



# Germany: The Act on the mitigation of the consequences of the Covid-19 pandemic in the areas of insolvency, civil and criminal procedure law

- Main points of interest and preliminary analysis -

Just a few days after a first draft bill was prepared by the German federal government, on 25 March 2020, the German federal parliament (*Bundestag*) passed the **Act on the mitigation of the consequences of the Covid-19 pandemic in the areas of civil, insolvency and criminal procedure law** (the Mitigation Act). On 27 March 2020, the Mitigation Act was adopted by the federal council (*Bundesrat*) and published on the same day in the federal law gazette. This allowed the Mitigation Act to already come into force on 28 March 2020.

The enactment of this new legislation is one of several measures the German government has been working on in order to mitigate the effects of the SARS-CoV-2-Virus outbreak (the Covid-19 pandemic). One of the most significant of these measures, apart from the Mitigation Act, being the emergency relief packages for businesses such as direct grants, subsidised lending, tax breaks and capital/equity injections which have been included in the Economic Stabilisation Fund Act (*Wirtschaftsstabilisierungsfondsgesetz / WStFG*), which came into force on the same day. Presumably, there will be further legislation over the next days and weeks, adapting to the developing needs of both the citizens and the economy in the exceptional situation created by the Covid-19 pandemic.

## I. Overview

The Mitigation Act covers four distinct areas:

- suspension of the obligation to file for insolvency, corresponding limitation of management's liability for allowing affected companies to continue to do business, the removal of legal impediments regarding doing business with and providing financing to, affected companies;

- simplification of the decision-making process for companies (most notably AGMs), associations, trusts and cooperatives;
- moratorium on contractual obligations of consumers and microenterprises regarding continuing obligations under certain long-term agreements, prolongation of debt service under certain consumer loan agreements as well as a prohibition on the termination of real estate lease agreements to avoid undue hardship; and
- trial suspension flexibility in criminal law procedural rules.

## 1. Insolvency law

The aim of the amendments to the existing regime is to enable companies that have either become insolvent or are facing financial difficulty as a result of the Covid-19 pandemic, to continue business operations. In order to achieve this, the Mitigation Act includes a comprehensive suspension of the obligation to file for insolvency until 30 September 2020 and includes a number of additional measures which shall (i) ensure that management can continue to run the business in the ordinary course, (ii) remove legal impediments in connection with the provision of new financing in a crisis and (iii) generally reduce clawback risks for contractual counterparties.

## 2. Corporate law

The Covid-19 pandemic has led to extensive restrictions on the public and private gathering of people, which also curtailed the ability of companies to hold (shareholder) meetings and pass resolutions. Given the importance of these resolutions for the shareholders (eg on the distribution of dividends) and – especially in light of the current situation – the company itself (eg on capital

measures or restructurings), the main objective of the Mitigation Act regarding corporate law is to enable companies to efficiently convene meetings and adopt resolutions without the physical presence of shareholders.

### 3. Civil law

The amendments to the Introductory Code to the German Civil Code aim to mitigate the loss of income and its potential negative consequences, in particular for consumers and microenterprises (as defined in Recommendation 2003/361/EC, ie enterprises which employ fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed €2 million).

The Mitigation Act establishes a right for consumers and microenterprises to refuse performance of continuing obligations under certain long-term agreements. This refusal right, which applies until 30 June 2020, is intended to safeguard (i) the consumer's adequate subsistence and (ii) the economic base of microenterprises by means of a moratorium. Regarding real estate leases, the Mitigation Act seeks to address the fear that tenants may not be able to pay rent when due. Under certain circumstances, landlords are prohibited from terminating real estate lease agreements even if the rent is not paid. To address the concern that consumers may face difficulties in repaying loans and paying loan instalments and interest when due, the Mitigation Act introduces a prolongation of debt service under certain consumer loan agreements. Whilst the provisions regarding continuing obligations under certain long-term agreements only apply to consumers and microenterprises, and the provisions regarding loan agreements only apply to consumers, all private individuals, entrepreneurs, companies and other legal entities shall benefit from the proposed protection with regard to the lease of real estate.

### 4. Criminal procedure law

The Mitigation Act amends the existing criminal procedure rules to allow criminal trials – which have to be interrupted because of the Covid-19 pandemic – to not have to re-start again once the restrictions have been lifted.

## II. Salient points of the Mitigation Act

The Mitigation Act does not introduce new wording or amend the existing wording of the relevant legislative codes but rather contains six articles which selectively (and temporarily) modify certain provisions of the mentioned codes.

