

European and German Programs Counteracting Liquidity Shortfalls and Relaxations in German Insolvency Law

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The significant decline in sales or even temporary close downs of businesses in the last couple of weeks already led to a massive shortfall in liquidity available to entrepreneurs while the cost level remains largely the same. In a joint effort to back the economy the European Central Bank as well as the German Federal Government (*Bundesregierung*) and the State Governments (*Landesregierungen*) implemented several programs to counteract a break-down of companies from large multinationals to sole entrepreneurs.

The below describes the measures available at the date hereof (or in the near future). Additional measures such as a federal emergency fund for small and medium sized enterprises are being discussed but details remain vague at this stage.

European Union Measures

In an effort to reduce interest rates, the European Central bank announced a program to acquire bonds including also corporate bonds in a volume of up to EUR 750 billion either directly from issuers or on the secondary market. Regional and sector specifics of the bonds targeted by the ECB are currently still open at this time.

The European Union, acting through the European Commission is also involved in the authorization of support measures by the Member States. Generally, to the extent Member State measures constitute State aid under European State aid laws, these measures require notification by the respective Member State to, and approval by, the European Commission (unless e.g. pre-existing programs are used or de minimis exceptions apply). In this context, the European Commission has signaled a high degree of willingness to allow the use of State aid measures by Member States to salvage the European economy in the present circumstances and to decide quickly on any notifications from Member States in this respect.

In particular, and following a similar temporary framework in 2008 in response to the global financial crisis, the European Commission has adopted a “Temporary Framework to enable Member States to use the full flexibility foreseen under State aid rules to support the economy in the context of the COVID-19 outbreak”. Together with many other support measures that can be used by Member States under the existing State aid rules, the Temporary Framework is intended to Member States to ensure that sufficient liquidity remains available to businesses of all types and to preserve the continuity of economic activity during and after the COVID-19 outbreak. For further details, please refer to our March 20, 2020 client alert “[European Commission Adopts Initiatives to Support the Real Economy Amid the COVID-19 Outbreak](#)”.

German Federal Support Programs

The measures adopted by the German Federal Government include the extension in

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volume and scope and the lowering of access conditions for pre-existing programs as well as the introduction of new programs. At federal level, support measures are generally granted through the involvement of KfW (*Kreditanstalt für Wiederaufbau*), Germany's state-owned development bank, and require the cooperation of (and on-lending by) the relationship bank of the relevant applicant. Applications for support also have to be made through the applicant's relationship bank. Details of the measures can be accessed on the KfW homepage. In the below sections, certain key preconditions and specifics are summarized.

The support measures outlined below are open to companies and sole entrepreneurs who face financial issues as a consequence of the COVID-19 crisis. Thus, applicants have to show that they (i) were in a stable financial condition on December 31, 2019 (i.e. no payment defaults, no covenant breaches under existing financing occurred) and that (ii) assuming a return to a normal economic environment, there is a positive continuation prognosis (*positive Fortführungsprognose*) until year end 2020. Further, companies can only apply if a controlling majority is privately held. Thus, it seems that companies held by (foreign) state owned funds are excluded.

The KfW's Special Program 2020 ("*KfW Sonderprogramm 2020 für Investitions- und Betriebsmittelfinanzierung*"), which includes two measures for subsidized interest rates for loans, has been notified to the European Commission on 20 March 2020 under the under the "Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak" as set out above. The Commission approved the program on Sunday, March 22, 2020 (cf. State aid case SA.56714) and found that the program is in line with the conditions set out in the Temporary Framework. Similarly, on March 24, 2020, the Commission has also approved a loan guarantee scheme on the temporary provision of guarantees, counter-guarantees within the territory of the Federal Republic of Germany in relation to the outbreak of COVID-19 ("*Bundesregelung Bürgschaften 2020*") (cf. State aid case SA.56787).

- KfW Entrepreneur Loan (*KfW Unternehmerkredit*)

An entrepreneur loan can be granted for investments and general working capital purposes, but also for the acquisition of other companies. Companies doing business in excess of five years are eligible for this program. In the case of large enterprises (in excess of either 250 employees, or EUR 50 million annual sales, or a balance sheet amount (*Bilanzsumme*) of EUR 43 million), KfW can assume a credit risk of up to 80%. In case of small and medium sized companies (SME) below such thresholds, the risk assumption by KfW is increased to up to 90%. Thus, the exposure of the relationship bank can be reduced to as little as 20% or 10%, respectively.

The maximum permissible loan amount is EUR 1 billion per group of companies (i.e. the applicant and its affiliates) but the amount is, in addition, limited to (i) a maximum of 25% of annual sales, (ii) two times the cost of labor in 2019, (iii) the amount of the liquidity required for the next 18 months (for SMEs) or the next 12 months (in respect of large enterprises), and (iv) loans in excess of EUR 25 million may not exceed 50% of the aggregate debt.

The term of loans varies between five years (in which case quarterly repayments as of year two will have to be made) and a two year term with a repayment in full at the end of the term. The interest rate will be determined on the basis of the credit rating of the applicant and the available collateral.

- ERP Start-Up Loan – Universal (*EPR Gründerkredit – Universell*)

For entrepreneurs doing business for three years (and up to five years) the program is comparable to the KfW Entrepreneur Loan provided that the interest rate can, in addition, be subsidized through funds of the EPR Special Fund (*EPR Sondervermögen*).

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It seems that there will be specific programs for SMEs and large entrepreneurs in business for less than three years but it seems that specifics are not yet publicly available.

