



The risk of insolvency at the time of Covid-19 Government measures in Germany and France Finding the right balance between health and economic emergencies

The Covid-19 epidemic will have a significant influence on economies. As such, the governments of France and Germany have adopted provisional measures to limit its effects.

Please find hereafter an analysis of those insolvency measures and, based on a longer-term analysis, recommendations for anticipating potential insolvency proceedings.

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I. Situation in Germany

Besides financial support from the state (short-time working and compensation, tax measures, cash aid etc.), the legislature adopted a federal law on 27th March 2020 containing amendments to civil law, criminal procedure and insolvency proceedings in order to alleviate the economic effects of the Covid-19 epidemic¹.

¹ COVID-19 Insolvency Suspension Act of 27th March 2020, entered into force on 1st March 2020 (Act on the temporary suspension of the obligation to file for insolvency and on the limitation of the liability of executive bodies in the event of insolvency caused by the COVID-19 pandemic), [BGBl. I S. 569 \(Nr. 14\)](#)



I.A. Suspension of the period for making an application for commencement of insolvency proceedings

Any legal person in Germany must apply for the opening of insolvency proceedings within three weeks after the occurrence of a payment-default or over-indebtedness², else it may be held liable and subject to a criminal sanction (§ 15a German Insolvency Code).

As this deadline is very short, the Federal act (COVInsAG) suspended this obligation until 30th September 2020. The three-week period remains applicable however if the payment-default does not result from the Covid-19 epidemic or if there are no chances of remedying the situation.

Furthermore, if the debtor was still solvent on 31st December 2019, it will be assumed that the insolvency is a consequence of the epidemic. We therefore recommend that companies keep evidence that they were solvent and that a positive business continuation report ("positive Fortführungsprognose") existed beforehand.

I.B. Creditor application for commencement of insolvency proceedings against its debtor

The right of a creditor to apply for the initiation of an insolvency proceeding against his debtor will be made more difficult to exert because the COVInsAG act provides that a creditor's application submitted between 28th March and 28th June 2020 will also have to demonstrate that the insolvency event (payment-default or over-indebtedness) already existed on 1st March 2020. De facto, this condition may deprive creditors of the ability to apply for the opening of insolvency proceedings within the period of time set by law.

It is quite possible that the Federal Ministry will extend the suspension of the application period (I.A.) as well as the time limit for the additional obligation on creditors to demonstrate that insolvency existed as of March 2020 (I.B.)¹. However, the extension could not extend beyond March 31st, 2021.

I.C. Consequences of suspension

Suspension of the time limit for making an application has consequences on the validity of various acts of the debtor and the possibility to challenge them:

- In principle, any payment by the debtor of claims existing before the insolvency procedure is prohibited. This prohibition has been made more lenient by the COVInsAG act : payments by the debtor that are made in the normal course of business will be deemed to be consistent with the diligence of a prudent and conscientious manager within the meaning of the German act on limited companies. A manager may not therefore be held liable for such payments.
- In principle, the public receivers may challenge before court acts made before the commencement. Under the COVInsAG act, they are now barred from challenging certain acts carried out prior to the initiation of insolvency proceedings. For instance, the repayment until

² Resp. paragraphs 17 and 19 of the Insolvency Code



30th September 2023 of new loans granted during the standstill period and the provision of guarantees for these loans are not considered detrimental to creditors and therefore may not be challenged.

- the granting of credits and securities/guarantees during the suspension period shall not be considered as unlawful contributions to a wrongful late declaration of insolvency ("Insolvenzverschleppung").
- under the Covid-19 measures, a security granted by a debtor to its creditor cannot be challenged unless the creditor knew that restructuring efforts would not prevent insolvency. The same applies, for example, to the granting of payment facilities, reduction of payment periods, etc., which are not subject to the insolvency law.

Normally, if the debtor has given its creditor a security to which the debtor was entitled and the creditor has knowledge of the debtor's difficulties, this may be open to challenge.

I.D. Consequences and perspectives

These measures enable the debtor not only to avoid the risk of liability arising from a late declaration of insolvency but also to reach agreements (including financial agreements) with its creditors to ensure the survival of its business. The stated objective is in line with France's stated objective of favouring direct negotiations with creditors. The creditors then have the possibility to maintain the commercial relationship with their debtors and thus perhaps also improve their economic situation after the end of the COVID-19 epidemic.

In the current economic environment, companies should anticipate that their own suppliers may only accept to carry out deliveries against payment on receipt. This requirement on the part of suppliers will generate additional requirements on cash flow management.

