

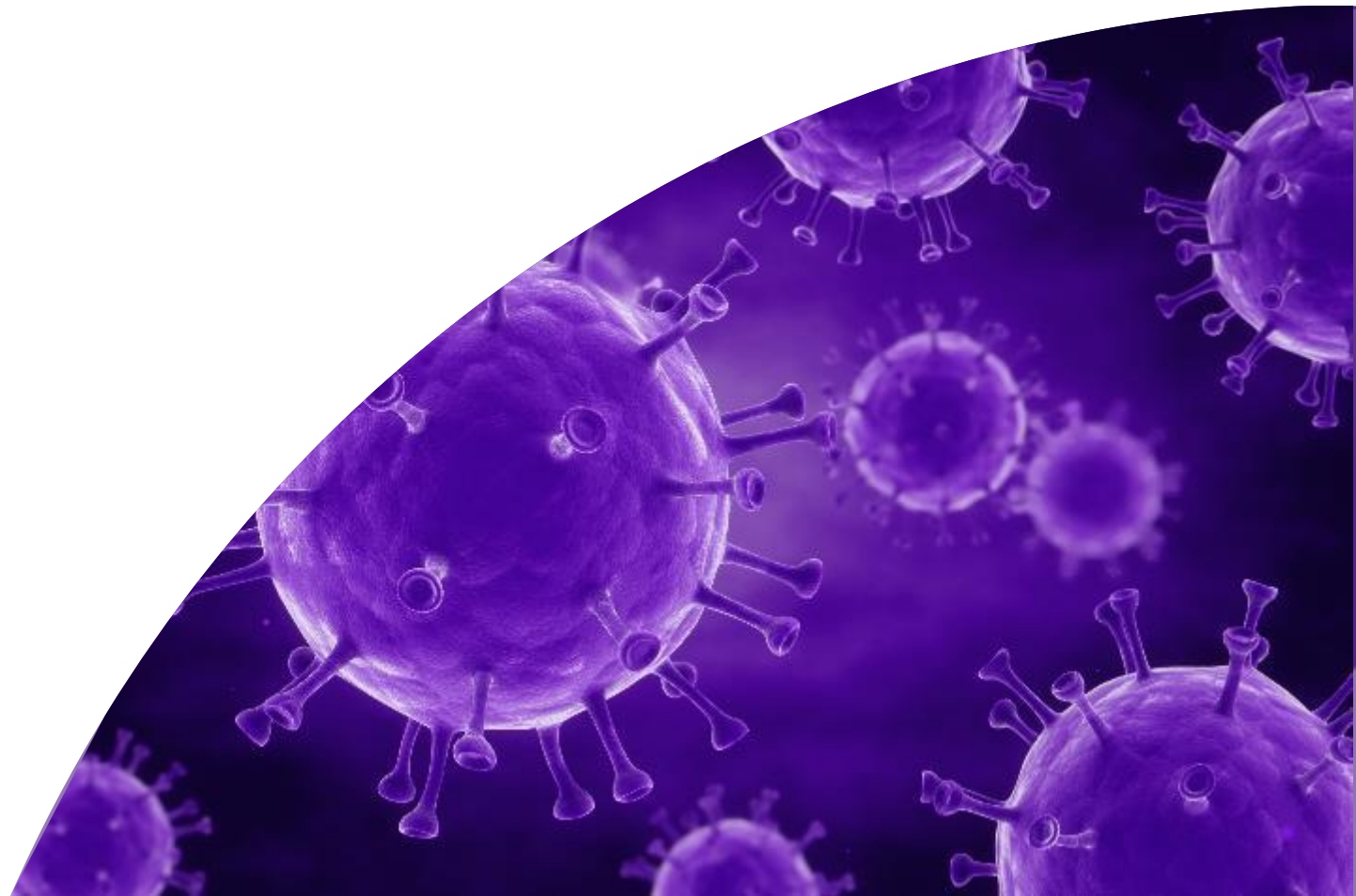


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Legal advice in the light of COVID-19

27 March 2020





A first glance on relevant regulations of the current COVID-19 legislation

„COVID-19 Act“

Act On Mitigating the Consequences of the COVID-19-Pandemic In Civil, Insolvency and Criminal Procedure Law" [Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil,- Insolvenz- und Strafverfahrensrecht"] as of 27/03/2020 (hereinafter referred to as "COVID-19 Act")

On 27 March 2020, the COVID-19 Act entered into force, which is aimed to mitigated the consequences of the COVID-19 pandemic for affected citizens and the economy. It includes special regulations for different areas of the private and the business life; these regulations are only valid for a limited period of time and are implemented to ensure the return to the previous legal situation after the end of this emergency situation.