- KfW Special Program Syndicated Lending (*KfW Sonderprogramm "Direktbeteiligung für Konsortialfinanzierung"*)

Under this program, KfW participates in syndicated lending either directly as one of several lenders or indirectly through a sub-participation.

It is envisaged that the KfW loan portion is in excess of EUR 25 million but is limited to (i) a maximum of 80% of the aggregate loan amount and 50% of the aggregate debt of the applicant, (ii) a maximum of 25% of annual sales, (iii) two times the cost of labor in 2019, (iv) the amount of the liquidity required for the next 12 months.

This program is also available to foreign companies (if a controlling majority is privately held) in respect of projects in Germany.

- Immediate Corona Support Program for small(est) enterprises and sole entrepreneurs (*Corona Soforthilfe für Kleinstunternehmen und Soloselbstständige*)

This program is designed for small(est) enterprises, sole entrepreneurs and members of the free professions with up to ten employees who have no access to regular bank financing.

In deviation from the general precondition for SMEs and large enterprises, applicants have to show that they were financially stable prior to March 2020 and are now in financial distress due to the COVID-19 crisis. Amounts are limited to EUR 9,000 and EUR 15,000 respectively in the individual case.

While the funds are provided by the German Federal Government, this program will be administered by the federal states or possibly local communities.

Federal and State Guarantees

For guarantees, competencies vary between federal and state level, usually depending on the guaranteed amount and/or underlying loan amount.

- Large Guarantees Programs (*Großbürgschaftsprogramme*)

Such guarantees were in the past available to companies to secure general working capital and investment financing in structurally disadvantaged regions but are now open to companies generally. Generally, the federal states (*Bundesländer*) are in charge, but for guarantees in excess of EUR 50 million the federal government is competent. The guarantees may cover up to 80% of the underlying debt.

In respect of guarantees by state guarantee banks (*Bürgschaftsbanken*) the guarantee limit has been extended and doubled to EUR 2.5 million.

State Support Programs

Programs at federal state (*Bundesländer*) governmental level are equally important. Typically, these cover the aforementioned guarantees as well as support for medium sized and small companies and sole entrepreneurs. For example, in Bavaria state measures include a so called Immediate Loan Program (*Akkutkredit*) for medium sized commercial enterprises with a loan amount of up to 2 million, and an Emergency Relief "Corona" (*Soforthilfe Corona*) for sole entrepreneurs and small enterprises. It is also contemplated to set up a State Funds (*Bayernfonds*) for (larger) medium sized enterprises aimed at providing the liquidity for (state) participations in companies which are considered

of “systemic importance” which are hit hard by the COVID-19 crisis but were previously financially healthy.

Generally, for all these programs and support initiatives, the key factor for making them successful is the speed in making funds available to companies in need of emergency liquidity. This will be a challenge for the governmental bodies (and state banks) administering the programs as well as for the relationship banks involved who still need to make appropriate risk assessment as a certain – albeit considerably more limited - exposure remains in most cases. In addition, other existing lenders of an applicant may have to be involved if waivers allowing for additional debt and/or intercreditor agreements are necessary. Consequently, the time period between the application for support measures and the actual funding will take a number of weeks. The backing of the support measures by the relief granted to debtors in respect of insolvency filings outlined below will thus be important.

Changes to German Insolvency Law

The German legislator has on March 25, 2020 passed a law to make certain temporary adjustments to German insolvency laws. These measures aim at mitigating the effects of the Corona pandemic on German companies. Previous obstacles and pitfalls for lenders granting bridge loans or rescue financings to distressed companies shall be eliminated to a large extent. Together with the above liquidity programs this can be an effective way to support (dis)stressed companies in Germany. The obligation on directors to file for insolvency will be suspended for scenarios caused by COVID-19.

- Filing requirement

With effect from March 1, 2020 until September 30, 2020 German companies do not have to file for insolvency in case of cash flow insolvency unless it is not caused by the Corona pandemic or there is no prospect that the cash flow insolvency will be remedied. To give directors comfort that there is no obligation on them to file, it will be assumed that an illiquidity is caused by the Corona pandemic where the company was not already cash flow insolvent on December 31, 2019.

- Payments by companies in a crisis

As a consequence the company can make payments in the ordinary course of business without management risking personal liability. This shall stabilize stressed companies and enable them to continue business with its contractual partners.

- Lender liability

The new law also eliminates legal risks in connection with the provision of financing in a crisis. Potential lender liability due to a delayed filing for insolvency is suspended. Also, claw-back risks relating to loans granted between March 1 and September 1, 2020 and repaid until September 30, 2023 or the granting of security for such financing have been minimized for all customary scenarios of financing in a crisis. This shall assist lenders in quickly making a decision to support stressed borrowers.

- Shareholder financing

Last but not least also shareholders can benefit from this new law. A shareholder shall be able to make available financing to its subsidiary between March 1 and September 30, 2020 without running the risk of legal subordination of such a loan in insolvency proceedings of the debtor until September 30, 2023. Legal subordination of shareholder loans had in the past often been an obstacle in many rescue financings attempted by shareholders.

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Governmental support programs in combination with the relaxation in respect of insolvency filings and the improved protection of lenders, other creditors and also funding shareholders aim to set a viable framework for rescue financings and, ultimately, may help to avoid mass insolvencies.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding developments related to the COVID-19 outbreak. For additional information, please contact any member of the firm's [Coronavirus \(COVID-19\) Response Team](#).

Gibson Dunn lawyers regularly counsel clients on the issues raised by this pandemic, and we are working with many of our clients on their response to COVID-19. Please also feel free to contact the Gibson Dunn lawyer with whom you usually work, any member of the team in [Frankfurt](#) or [Munich](#), or the authors:

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