## 1. Insolvency law: Temporary suspension of the obligation to file for insolvency

The amendments contained in the so-called Covid-19 Insolvency Suspension Act (COVInsAG) include (i) an amendment to the strict liability regime applicable to management regarding payments effected after the occurrence of either a cash flow insolvency or a balance sheet insolvency, (ii) liability, clawback and other exemptions regarding new financing arrangements and collateral, including an exception from the general rule that shareholder loans are subordinated in a subsequent insolvency of the subsidiary, and (iii) clawback exemptions to prevent contractual counterparties from discontinuing trading or terminating contractual relationships. These provisions apply from enactment with retroactive effect to 1 March 2020.

### § 1 Suspension of the obligation to file for insolvency

The obligation to file for insolvency pursuant to sec 15a of the German Insolvency Code (InsO) and sec 42 para 2 of the German Civil Code (BGB) is suspended until 30 September 2020. The suspension shall not apply to insolvency not caused by the effects of the Covid-19 pandemic or if there exist no prospects to remedy an existing cash flow insolvency (*Zahlungsunfähigkeit*). If the debtor was not cash flow insolvent as at 31 December 2019, there is a presumption of law that the insolvency is caused by the effects of the Covid-19 pandemic and that there exist prospects of remedying an existing cash flow insolvency. If the debtor is a private individual, in the period between 1 March 2020 and 30 September 2020 a discharge of such private individual's residual debt cannot be rejected on the grounds that the opening of the insolvency proceedings was delayed; this exemption does not apply if the insolvency was not caused by the Covid-19 pandemic. However, there is a presumption by law that if the debtor was not insolvent as at 31 December 2020, the insolvency was caused by the Covid-19 pandemic.

### § 2 Consequences of the suspension

(1) Insofar as the obligation to file for insolvency is suspended pursuant to § 1,

1. payments that are made in the ordinary course of business, in particular payments that are made to maintain or resume business operations or to implement a restructuring concept, are deemed to be carried out with the due care of a prudent director within the meaning of sec 64 sentence 2 of the German Limited Liability Companies Act (GmbHG), sec 92 para 2 sentence 2 of the German Stock Corporation Act (AktG), sec 130a para 1 sentence 2, also in connection with sec 177a sentence 1 of the German Commercial Code (HGB) and sec 99 sentence 2 of the German Cooperative Societies Act (GenG);

2. the repayment until 30 September 2023 of a new loan granted during the suspension period, and the granting of security in respect of such loans during the suspension period are deemed not to disadvantage creditors; this also applies to the repayment of shareholder loans and payments in respect of claims arising from legal acts that correspond economically to such a loan, but not to any security granted in respect of such loans or claims; sec 39 para 1 no 5 and sec 44a of the Insolvency Code do not apply in respect of insolvency proceedings relating to the debtor's assets that were applied for by 30 September 2023;

3. the granting of credit and the taking of security/collateral during the suspension period is not to be regarded as being contrary to public policy (*sittenwidrig*);

4. legal acts which have granted or enabled the other party security/collateral or satisfaction, to which such other party was entitled to in such form and at such time are not subject to clawback rights; this does not apply if the other party was aware that the debtor's restructuring and financing efforts were not suitable to remedy an existing cash flow insolvency (*Zahlungsunfähigkeit*). Sentence 1 applies accordingly to:

- performance instead of or on account of performance (*Leistung an Erfüllung statt oder erfüllungshalber*);
- payments by a third party at the behest of the debtor;
- the granting of a security other than the security originally agreed, if such security is not more valuable;
- the shortening of payment terms; and
- the granting of accommodations for payment.

(2) Paragraph 1 no 2, 3 and 4 also applies to companies that are not under an obligation to file for insolvency as well as to debtors that are neither cash flow insolvent (*zahlungsunfähig*) nor over-indebted (*überschuldet*).

(3) Paragraph 1 no 2 and 3 also applies to loans granted by the German Kreditanstalt für Wiederaufbau (KfW) and its financing partners or granted by other institutions acting under governmental assistance programmes in connection with the Covid-19 pandemic; this also applies if the loan is granted or security for the loan is provided after the suspension period has terminated, and will apply without time limitation for the repayment.