Suspension of the legal obligation to file for insolvency

I. Legal situation

The COVID-19 pandemic is unfolding a significant negative impact on the business of many companies, which might even lead to insolvency. In case of insolvency, creditors may file a request for the opening of insolvency proceedings (Section 14 Insolvency Statute [Insolvenzverordnung - InsO]), while directors of limited liability companies are obliged to file such request for the opening of insolvency proceedings. If they do not comply with this obligation, they have to expect severe consequences in terms of criminal law and liability. Additional liability risks derive from the provisions concerning liability for payments following illiquidity or over-indebtedness (Section 64 sentence 1 Limited Liability Companies Act [Gesetz betreffend die Gesellschaften mit beschränkter Haftung - GmbHG], Section 92 (2) sentence 1 Stock Corporation Act [Aktiengesetz - AktG], Section 130a (1) sentence 1, also in conjunction with Section 177a sentence 1, German Commercial Code [Handelsgesetzbuch - HGB] and Section 99 sentence 1 Cooperative Act [Genossenschaftsgesetz - GenG]. Also boards of associations are required to file for insolvency if they are insolvent or overindebted (Section 42 (2) German Civil Code [Bürgerliches Gesetzbuch - BGB]).

Furthermore, the current uncertainties make it difficult to prepare reliable forecasts and plans on which loan restructuring could be based. Hence, rehabilitation import credits are associated with liability risks and the risks of avoidance actions, which further reduces the willingness to grant credits.

Shareholders are reluctant to provide funding since their repayment claims would be subordinated in an insolvency by operation of law (so-called "equitable subordination") according to Section 39 para. 1 no. 5 InsO and relating provisions (SectionSection 44a, 135 para. 1 no. 2 InsO).

Suspension of the legal obligation to file for insolvency

Measures for avoiding insolvency, directors and officers liability

Pursuant to Section 15 (1) InsO, where a business becomes illiquid or overindebted, its directors are currently required to file a request for the opening of proceedings at the latest three weeks after the commencement of insolvency or overindebtedness. If the management does not comply with this obligation, it faces a substantial civil and criminal liability regime.

According to Art. 1 section 1 COVID-19 Act, the legal obligation to file for insolvency under Section 15a (1) InsO is suspended **until 30 September 2020** for businesses affected by the COVID-19 pandemic. During the devastating floods in 2002, 2013 and 2016, similar regulations were adopted. The suspension may be adopted under the condition, that the insolvency was caused by the effects of the COVID-19 pandemic.

The obligation shall not be suspended if the insolvency reasons are not related to the COVID-19 pandemic or if there is no prospect of resolving the existing illiquidity, which is to be proven by the authority enforcing the obligation to file for insolvency. It will be assumed that the insolvency reasons are related to the Covid 19-pandemic situation and that there is prospect of resolving the existing illiquidity, unless the business was illiquid on 31 December 2019 already. However, the burden of proof is not affected by the regulation of Section 1 sentence 3. Even if the debtor was illiquid on 31 December 2019, it remains the case that the burden of proof that the illiquidity was not caused by the consequences of the COVID-19 pandemic or that there are not prospects of discharge of their debt is with those relying on the suspension of the legal obligation to file for insolvency.

In order to prevent additional liability claims against the management, the prohibition of payments associated with insolvency pursuant to Section 64 sentence 1 GmbHG, Section 92 (2) sentence 1 AktG, Section 130a (1) sentence 1, also in conjunction with Section 177a sentence 1 HGB and Section 99 sentence 1 GenG is suspended for the period of the suspension of the legal obligation to file for insolvency, insofar as those payments are made in connection with management measures within the normal course of business, including measures for maintaining or resuming the business activities as well as reorganisation of the business itself or the business model.

Suspension of the legal obligation to file for insolvency

Shareholder loans

In addition, new shareholder loans can be granted without the risk of claw-back and lender-liability in order to provide an incentive for granting such loans. Existing business relationships are protected against claw-back to a certain extent to encourage business partners to continue its business with the company.

Assessment and advice

The suspension of the legal obligation to file for insolvency is a reasonable and necessary complement to the announced relief measures for the German economy. However, it will be crucial for the management of affected companies to analyse in detail whether the requirements of the planned amendment are fulfilled, i.e. whether the legal obligation to file for insolvency may be suspended in the individual case, in order to prevent the risk of liability claims against the management due to delay in filing a request for insolvency proceedings. i.e. whether the legal obligation to file for insolvency may be suspended in the individual case, in order to prevent **liability claims against the management** due to delay in filing a request for insolvency proceedings.