In addition, a number of measures have been adopted, which also aim at curbing the effects of the epidemic and supporting the economic activity of companies, for example, in the payment of rents and commercial leases, holding general meetings of joint stock companies, etc.:

(a) **No termination of the lease for non-payment of rent following the Covid-19 crisis :**

For leases and commercial leases, termination by the lessor is excluded if it occurs solely due to non-payment of rent during the period from April 1st 2020 to June 30th 2020, provided that the non-payment is a consequence of Covid-19 epidemic. However, the obligation to pay the rent is not suspended! The tenant must provide prima facie evidence showing the link between the epidemic and the non-payment. In any case, the rent due must be paid no later than June 30th 2022. In addition, interest for late payment and possible compensation for damages may be claimed.

b) In 2020, **general meetings of public limited companies** (Aktiengesellschaft - AG) may be held by electronic means of remote communication.

Both creditors and debtors should therefore be aware and make use of the measures created by the legislator.



II. Situation in France

In the ordinance No 2020-341 of 27th March 2020, the government adopted exceptional measures in respect of insolvency proceedings, these measures consisting foremostly in the extension of procedural deadlines (II.A.).³

These measures do not preclude the commencement of insolvency proceedings, including during the health emergency period of time (II.B.).

Anticipation through concrete measures is needed (II.C.).

II.A. The main measures of the ordinance

In short, the ordinance provides for two types of extensions:

- ✓ Automatic extension of several phases during an insolvency procedure: observation phase, the plan implementation, the business continuation phase, the simplified judicial liquidation and the observation period ordered by a Court of Appeal,
- ✓ Optional extension, decided by the judges, of the duration of the safeguard or receivership plans (*sauvegarde ou redressement judiciaire*). In this case, the ordinance does not consider the current state of health emergency as a circumstance justifying an extension of the legal deadline.

In detail, the extensions are as follows:

- ✓ At the beginning and during the insolvency proceedings:
 - Until three months after the end of the health emergency, when assessing whether a business is insolvent, the judge will have to consider the situation of the debtor as of 12th March 2020⁴.
The government's stated approach is here to favour the use of two non-judicial procedures: ad hoc mandate and conciliation. Under both procedures, creditors will potentially have to renegotiate debts that have fallen due.
 - The durations of the observation period, the plan, the continuation of the business operation and the simplified liquidation procedure are extended (also the observation period ordered by a Court of appeal).

³

<https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000041762344astPos=5astReqId=1020583391categorieLien=cidIdAction=rechTexte>

⁴ The report to the President of the Republic states: "This crystallization of situations will enable companies to benefit from preventive measures or procedures even if, after 12 March and during the period corresponding to the health emergency plus three months, they experience a worsening of their situation such that they would then be in payment-defaults. This provision mainly concerns conciliation and safeguard procedures."



The duration of the extension is equivalent to that of the health emergency plus one month, so currently: 3 months from 24th June onwards.

- With regard to the AGS⁵ wage guarantee: the deadlines for the compensation by the AGS of non-paid wages, in particular following a plan of assets sale, or conversion into liquidation, are extended until the expiry of a period of one month after the end of the health emergency and for a duration equivalent to the period of the health emergency plus 1 month.

These provisions are justified by the practical impossibility of meeting the AGS deadlines due to the state of emergency (deadline for terminating contracts in particular). It should be noted, however, that the guarantee thresholds do not appear to have been modified ...⁶

✓ At the stage of implementation of the safeguarding or receivership plan:

- Possibility of extension of safeguard / receivership plans up to five months (duration of the health emergency plus three months). The request for an extension must be made within three months after the end of the health emergency at the latest.
- A longer extension (one year) is possible at the request of the Public Prosecutor's Office or the public receiver. Requests for plan extensions are therefore quite possible after the end of the health emergency.

Government also set up a programme of state-guaranteed loans, aimed at companies for which an insolvency business plan was adopted. However the success of that programme will depend on the willingness of banks to accept the loan applications ...

II.B. Medium-term perspective

1. These interim measures shall not preclude the initiation of insolvency proceedings. To that extent, the period of health emergency could generate cash-flow difficulties.