### § 3 Opening of proceedings based on the application of a creditor

In case of applications for the opening of insolvency proceedings filed by creditors between 28 March 2020 and 28 June 2020, the opening of insolvency proceedings requires that the reason for the opening of insolvency proceedings already existed on 1 March 2020.

### § 4 Authorisation to issue regulations

The Federal Ministry of Justice and for Consumer Protection is empowered to extend the suspension of the

obligation to file for insolvency pursuant to § 1 subpara 1 and the provision on the reason for opening insolvency proceedings in case of applications filed by creditors pursuant to § 3 until 31 March 2021 by way of a regulation (*Rechtsverordnung*) without the consent of the federal council (*Bundesrat*), if this is necessary (*geboten*) due to ongoing demand for available public aid, ongoing funding difficulties or other circumstances.

## 2. Corporate law: Measures to simplify the decision-making processes in corporate law, the laws of associations and of cooperatives as well as residential property law

### § 1 Stock corporations (Aktiengesellschaften); partnerships limited by shares (KGaA); European Companies (SE); mutual insurance associations

Pursuant to the Mitigation Act, the management board can decide that the (annual or extraordinary) general meeting (AGM) is held virtually by means of electronic visual and audio transmission, even if this not provided for in the articles of association (see sec 118 para 1 sentence 2 German Stock Corporations Act), that shareholders participate and vote virtually/electronically and that members of the supervisory board participate by means of audio or video conference. Furthermore, the management board is free to decide that the AGM is entirely conducted in virtual format, ie

- without any physical presence of shareholders, provided that the following prerequisites are met:
- the entire AGM is transmitted electronically in sound and vision (ie via the internet);
- shareholders can vote and grant powers of attorney electronically;
- shareholders can ask questions by means of electronic communication;
- the voting shareholders are given the necessary means to contest resolutions of the AGM without being physically present (according to sec 245 para 1 German Stock Corporations Act physical presence used to be a requirement).

It is at the management board's due and free discretion (*nach pflichtgemäßem, freiem Ermessen*) to determine whether and in what form shareholders' questions regarding agenda items of the AGM are to be submitted and answered. The management board is also allowed to determine that such questions must be submitted electronically at the latest two days prior to the AGM. In addition, the supervisory board is not obliged to answer all questions but may select questions in the proper exercise of discretion. This facilitates the process in considerable measure in comparison to the general right to ask questions (see sec 131 German Stock Corporations Act). Furthermore, the shareholders' right to submit motions

during a virtual AGM can be restricted.

The convocation period of AGMs is reduced to 21 days (and other related periods are shortened accordingly) and the current requirement for companies to convene their AGM within eight months of their business year (see sec 175 para 1 sentence 2 German Stock Corporations Act) – ending for most companies on 31 August 2020 – is extended to 12 months (ie 31 December 2020). The latter does not apply, however, to European Companies (SE).

The management board can further decide to make an interim payment out of the prospective balance sheet profit (see sec 59 German Stock Corporations Act) for the last fiscal year even if this is not provided for in its articles. The same applies for an advance payment of compensations (see sec 304 German Stock Corporations Act) to external shareholders on the grounds of inter-company agreements.

All of the above decisions require consent of the supervisory board and can also be done in writing, by telephone or via similar channels of communication.

Shareholders' rights to contest AGM resolutions based on certain formalities, including the convocation in electronic/virtual format (referred to above), are limited; they can only be based on intentional violations.

§ 1 of the law also applies to partnerships limited by shares (KGaA) and – except for the extension of the convocation period to 12 months – European Companies (SE). AGMs of European Companies still must be convened within six months of their fiscal year pursuant to the requirements of European law (art 54 para 1 SE Regulation). Most of these provisions apply also to mutual insurance associations.

## § 2 Limited liability companies

Regarding limited liability companies (*GmbH*), the Mitigation Act provides that resolutions of shareholders can also be taken in written form or by voting in writing without a physical meeting, even if not all shareholders agree with such procedure.

## § 3 Cooperatives (Genossenschaften)

The Mitigation Act further includes various mitigation measures with respect to cooperatives (*Genossenschaften*). In particular, similar to the rules applying to stock corporations (*AG*), partnerships limited by shares (*KGaA*), European Companies (*SE*) and mutual insurance associations, the Mitigation Act also provides that members of cooperatives can take their resolutions in writing or electronically, irrespective of whether this is permitted under the articles of association. The law also provides that the annual financial statements can be approved by the supervisory board instead of the members' assembly. Management and supervisory board members can remain in office even beyond the original term of their nomination

until dismissal or election of a successor. The law further allows for the actual number of board members to fall short of the prescribed minimum number of members for the relevant boards. Resolutions of the members' assembly taken in writing or electronically cannot be challenged on the grounds of a breach of law or membership rights caused by technical malfunctions – except for intent or gross negligence.

