New German Legislation on Measures to Combat Effects of Coronavirus

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Firm General and Europe

In order to mitigate the effects of the Corona-pandemic on the ability of enterprises to pay their current liabilities, the German parliament has passed a law today containing a set of measures dealing, inter alia, with (i) the obligation to file for insolvency, (ii) certain liability risks of individual directors and managers in connection with a potential insolvency, (iii) the termination of lease agreements, and (iv) liability and claw-back risks resulting from the provision of new credit in the crisis.

In addition, the German government has set up a protective shield for enterprises financially affected by the crisis, which, in addition to short-time work compensation and tax deferrals, establishes a KfW (the German state development bank) credit program and specific further financial measures under the German Economic Stabilisation Fund.

Obligation to File for Insolvency Suspended until 30 September 2020

The obligation to file for insolvency for affected companies will be waived until 30 September 2020 (the "**Suspension Period**"). The Ministry of Justice will be authorized to extend the Suspension Period until 31 March 2021.

Such suspension does not apply in cases where (i) the insolvency does not result from the effects of the Coronavirus crisis or (ii) there are no prospects for an existing illiquidity to be remedied. Provided that the debtor was not illiquid on 31 December 2019, it is assumed that the insolvency is caused by the effects of the Corona-pandemic and that the existing illiquidity can be remedied. Thus, the debtor's ability to demonstrate and prove that the company was not illiquid as of the test date of 31 December 2019 is crucial.

In addition, insolvency filings initiated by a creditor during the three months period after the new law has become effective require that the company was already insolvent on 1 March 2020.

Implications of the Suspension / Additional Mitigations

a) Personal Liability Risks for Managers/Directors

Under current law, in case of an insolvency, managers/directors face personal liability risks if they continue business operations and carry out payments. It is unclear whether investments planned or initiated by the management before the crisis or required in the normal course of business to maintain business operations are allowed. This uncertainty is a significant problem for managers because taking the wrong decision implies potential personal liability for damages, and even criminal liability.

To address this issue, the new law will provide that any payments made during the Suspension Period in the ordinary course of business, including in connection with a restructuring concept, are deemed to be made under the care of a diligent manager/director. Therefore, managers should have sufficient comfort to steer the business through the crisis.

b) Additional Financial Support during the Crisis

It is evident that, during the crisis, imminent liquidity needs of the companies will require additional short term financing and refinancing sources, which will put additional demands on KfW and the commercial banks or "house banks" of the affected companies.

However, there are several impediments under German law which reduce the willingness of third party creditors or shareholders to provide additional financing to a distressed company:

First, third party creditors face (i) claw-back risks in case of a repayment on loans or collateral granted in a financial crisis and (ii) liability risks if their support is regarded as help to delay an insolvency filing. Second, a shareholder granting a loan to the company in crisis faces the risk of subordination and therefore total loss in case of an insolvency.

Therefore, under the new law, the personal liability of creditors shall be mitigated and the subordination of shareholder loans and the claw back rules shall be suspended as follows:

- Until 30 September 2023, both (i) the repayment of a new loan (or equivalent transactions) granted during the Suspension Period (i.e. until 30 September 2020), and (ii) the provision of collateral to secure such loans during the Suspension Period shall not be deemed to be disadvantageous to creditors.
- Shareholder loans granted during the Suspension Period shall not be subordinated to other creditors in insolvency proceedings that have been filed for by 30 September 2023.
- The granting of a new loan - this also applies to credit prolongations and novations - or collateral during the Suspension Period does not qualify as an improper measure to delay insolvency filings. Although not totally clear from the wording of the new law, this should also apply for waivers and other agreements the company and its creditors agree on during the Suspension Period.
- Legal acts during the Suspension Period which have secured or satisfied (or enabled to secure or satisfy) the other party's claims, shall not be subject to claw-back in subsequent insolvency proceedings, provided the other party was aware that the debtor's restructuring and financing efforts were not capable to remedy an existing illiquidity.

Prohibition to Terminate Lease Agreements

As a further measure to help distressed companies the termination right of the landlord because of rent arrears incurred during the period from 1 April 2020 until 30 June 2020 will be suspended until 30 June 2022. The tenant is required, however, to provide prima facie evidence that the non-payment is caused by the effects of the Coronavirus-pandemic; this can be achieved, e.g. by providing proof of the application for state aid.