In order to prevent future economic disadvantages, we recommend obtaining substantial legal advice with regard to the assessment as to whether new loans may be granted during the crisis.

Companies' crisis management

Problem

The pandemic has led to substantial restrictions directly affecting shareholders' meetings, which constitute the basis for all decisions under company law. The new German legislation includes substantial temporary relief for holding shareholders' meetings in order to ensure that companies keep their ability to make decisions and take action in the current crisis, even if there is no appropriate legal basis for the relevant statutes.

Solution approaches of the legislator

- **Decisions not requiring personal attendance and additional relief for various types of companies, including German stock corporations (AG), German companies limited by shares (KGaA), European public limited-liability company (SE), German mutual insurance companies (VVaG) and the like**
 - Comprehensive relief for online participation and voting by shareholders in shareholders' meetings even if the company's articles of association do not provide for this option and with limited right to challenge any resolution adopted at the meeting
 - Increasing flexibility with regard to timing of shareholders' meetings during the crisis by:
 - Statutory reduction of the time limit (including statutory time limit) for convening shareholders' meetings to a minimum of 21 days
 - Reduction of the period up to the record date for shareholders of listed companies
 - Shareholders' meeting may be held during the financial year (after the expiry of the statutory time limit of eight months)
 - Free professional judgement of the management board in response to questions submitted in writing and by telephone
 - Relaxation of the requirement for interim payment towards the net income to stockholders
- **Resolutions of the shareholders' meeting of German limited liability companies may be taken in text form or in writing even without the consent of all shareholders**

Companies' crisis management

- **Relief for cooperatives, incl.**
 - Convocation of meetings via website; "virtual" decisions of members, management board and supervisory board are made easier
 - Relief for interim payments towards balances at settlement or dividends
 - Application mutatis mutandis to European cooperatives pursuant to Council Regulation (EC) No 1435/2003
- **Relief for associations and foundations, incl.**
 - Ensuring the ability to act through automatic renewal of the term of office of board members
 - Possibility of holding purely virtual or "mixed" general meetings
- **Relief relating to the legal requirements concerning timeliness of the closing balance sheet pursuant to Section 17 (2) sentence 4 UmwG**
 - The legislator extends the maximum term for the closing balance sheet date to 12 months, to be calculated retroactively, for filings in 2020 in order to prevent that restructuring measures required during the crisis cannot be taken solely because the necessary meetings cannot be held within the prescribed time-limit.
 - The companies' ability to act is considered more important than the timeliness of the closing balance sheet.

Practice note

The increased flexibility provided by the legislator to the companies and its bodies to ensure their ability to act and to take decisions in spite of the restrictions imposed by the pandemic is to be appreciated. However, caution should be exercised in practice. The facilitations mentioned above are an incomplete summary of the provisions to be observed, however, restrictions in conjunction with existing regulation remain in force.

Tenancies and leases

Art. 5 section 2 of the COVID-19 Act

- **Exclusion of regular terminations of leases/ terminations for cause due to non-payment of rents in the period from 01/04/2020 to 30/06/2020 even if their payment is due** if the non-payment was **caused** by the effects of the COVID-19 pandemic.
- The tenants'/leaseholders' **obligation to pay the rent as such continues to exist**. The rent is neither deferred nor abated.
- The tenants are **required to demonstrate the connection between the COVID-19 pandemic and non-payment**.
- The restriction on termination is valid until 30/06/2022.

The issues

- If the arrears of payment which arose between 1 April 2020 and 30 June 2020 are not settled until 30 June 2022, it is possible to terminate tenancies/leases due to arrears of payment from 1 July 2022.
- Arrears of payment arising between 1 April 2020 and 30 June 2020 are subject to interest at statutory default interest rate.
- The economic implications are not yet foreseeable and may require additional rent reductions. The Federal Government can extend the limitation of termination rights, by way of a legislative decree, to include those payment arrears that arise in the period from 1 July 2020 to 30 September 2020 at the latest.

Solution approach

Contractual amendments taking into account the current challenges and ensuring the continuation of the tenancies/leases in relation to the agreed term of the lease contract.

Ongoing conStruction projects

Problem

- Shortage of materials and quarantine measures ordered at the building contractor's business
- Threatening contractual penalties in case of delays regarding the agreed periods of completion
- Liquidity problems of the builder-owner
- Threatening termination for cause of construction contracts according to the regulations of the German Civil Code and German Construction Contract Procedures Part B (VOB/B)

Solution approaches

We would recommend negotiating and implementing the necessary amendments to the contract between the parties as soon as possible in order to allow builder-owners to ensure and to plan procedures for the completion of the construction project by the commissioned construction company in case of delays or the actual closure of the construction site and also to enable contractors to perform their duties under agreed contracts.