Several commercial courts have explicitly confirmed that they will be able to adopt insolvency measures during the period of the emergency health state. In this respect, the ordinance provides for the possibility of making written/e-mail applications without a hearing.⁷

The measures / procedures that a court may adopt, or lodge may be summarized as follows:

- confidential measures to prevent difficulties: ad'hoc mandate or conciliation, before the insolvency occurs:
The initiation of conciliation is facilitated as a result of the Ordinance of 27th March. Indeed, while conciliation is in principle only possible before insolvency or less than 45 days after insolvency occurs, during the period of health emergency plus three months

⁵ AGS: wage guarantee insurance association

⁶ <https://www.ags-garantie-salaires.org/actualites/items/covid-19-le-regime-de-garantie-des-salaires-ags-mobilise.html>

⁷ For example, the Commercial Court of Nanterre, which is one of the most important in France: <http://www.greffe-tc-nanterre.fr/actualites/locale/covid-19-judiciaire-lettre-numero-4-464.html>



(23rd March - 24th August 2020), the judge will consider the situation of the business as of 12th March in order to assess whether it is insolvent. Conciliation would then be possible even in the presence of an insolvency if it appeared after March 12th.

- ✓ judiciary proceedings:
 - safeguard procedure in the absence of insolvency of the company. Under this procedure, pre-filing claims (claims existing before the initiation of the insolvency proceeding) may not be settled. It also allows the adoption of a safeguard plan.
 - in the event of an insolvency, the opening of a receivership or judicial liquidation may be considered during the period of health emergency or, more likely, at the end of it. A short reminder here: during the health emergency plus three months, the assessment by the judge as to whether a business is insolvent is frozen on 12th March 2020. Thus, during this period, a receivership or liquidation may not be opened when the insolvency occurred after March 12th (except for fraud).

2. If the measures taken by the Government and the possibility of initiating insolvency proceedings during the period of health emergency are intended to support debtors⁸, the rights of creditors are preserved.

In particular, acts passed between the date of insolvency and the opening of the insolvency proceedings itself can always be annulled if they are fraudulent.

In the future, it cannot be excluded that, if an ad'hoc mandate or a conciliation was not successful or not chosen by the debtor, the latter may then seek the initiation of a judicial safeguard proceeding.⁹

A safeguard-proceeding may be interesting in several regards:

- firstly, the debtor may apply for commencement as soon as difficulties arise, without waiting for insolvency.¹⁰
- secondly, the safeguard entails the prohibition of settlement of claims which existed prior to the initiation of the insolvency proceedings,
- furthermore, the manager is not divested of the management of the company,
- lastly, there is no risk of nullity of pre-filing acts as regards the safeguard procedure. Annulment is indeed possible only in case of insolvency.

The safeguard procedure could therefore become of real interest while it was less used until now.

⁸ Thus the report on the order to the President of the Republic states that "*Setting 12 March 2020 as the date for assessing the state of insolvency can only be in the debtor's interest, which also prevents him from exposing himself to personal sanctions for having declared this state late.*" JORF n°0076 of 28 March 2020,

<https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000041762330&categorieLien=id>

⁹ The debtor in conciliation may request the opening of so-called accelerated safeguard proceedings if it has a sufficiently broad support of its creditors (Art. L.628-1 et seq. of the Commercial Code).

¹⁰ Reminder: during the period of the health emergency plus three months (23rd March – 24th August), the judge will consider the situation of the debtor as of March 12th 2020 when assessing whether it is insolvent.



II.C. Synthesis and anticipatory measures

The government's approach is to ensure that the difficulties related to the health crisis have the least possible impact on the debtors' capacity to turn around.

In this context, companies under a safeguard or receivership plan can benefit from loans guaranteed by the State under certain conditions. Furthermore, the ordinance No. 2020-306 of 25th March 2020 extends all legal deadlines by a maximum of two months and suspends the effects of contract penalty clauses.

There is no doubt, however, that the economic difficulties of companies will last much longer than the health emergency. We hence recommend anticipating these difficulties now and to already take steps, for example the following measures:

- ✓ monitor all late payments and regularly check that no insolvency proceeding has been initiated against your debtors,
- ✓ in the event of the initiation of an insolvency proceeding: declare your claim as soon as possible (receivership, liquidation but also judicial safeguard),
The declaration of claim can be made via a secure online service to which our firm has subscribed. We recommend that you avoid relying on the extension of the legal time limits provided for in the ordinance 2020-306.
- ✓ list all your pledges and various guarantees and make sure they are registered, especially rental contracts for movable property,
- ✓ grant more time for payments during the health emergency and at the very least prepare oneself for negotiations with an officer appointed by court (*mandataire*) or a conciliator. It is important to remain vigilant on both creditor's and debtor's sides: these deferrals of payment must be payable within a reasonable period of time, failing which insolvency proceedings will be opened.

We are at your disposal to anticipate right now the best options to enable effective payments.

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