State Backed Credit Instruments

a) KfW Credit Program

The KfW special credit program will be available from 23 March 2020 to enterprises facing temporary financing difficulties due to the Coronavirus crisis. In concrete terms, this means that enterprises that were not in difficulties on 31 December 2019 can apply for a loan. It is further required that the company had a solid financial standing, the principal bank or consortium bank was not aware of any payment arrears of more than 30 days, and there were no deferral agreements or breaches of covenant.

The applicant has to prove that it is expected to be fully financed until 31 December 2020 according to current planning, based on the assumption of an overall economic situation returning to normal ("as before the crisis"). There must be a positive going concern forecast for the company, assuming a return to a normal economic environment.

KfW provides the following alternative instruments to facilitate the short-term supply of liquidity to companies which are affected by the current crisis:

(i) KfW entrepreneur loan for enterprises on the market for longer than 5 years:

a) For large enterprises (i.e. with more than 250 employees, more than EUR 50 million turnover, or more than EUR 43 million balance sheet total) KfW assumes the insolvency/credit risk of up to 80% for the on-lending financing partners (usually the regular banks) for investment or working capital loans.

b) For small and medium-sized enterprises (i.e. usually up to 250 employees and up to EUR 50 million turnover) KfW assumes the insolvency/credit risk of up to 90% for the on-lending financing partners (usually the regular banks) for investment or working capital loans.

c) The interest rates vary (i) between 1-1.46% for small and medium-sized enterprises, and (ii) between 2-2.12% for larger enterprises.

d) A simplified risk-assessment applies for loans up to EUR 3 million by the house bank and for credits between EUR 3 million up to EUR 10 million by KfW.

(ii) KfW loans for enterprises on the market for less than 5 years:

Similar instruments are available for enterprises that have been on the market for less than 5 years, or - in case of large enterprises - for more than 3 years.

(iii) KfW Special Program - Syndicated financing from EUR 25 million:

KfW participates in syndicated financing for investments and working capital of medium-sized and large enterprises. KfW assumes up to 80% of the credit risk, but not more than 50% of the risks of the total debt. The financing can be individually structured and tailor-made.

The KfW risk share amounts to at least EUR 25 million and is limited to

- 25% of the annual turnover in 2019, or
- twice the wage costs of 2019, or
- the current financing requirements for the next 12 months.

Optionally, all banks participating in the consortium can be refinanced by KfW.

In order for the house banks/KfW to be able to assess whether the respective enterprises were not facing financial difficulties as of 31 December 2019 the enterprises have to supply their financial statements for 2019, or, if these are not yet available, the financial statements for 2018 supplemented with management accounts for the year 2019.

b) Economic Stabilisation Fund (ESF)

The Economic Stabilisation Fund (ESF) set up by the German government aims to ensure liquidity and the solvency of large enterprises whose existence is of considerable importance for Germany's economy or labour market. It is also applicable for smaller enterprises operating in a critical infrastructure sector. In addition, it is intended to eliminate liquidity bottlenecks, support refinancing on the capital market and, above all, strengthen the capital base of affected companies. The ESF may also invest directly in companies for a limited period. The aim here is to prevent a sell-off of German economic and industrial interests.

The ESF will be able to offer the following support/instruments:

- a guarantee framework of EUR 400 billion to help companies refinance themselves on the capital market (bridging liquidity bottlenecks);
- a EUR 100 billion credit authorisation for direct participations in companies by the German state (recapitalisation via equity or mezzanine instruments); and
- an additional credit authorisation for EUR 100 billion to refinance the KfW special programs.

Enterprises whose liquidation would have a significant negative impact on the economy, technological sovereignty, security of supply, critical infrastructures or the labour market, are generally eligible, provided they meet - during two business years prior to 1 January 2020 at least two of the following three criteria:

- a balance sheet total of more than EUR 43 million,
- more than EUR 50 million in sales revenues, and
- more than 249 employees on an annual average.

Further, companies can only apply for support measures from the ESF if they have no access to other financing sources. In addition, companies applying for a measure must not have been in financial difficulty as of 31 December 2019. Also the stabilisation measures must result in a clear independent going concern perspective once the pandemic has been overcome.

Outlook

The respective laws have been passed by the German parliament this Wednesday (25 March 2020) in an expedited procedure. Due to its state aid aspects, the ESF also requires the approval of the Bundesrat which meets on 27 March 2020 and the EU Commission.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Frankfurt office:

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