## § 4 Transformation Law (Umwandlungsrecht)

For measures under the German Transformation Act (*Umwandlungsgesetz*) such as mergers and demergers, the Mitigation Act provides that these may be registered and thereby become effective, if the balance sheet – which the transformation measure is based upon – relates to a date within the last 12 months (instead of the previous eight months).

## § 5 Associations (Vereine) and foundations (Stiftungen)

Regarding associations (*Vereine*) under German civil law and foundations (*Stiftungen*), the Mitigation Act provides that members of the executive board can remain in office even beyond the original term of their nomination until dismissal or election of a successor. Even without an express authorisation under the articles of association, the board can allow members to participate and use their rights in a general meeting virtually, as well as to cast any votes for a general meeting in advance in writing. Finally, the requirements for resolutions outside of a general meeting are loosened. While all members must be involved, only half of the members need to cast their votes and the relevant majority has to be reached.

## § 6 Homeowners' Associations (Wohnungseigentümergeinschaften)

Regarding German homeowners' associations (*Wohnungseigentümergeinschaften*), the law provides that the last appointed administrator can remain in office until dismissal or election of a new administrator, and that the last budget plan (*Wirtschaftsplan*) will also remain valid and in place until a new plan is resolved upon.

## § 7 Transitional provisions / § 8 Authorisation to issue regulations

§§ 1 to 5 only apply to actions and events (ie AGMs or other meetings, payments of interim dividends paid, commercial register filings) taking place in 2020. The Ministry of Justice and for Consumer Protection may – with consent of the German federal council – extend this period until 31 December 2021 if deemed necessary in light of the Covid-19 pandemic.

### **3. Civil law: Moratorium on certain contractual obligations, restrictions for the termination of real estate lease agreements and postponement of repayment of consumer loans**

Several provisions were added to the Introductory Code to the German Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch, EGBGB*) in a new article 240 which entered into force on 1 April 2020.

#### **§ 1 Moratorium**

A consumer who is a debtor of an obligation arising out of or in connection with a 'material' long-term agreement which was entered into prior to 8 March 2020 may refuse performance of his/her obligations under such agreement until 30 June 2020. This is only permissible if – due to circumstances that are created by the Covid-19 pandemic – the debtor cannot fulfil the obligation without putting his/her adequate subsistence at risk, or that of his/her dependents. A microenterprise (as defined in Recommendation 2003/361/EC) may refuse to fulfil an obligation arising from a 'material' long-term agreement which was entered into before 8 March 2020, if – due to circumstances that are created by the Covid-19 pandemic – it cannot discharge the obligation or the fulfilment of the obligation would endanger the economic base of its business. The respective obligation then, however, needs to be fulfilled after 30 June 2020, and does not fall away indefinitely ('moratorium'). In both cases the moratorium only applies to 'material' long-term agreements, ie agreements which – in case of consumers – are necessary to obtain an 'appropriate' level of services of general interest, or – in case of microenterprises – are necessary to obtain services required for the 'appropriate' continuation of the business.

The moratorium applies irrespective of whether the obligation of the debtor is to pay the contractual remuneration (ie money) or to render any other contractual performance (eg to deliver goods or services). It does not only apply to primary claims against the debtor, but also to contractual or statutory secondary claims, such as claims for restitution, damages and reimbursement of expenses. For the duration of the moratorium, no payment will be due and, consequently, no interest for late payment accrues during the period in which the prerequisites for a moratorium have been met. Debtors bear the burden of proof that discharging the obligation (i) would endanger their adequate subsistence (consumers) or (ii) is impossible or would endanger the economic base of their business (microenterprises).

An exception applies where the refusal to fulfil the debtor's obligation would cause undue hardship for the creditor, whereby essentially the same rules apply as regarding to the debtor's right to refuse fulfilment. If the debtor's refusal right is excluded because it would result in an undue hardship for the creditor, the debtor may, to

avoid its obligation to perform, terminate the contract (*kündigen*). Such termination does, however, apparently not trigger any early termination fees or similar compensation payments for the debtor.

This moratorium and its related provisions do not apply to real estate lease agreements and loan agreements (for which a special protection scheme applies, see §§ 2 and 3 of the provisions) or to employment-related claims.

