuerberatern

Berlin
Friedrichstraße 88/Unter den Linden
10117 Berlin
Tel.: +49 30 2 20 02 81 0
Fax: +49 30 2 20 02 81 199

Frankfurt am Main
Bethmannstraße 50-54
60311 Frankfurt am Main
Tel.: +49 69 2 99 08 0
Fax: +49 69 2 99 08 108

Düsseldorf
Neuer Zollhof 2
40221 Düsseldorf
Tel.: +49 211 3 11 16 0
Fax: +49 211 3 11 16 199

München
Theatinerstraße 23
80333 München
Tel.: +49 89 5 52 38 0
Fax: +49 89 5 52 38 199

www.bakermckenzie.com

Get Connected:

This client newsletter is prepared for information purposes only. The information contained therein should not be relied on as legal advice and should, therefore, not be regarded as a substitute for detailed legal advice in the individual case. The advice of a qualified lawyer should always be sought in such cases. In the publishing of this Newsletter, we do not accept any liability in individual cases.

Baker McKenzie Rechtsanwaltsgesellschaft mbH von Rechtsanwälten und Steuerberatern is registered with the Local Court of Frankfurt/Main (registered seat) HRB 123975. It is associated with Baker & McKenzie International, a Verein organized under the laws of Switzerland. Members of Baker & McKenzie International are Baker McKenzie law firms around the world. In common with terminology used in professional service organizations, reference to a "partner" means a professional who is a partner, or equivalent, in such a law firm. Similarly, reference to an "office" means an office of any such law firm.

© Baker McKenzie