Lending law

New legal situation for consumer contracts

- Deferment of interest/principal repayment claims of lenders against consumers due between 1 April and 30 June 2020 if the borrower suffers loss of income due to the extraordinary circumstances caused by the COVID-19 pandemic. The due dates of payments to be made in this period will be postponed by three months, e.g. if a payment would be due on 2 May 2020, it would be deferred until the expiry of 1 August 2020 and its due date postponed to 2 August 2020.
- Possibility of amendment of agreements: The contracting parties may explicitly enter into agreements that deviate from the legal deferment regulations, in particular on possible partial payments, adjustments to interest and principal payments or debt rescheduling (paragraph 2). This agreement implementing the payment dates of the loan agreement before the deferral does not constitute a premature fulfilment causing a prepayment penalty according to section 502 German Civil Code [BGB].
- Temporary exclusion of the lender's termination rights on the grounds of late payment and (threatening) significant deterioration in financial circumstances of the borrower according to section 490 BGB.
- Obligation to offer a discussion about the possibility of a mutual agreement (paragraph 4) and extension of the term of the agreement if a mutual agreement is not reached (paragraph 5). The latter means that if a mutual agreement with regard to is not reached with regard to the continuation of the loan agreement for the period after 30 June 2020, the contract will be continued as originally agreed and term of the agreement is extended by three months. The relevant due date of the contractual payments shall be postponed by this period.
- The regulations mentioned above concerning the protection of consumers do not apply if the deferral or the exclusion of the termination right is unreasonable for the lender (paragraph 6; the draft law assumes that, due to the great need for protection of consumers, their interest in a deferral of payment will generally prevail.
- By authorisation to issue regulations, the scope of application may be extended to other borrowers (paragraph 8).

Lending law

Problem: Loan agreements of commercial borrowers

Commercial borrowers may also suffer loss of income due to the extraordinary circumstances caused by the COVID-19 pandemic leading to the impossibility of interest/principal repayments.

Solution approaches

- Contact the lender for a discussion about the possibility of deferring the interest/principal repayments due.
- Contractual amendments concerning termination of the contract, repayment of the deferred amounts, extension of the term of the contract, etc.
- Exploring the scope of possible debt rescheduling or supporting/bridging measures, taking into account and solving the problem of prepayment penalties

Short term work - a brief outline

Requirements for receiving short-time working benefits

- Substantial interruption of the business including loss of wages and salaries, which is temporary and inevitable.
- Company requirements: minimum of one employee
- Personal requirements of affected employees: employment subject to compulsory social security insurance and not subject to grounds for exclusion
- Notification of the Federal Employment Agency [Agentur für Arbeit] and submission of the required request within the prescribed time limit.

Contractual basis required

- Short-time work cannot be imposed unilaterally by the employer, but requires a contractual basis e.g. by provisions under collective law (collective agreements or company agreements) or by agreements included in the contracts on an individual basis. •The company's works council, if any, is to be consulted pursuant to Section 87 German Works Constitution Act [Betriebsverfassungsgesetz - BetrVG].

Short term work - a brief outline

Procedure

Stage 1 ► Notification of the loss of working hours

Note: As a rule, short-time working benefit is only paid starting in the calendar month in which the Federal Employment Agency receives the notification.

Stage 2 ► Application for short-time working benefit

Note: A 3 months' peremptory time limit applies after the end of the calendar month during which the short-time work is performed. Reinstatement of rights [Wiedereinsetzung] is not admissible.

Duration and amount of the short-time working benefit

The short-time working benefit amounts to 60 or 67 percent (for employees with dependent children) of the loss of net earnings calculated on a flat-rate basis.

As a rule, short-time working benefit may only be granted for a maximum of 12 months. If extraordinary circumstances prevail in the employment market, the duration of its payment may be extended to 24 months by statutory rules and orders.

Short-time work - what can be expected from the legislative amendments

- A company may file for short-time work if at least 10 % of the employees are affected by the loss of working time. Previously, this threshold amounted to 30% of the workforce.
- **Complete or partial waiver to build-up negative working time balances before paying the short-time working benefit** shall be possible. Under currently applicable law, companies with agreements on flexible working times and annualised hours are required to use such agreements to avoid short-time work and to build up negative time balances on working time accounts.
- The new regulations permit that short-time working benefits are also paid to **temporary workers**.
- The social security contributions that employers normally have to pay for their employees (in relation to short-time work benefits) will be fully reimbursed in the future by the Federal Employment Office.