#### **§ 2 Restriction for the termination of real estate lease agreements**

Landlords may not terminate real estate lease agreements, if the tenant (whether consumer, microenterprise or other business) fails to make rental payments during the period of 1 April 2020 through 30 June 2020, when due. This will only be the case where such failure is caused by the effects of the Covid-19 pandemic. The tenant bears the burden of proof to show that its failure to pay on is caused by the effects of the Covid-19 pandemic. The unpaid rent must be paid by 30 June 2022 at the latest. This applies to both ordinary real estate leases (*Mietverträge*) as well as long-term leases (*Pachtverträge*).

#### **§ 3 Possibility to postpone repayment of consumer loan agreements**

For consumer loan agreements which were entered into prior to 15 March 2020, claims for repayment of capital as well as payment of interest falling due between 1 April 2020 and 30 June 2020 are postponed by three months from the respective due date, if the borrower suffers a decrease in income due to the extraordinary circumstances caused by the Covid-19 pandemic. This form of relief shall only be available in circumstances where the fulfilment of the relevant obligation would lead to undue hardship for the borrower, specifically in cases where the borrower's adequate subsistence (including his/her dependants' adequate subsistence) is endangered. Lenders' termination rights arising out of (i) default in payment, (ii) a substantial deterioration in the borrower's financial situation or (iii) of the intrinsic value of the securities/collateral furnished for the loan are excluded until the postponement period terminates. The lender shall offer the consumer the possibility to discuss potential options for a mutually agreed solution and possible ways to support the borrower. If the lender and borrower cannot agree on an arrangement for the time period after 30 June 2020, the term of the original agreement will be extended by three months.

The relief for the borrower shall not apply if the lender can show that the postponement of the payment(s) or the exclusion of the termination right would result in undue hardship for the lender, taking into account all the relevant circumstances.

### § 3 subpara 8 / § 4 Extension possibility

Subject to the consent of the German federal parliament (*Bundestag*), the government can extend the application of the measures regarding consumer loan agreements (§ 3) to other persons and/or entities (including, in particular, to microenterprises). In addition (and without the consent of the federal council (*Bundesrat*)), the government may extend (i) the moratorium until 30 September 2020, (ii) the prohibition on termination for real estate lease agreements to unpaid rent relating to the period between 1 July 2020 and 30 September 2020, and (iii) the three months' debt service suspension regarding claims for payment of principal and interest under consumer loan agreements to claims which become due until 30 September 2020, and the extension of the loan term to up to 12 months.

### 4. Criminal Procedure: Extension of time between two trial dates

Previously, German criminal procedure law dictated that a criminal trial, once commenced, could not be interrupted for an extended period of time (maximum between three weeks and one month, with some further extensions in special circumstances). If any interruption extended beyond this time limit, the trial had to re-start, with all the evidence taken becoming null and void.

The new law extends the maximum time between consecutive main hearings in criminal cases to a total of three months and 10 days. The statute shall be revoked after one year.

The prerequisite for the extension under the Mitigation Act is that the next main hearing appointment cannot be held sooner due to the Covid-19 pandemic. This is the case, for example, if the trial involves individuals at heightened risk (such as the elderly and people with pre-existing health conditions) or if the respective court's ordinary business is restricted due to the measures to contain the virus. The latter should be the case for practically every German criminal court already as of the date of entry into force of the Mitigation Act – and therefore allow every case on trial today in Germany to be interrupted for three months and 10 days (the principle of urgency, especially in cases involving arrest, allowing).

## III. Initial observations

### 1. Insolvency law

The amendments aim to enable companies that have become insolvent or are facing financial difficulty as a

result of the Covid-19 pandemic to continue their business operations and to access financing.

### Suspension of insolvency filing obligation

By way of the comprehensive suspension of the statutory filing obligation after the occurrence of balance sheet insolvency (*Überschuldung*) and cash flow insolvency (*Zahlungsunfähigkeit*), businesses shall be afforded the necessary time and space to be able to access any form of the state-backed funding programmes or to avert insolvency by any other means. According to the legislator, any negative effects resulting from this for the cohort of creditors in a potential follow-on insolvency have to be accepted 'to avoid the breakdown of entire economic sectors as the result of a lack of access to new loan agreements or especially difficult conditions for continuing business'. The suspension does not apply if insolvency is not caused by the Covid-19 pandemic or if there exist no prospects that cash flow insolvency can be remedied. The far-reaching statutory presumption that insolvency has been caused by the effects of the Covid-19 pandemic and that there are chances to remedy an existing cash flow insolvency (if the debtor was not cash flow insolvent as at 31 December 2019), seeks to compensate for the obvious uncertainties and takes significant burden off the directors in assessing whether or not the filing obligation is suspended.

### Effects of suspension

§ 2 no 1 COVInsAG is meant to enable directors to continue to run the company in the ordinary course. As a matter of German law, after the occurrence of balance-sheet insolvency (*Überschuldung*) and cash flow insolvency (*Zahlungsunfähigkeit*), management is under an obligation to apply a so-called emergency management with the effect that it may only make such payments which are absolutely necessary to avoid an immediate break-down of the business. The Mitigation Act allows management to make any payments in the ordinary course of business. This does not only include payments to maintain or resume business operations but also payments required to implement a restructuring.

§ 2 no 2 and 3 COVInsAG aim to encourage and facilitate to provision of new financing to companies affected by the Covid-19 pandemic.

Pursuant to § 2 no 2 COVInsAG any repayments until 30 September 2023 of new loans (including trade credit) granted during the suspension period and the granting of security in respect of such new loans shall be exempted from insolvency clawback in subsequent insolvency proceedings concerning the debtor. The Mitigation Act also provides for incentives for shareholders to provide funding to struggling subsidiaries. Contrary to German insolvency law as applicable hitherto, new shareholder loans granted within the suspension period are not subordinated in a

subsequent insolvency of the subsidiary (applied for until 30 September 2023) and any repayments on such shareholder loans are also exempted from clawback. However, contrary to third party loans, any security granted in favour of shareholder loans is not privileged so that they remain subject to clawback with a look-back period of 10 years from the date of the filing for the opening of insolvency proceedings.

§ 2 no 3 COVInsAG significantly increases the legal certainty for loans extended to a company in a financial crisis. Previously, as a matter of German law, a lender that had extended a loan or other form of credit to a distressed company would have been exposed to liability risks if such loan or credit were insufficient to achieve a turnaround, only delayed an inevitable insolvency and therefore inflicted harm on other creditors. Any security granted in respect of such loan or credit could be regarded contrary to public policy (*sittenwidrig*) and therefore void. The new provision affords comfort in respect of any new loans or credit granted during the suspension period.

All loans granted by the German Kreditanstalt für Wiederaufbau (KfW), its financing partners or other institutions acting within the assistance programmes triggered by the Covid-19 pandemic are protected in the same way, and the new law even extends such protection to state-supported loan agreements which will be granted or covered after the suspension period in order to include all public financial support being granted for the prevention of financial difficulties caused by the Covid-19 pandemic.

Finally, in addition to the clawback protection for loans and security under § 2 no 2, § 2 no 4 COVInsAG affords protection against insolvency clawback for other counterparties such as, eg, suppliers, customers and lessors. Without such protection, based on the clawback provisions which were applicable hitherto, contractual counterparties would run a significant risk that payments, deliveries, etc are clawed back in a subsequent insolvency and they would therefore most likely discontinue trading or terminate the contractual relationship. The first sentence of number 4 contains a privilege for congruent coverage (*kongruente Deckung*), ie where the counterparty was specifically entitled to performance or security in the form and at the time. Sentence 2 contains a privilege for selected forms of incongruent coverage (*inkongruente Deckung*), ie where performance or the granting of security deviates from what is owed contractually or otherwise. The clawback exemptions do not apply if the counterparty had knowledge that the restructuring or financing efforts of the debtor were not suitable to remedy an existing cash flow insolvency (*Zahlungsunfähigkeit*) which may, depending on the circumstances, give rise to some uncertainty.

## 2. Measures to simplify decision-making in corporate law

The Mitigation Act offers a viable path for corporations to convene their respective meetings and pass all relevant resolutions in the face of curfews and bans on assembly.

While the previously applicable provisions of the German Stock Corporations Act already allowed the broadcasting of AGMs and electronic shareholder participation (if this was provided for in the articles of association), companies hardly made use of this possibility due to the technical difficulties and related uncertainties – especially regarding shareholder’s action for annulment. The partial exclusion of actions for annulment will most likely provide some comfort in this regard.