Securing entrepreneurial freedom of decision

Problem

- Businesses must always be able to act and often make decisions quickly and without bureaucracy. For this purpose, all shareholders (and/or directors) must be capable of contracting and contactable. Due to an outbreak of the COVID-19 illness, however, the management may be temporarily incapable of acting and contracting and hence an entire business may be paralysed for a certain time.
- The appointment of an emergency management or of a guardian, as may be required by law, is not always appropriate in the circumstances or desirable. This would mean that third parties would be involved in your business and prevent quick decisions.

Solution approaches

- We recommend issuing a business lasting power of attorney which is custom-tailored to your business needs in conformity with the articles of association.
- Without an appropriate power of attorney neither your spouse nor other family members would have power of representation also in your personal sphere. They would not be appointed as guardians automatically. Therefore, a personal lasting power of attorney is also inevitable here.



What can we do?

Present and future



Suspension of the legal obligation to file for insolvency / directors and officers liability

Questions directors of a distressed business should ask themselves

- How can I avoid personal liability in a distressed business?
- What steps do I have to take for the distressed business?
- What action is required if due invoices cannot be paid from the liquid funds?
- How much flexibility do I have for paying due invoices at a later point in time?
- Can I suspend interest and principal repayments to the bank under loan agreements?
- Do I have to worry that the bank will terminate the loan agreement due to the adversely affected assets of the business and liquidate the security interests in collateral?
- Will the bank rely on the personal guarantee due to the distressed business and have recourse to me personally?
- Will I have to sell my home/my assets due to the distressed business?
- What is my risk if I grant a shareholder loan to the distressed business?
- Does my business have a reliable liquidity plan?



Tax structuring and planning/business structuring

Have you ever considered ...

- ... consolidating your business or company group and prepare the corporate structure for the time after the distress?
- ... using the distress as a starting point for implementing succession regulations in your articles of association or to double-check the succession regulations in place – also in terms of tax law?
- ... ensuring the capability of your business to act by commercial powers of attorney, lasting power of attorney and will?
- ... double-checking succession regulations in the articles of association and to put them in sync with the regulations in the will?
- ... optimising your company group also in relation to liability issues and securing special asset groups, if any (e.g. real estate)?
- ... implementing the planned statutory moratorium in particular in order to make it easier to hold general meetings and shareholders' meetings and to postpone liquidity outflows for tax purposes?



Contract law and distressed M&A

What are your legal options ...

- ... in relation to your current company loan agreements and the related agreements with the lenders? Can your bank withdraw an existing financing commitment due to the COVID-19 pandemic and refuse your drawdown of the loan, e.g. for financing a purchase?
- ... if you are no longer able to meet your loan commitments easily?
- ... if you can no longer render to contractually owed services to your customers due to the COVID-19 pandemic?
Is there a risk that damages will be claimed or contractual penalties will be incurred?
- ... if your suppliers cease their services in whole or in part?
- ... if you wish or have to make general contractual amendments with your contract and business partners due to the COVID-19 pandemic and the related consequences?
- ... if you consider getting rid of business lines or participating interests in the short or medium term –
in particular in the aftermath of the COVID-19 pandemic?



Rental/lease law

Do you need answers to questions, e.g.:

- Which standard must be applied to the evidence provided to demonstrate the connection between the COVID-19 pandemic and non-payment of rents/leases?
- May the landlord/lessor still realise the rental collateral (e.g. cash rent deposits, guarantees and letters of comfort) or claim the landlord's lien due to payment arrears?
- Are arrears of payment arising between 1 April 2020 and 30 June 2020 subject to interest at the statutory default interest rate?
- What possibilities exist with regard to contractual amendments ensuring the continuation of the tenancies/leases and therefor protecting the economic basis of both parties under consideration of the parties' interests?



Labour law

What employers should ask themselves:

- As an employer, can I dismiss employees due to financial reasons?
- When does compulsory redundancy come into consideration?
- What do I have to bear in mind when introducing short-time work?
- As an employer, do I have to tell my employees to take their leave first before I can apply for short-time working benefit?
- As an employer, can I place my employees on mandatory leave?
- Do I have to take into account benefits in kind, if any, in connection with the short-time working benefit?
- The business closes temporarily. Do I have to continue to pay salary?
- An employee was quarantined. Does he still get a salary?
- How can I as an employer minimise my economic risk?
- As an employee, am I required to inform my employer if I contracted the virus?
- Are there any privileges that apply to social security contributions?

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