The introduction of an entirely virtual AGM is a novelty that was already discussed in previous years but ultimately rejected by the legislator as the shareholders’ right to be physically present during the AGM seemed too important to be abolished. Given the current circumstances this abolition is reasonable, however, it remains to be seen if and how fast companies are able to establish the electronic prerequisites (especially the rights to ask questions electronically) in order to comply with new provisions. In addition, the voting guidelines of some proxy advisers have been reluctant to support fully virtual AGMs in the past – however, given the current situation it is fair to assume that these guidelines will be amended accordingly in the weeks to come.

Regarding the right of shareholders to ask questions during an AGM, experience with digital media may suggest that both the absolute number of questions and the number of unjustified or inadmissible questions may increase ‘from a safe distance’. In this respect, the clear statement of the legislator in the draft reasoning, whereby the management does not need to answer all questions but can summarize multiple replies and select meaningful questions in the interest of all shareholders, deserves support. The right of the managing board to set a two days’ deadline for the submission of questions before an AGM can also considerably contribute to enable the channelling and structuring of the potential quantity of questions.

Unfortunately, the option to hold the AGM until 31 December 2020 does not apply to companies in the legal form of an SE due to mandatory law contained in the SE Regulation requiring the AGM to be held by no later than six months after the end of the financial year.

Note that the possibility to pay advance dividends is limited to the payment of 50 per cent of the company’s annual surplus and may not exceed 50 per cent of the balance sheet profit of the previous fiscal year 2018.

Prior to publication of the draft law, the German organisation ‘Deutsches Aktieninstitut’ (DAI) had also

issued a number of recommendations in relation to German stock corporation law, not all of which have been adopted by the German legislator (eg more far-reaching privileges from corporate bodies' liability and voidability/ invalidity of shareholders' resolutions; possibility to pay (full) dividends on the basis of executive/supervisory board resolutions; possibility to nominate the auditor solely on the basis of a supervisory board resolution; etc).

### **3. Moratorium and temporary relief on certain contractual obligations**

The Mitigation Act interferes with contractual relationships in an unprecedented manner. The law clearly aims at the protection of tenants (consumer or not), consumers and microenterprises with regard to certain long-term agreements, and borrowers of consumer loans. While the postponement of payment obligations will bring immediate relief to debtors, it will at the same time cause an immediate impact on creditors, in particular on financial institutions as well as private and commercial landlords.

#### **Scope of measures**

The moratorium on 'material long-term agreements' only applies to consumers and microenterprises as debtors, explicitly restricting the right to refuse fulfilment of contractual obligations under long-term agreements which are essential to cover the basic needs of the consumers or for an adequate continuation of business of microenterprises, covering eg mandatory insurances, electricity and gas supply, telecommunication services and – if provided under civil law contracts – the supply and disposal of water. Especially in view of the continuation of a business, other sectors in addition to the above-mentioned examples taken from the explanatory memorandum to the Mitigation Act may be considered as material within the meaning of the law. However, this will explicitly not be the case for lease, loan and employment agreements.

With regard to the mitigating measures for consumer loan agreements, a deferral of the borrower's obligation is only allowed to the extent the borrower lacks the necessary funds for fulfilment of his/her obligations. The same applies to the debtor's obligations under the moratorium. In both cases, the deferral of the fulfilment of contractual obligations is only temporary. If the losses suffered because of the crisis cannot be recovered, the debtor will face its aggregated debts after the period of relief potentially without the funds required for payment.

In the first drafting suggestion for the moratorium, the government had not yet intended to restrict the group of protected debtors to consumers and microenterprises but had included all types of agreements without further differentiation, as long as their performance was affected

by the Covid-19 pandemic. Furthermore, the moratorium was planned to apply until 30 September 2020. During the debate, the initial scope was reduced significantly, which is owed to the fact that larger companies will have easier access to loan programmes of the German Kreditanstalt für Wiederaufbau (KfW) and other assistance provided by the Economic Stabilisation Fund Act (WStFG) with no need to interfere in existing agreements. Focussing on debtors and agreements with a special need for protection seems a good decision because even during the crisis the confidence in a balanced, legally secure commercial trade should be maintained.

The proposal is embedded into the Introductory Code to the German Civil Code (EGBGB) and should therefore extend to German substantive civil law only, but not to contractual relationships governed by foreign laws.

#### **Enforcement and legal implications**

The debtor has to invoke the right to refuse fulfilment of contractual obligations as stipulated in art 240 sec 1 para 1 or 2 EGBGB as a defence and bears the burden of proof of all prerequisites for the moratorium applicable to him/her as an individual or as a business. While it appears to be obvious whether a microenterprise is able to fulfil its obligations (objective test), it remains unclear at what point the economic base of a business is endangered, as probably is the notion of a debtor's adequate subsistence and the adequate continuation of a business.

Within the scope of a moratorium invoked by the debtor, the deferral of the debtor's obligation might at the same time block a right of the creditor to set-off own obligations against the deferred obligation. The same appears to apply for the ordinary right of retention (sec 273, 320 para 1 German Civil Code), that would otherwise allow the creditor to hold back its own (counter-)consideration until the other party's consideration is likewise fulfilled. It is unclear whether the same is true for the special right of retention of the creditor (pursuant to sec 321 para 1 German Civil Code) which applies if the fulfilment of the debtor's obligation is endangered due to its inability to perform. However, one could argue that this would contradict the intention of the Mitigation Act.

The debtor, benefitting from the moratorium or the deferral in case of consumer loan agreements is not required to pay default interest, as the respective obligations of the debtor do not fall due for payment. According to the explanatory memorandum, this also applies to payments already due before the prerequisites of the moratorium occurred. Such payment obligations will be due again after the moratorium terminates. It is questionable whether such a generous interpretation of the provisions, where the defaulting debtor is protected before the occurrence of the Covid-19 pandemic, is reasonable, since it has to be assumed that other reasons must have led to the outstanding payments, at least until the Covid-19

pandemic started.

This effect will not occur in lease agreements, as the rental payment obligation will not be subject to a moratorium, but a payment default will – under the specific circumstances – not trigger a termination right of the landlord. In contrast to a moratorium, the mitigating measures for lease agreements obviously are not intended to bridge financial straits but rather to avoid the termination of lease agreements and the resulting negative consequences for the tenant. To the extent evident, the reasons for the difference in treatment as compared to long-term agreements for basic supplies or maintaining the economic base so far have not been explained.

As to a possible extension of the term of consumer loan agreements in case an individual, consensual agreement cannot be reached, the explanatory memo states that the original structure of the contract shall stay in place and will only be postponed. Due to the short time frame it is understandable that the legislator was not yet able to go into the detail of certain questions, eg with regard to bank fees, variable interest rates, and effects on associated contracts.

### Outlook

The Mitigation Act is necessarily addressing the debtor-creditor relationship in a brief and general manner. When relying on the law during the times of the crisis and when interpreting it in the aftermath, this may prove to cause uncertainty in many situations, eg if the creditor may reasonably claim that the delay of payment does (or did) cause undue hardship for the creditor, that payment should have been made in time, or that a notice of termination given was valid and effective at the time. In addition, compliance with the freedoms guaranteed by the German Constitution will be discussed and eventually tested. However, it is generally acknowledged that the German Constitution permits within certain boundaries the interference with the individual's property and economic interests. These and further questions will have to be answered, once the urgent challenges of the Covid-19 pandemic will hopefully have been mastered.

In contrast to the initial drafting, the final version of the Mitigation Act restricts the extensive rights allowing the responsible ministries and the government to extend the application of the law with regard to persons/entities and periods of time. This is probably owed to concerns expressed during the legislative process with regard to constitutional restrictions on shifting legislative powers towards the executive branch. However, the law vests the federal government with extensive powers for extending the duration of the described protective measures without obtaining the consent of the legislative.

## 4. Criminal procedure

Long periods of time between hearings are generally of concern to individual and corporate defendants. However, the first days of the Covid-19 pandemic saw several large white-collar proceedings which were set to go on for weeks, massively accelerated and rushed to judgment in an effort to clear out the oftentimes crammed courtrooms.

Against this alternative, the proposed change to the law appears to be the lesser of two evils. It would be preferable, however, to apply the new rule only to trials that must be continued (eg cases involving pre-trial detention) and to suspend all other trials and restart them after the end of the Covid-19 pandemic.

## IV. Summary

The Mitigation Act came into being within a week's time – similar to the swift response taken during the financial crisis –, creating an effective protective shield for consumers and enterprises with regard to civil, corporate and insolvency law. The speed at which the law – along with numerous other legal initiatives for mastering the effects of the Covid-19 pandemic – has been designed and pushed through the legislative process under difficult circumstances is impressive. Everyday business will shed light on the vague parts of the law – and it remains to be hoped that the interference in the law of obligations (which inevitably will lead to one-sided economic strains) will be short-lived.

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