

## CORONAVIRUS: GERMANY TO TAKE EMERGENCY MEASURES IN RESPONSE TO COVID-19 PANDEMIC

According to a [draft law](#) published by the German Ministry of Justice and Consumer Protection on 23 March 2020, the German Federal Government intends to implement certain emergency measures to mitigate the negative effects of the SARS-CoV-2 virus (Covid-19 pandemic) in the areas of civil law, corporate law, insolvency law and the law of criminal procedures. This briefing summarises the measures imposed under German civil law relevant to the finance industry.

### SCOPE OF THE MEASURES

In summary, the draft law provides for the following measures:

- Suspension of insolvency filing requirement until 30 September 2020 if insolvency was caused by the Covid-19 pandemic (see our separate newsletter on insolvency measures);
- Moratorium until 30 June 2020 in respect of payment and performance obligations for (i) consumers under consumer contracts and (ii) micro-enterprises under certain agreements governed by German law who cannot fulfil their contractual obligations because of the Covid-19 pandemic provided in each case that the underlying agreement constitutes a material continuing obligation (*Dauerschuldverhältnis*) (see "General Moratorium" below);
- Deferral of payments, exclusion of termination rights and adjustments by mutual agreement of consumer loan agreements (and subject to issue of an ordinance, loan agreements with in particular micro enterprises, but also other corporates) for three months (see "Deferral of Loan Payments" below);
- Virtual participation in shareholder meetings;
- Restriction on termination of property lease agreements until 30 June 2020 if a lessee is in default with rental payments where the default has been caused by the Covid-19 pandemic; and
- Additional reason for suspending the interruption periods under criminal law, allowing the courts to interrupt the criminal trial for a maximum of three months and ten days if the trial cannot be held due to infection control measures to prevent the spread of the Covid-19 pandemic.

### Key issues

- The draft law published by the German Federal Government proposes to implement certain emergency measures to mitigate the negative effects of the Covid-19 pandemic in the areas of civil law, corporate law, insolvency law and the law of criminal procedures
- Suspension of insolvency filing obligation for businesses affected by the Coronavirus until 30 September 2020
- Moratorium until initially 30 June 2020 in respect of payment and performance obligations for consumers under consumer contracts and micro-enterprises under certain agreements based on circumstances relating to the Covid-19 pandemic
- Deferral of payments falling due until 30 June 2020 by three months and exclusion of termination rights under consumer loan agreements

The proposed changes to German civil law by the draft law to mitigate the effects of the COVID-19 pandemic under civil, insolvency and criminal procedures law (*Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*) address in particular the needs of consumers and micro enterprises (such as owners of restaurants and cultural facilities).

While most of the measures initially apply until 30 June 2020, the Federal Government is authorised to extend such measures by way of ordinance until 30 September 2020 where the social life, the economic activities of multiple companies or the occupational activities of a large number of persons can be expected to continue to be significantly impaired by the Covid-19 pandemic. The deadlines may be extended beyond 30 September 2020 if the impairments continue to exist after the entry into force of such ordinance.

## **GENERAL MORATORIUM**

Article 240 section 1 of the Introductory Code to the German Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch, "EGBGB-E"*) introduces a general moratorium subject to a number of exemptions. As proposed, a consumer shall have the right to refuse performance until 30 June 2020 of any obligation related to a consumer contract which contains continuing obligations (*Dauerschuldverhältnis*) concluded before 8 March 2020 if due to circumstances resulting from the Covid-19 pandemic, the performance would not be possible without endangering the consumer's reasonable subsistence or the reasonable subsistence of the consumer's dependants. The consumer's right to refuse performance is limited to material continuing obligations (*wesentliche Dauerschuldverhältnisse*), which are defined as such obligations which provide the consumer with essential goods and services required to maintain an adequate livelihood.

Pursuant to Article 240 section 1 para. 2 EGBGB-E, a micro-enterprise (*Kleinstunternehmen*) within the meaning of Recommendation 2003/361/EC of 6 May 2003 of the Commission concerning the definition of micro, small and medium-sized enterprises have a right to refuse performance until 30 June 2020 of any obligation related to a contract which contains continuing obligations (*Dauerschuldverhältnis*) concluded before 8 March 2020 if, as a result of circumstances relating to the Covid-19 pandemic, the micro-enterprise is unable to perform or would not be able to perform without endangering the economic basis of its business operations. As for consumers, the right to refuse performance is limited to material continuing obligations, which are defined as those obligations which provide the micro-enterprise with essential goods and services required for the reasonable continuation of its business operations.

Irrespective of whether the debtor under the contract is a consumer or a micro-enterprise, performance relates to both payment and delivery obligations (as well as any other performance owed under the relevant contract).

The right of refusal of a consumer does not apply as proposed under Article 240 section 1 para. 3 EGBGB-E, if the exercise of the right to refuse performance would be unreasonable for the creditor as the non-performance would endanger the economic basis of the creditor's business. Similarly, a micro-enterprise's right of refusal does not apply if the exercise of the right to refuse performance would be unreasonable for the creditor as non-performance would endanger the

creditor's reasonable subsistence or the reasonable subsistence of the creditor's dependants or the economic basis of the creditor's business.

If the right to refuse performance is excluded as described above, the debtor (i.e. the consumer or the micro-enterprise) may terminate the contract.

The moratorium shall likewise not apply in connection with property rental and lease agreements (*Pacht- und Mietverträge*), loan agreements and employment contracts (Article 240 section 1 para. 4 EGBGB-E).

Article 240 section 1 para. 5 EGBGB-E states that the aforementioned is mandatory law and may therefore not be derogated from to the detriment of the debtor. Article 240 EGBGB-E applies to agreements governed by German law. It is however not clear whether these provisions are to be considered as overriding mandatory provisions within the meaning of Article 9 Rome I Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations ("**Rome I**"). If so, a German court would generally have to recognise these restrictions, irrespective of the law governing the transactions (Article 9 para 2 Rome I). However, to the extent bound by Rome I, a court outside Germany would have to consider applying such termination restrictions only if the obligations arising out of the transactions had to be or have been performed in Germany (Article 9 para 3 Rome I).

## **DEFERRAL OF LOAN PAYMENTS**

The measures described below will initially only apply to consumer loans. However, they can be widened by simple ordinance to loans extended to in particular micro-enterprises, but also other corporates.

To avoid termination of loan agreements for payment default or deterioration of financial conditions as well as to enable borrowers to apply for support measures and make use of support offers, the draft law contains in Article 240 section 3 EGBGB-E substantial measures applicable to loan agreements with consumers concluded before 15 March 2020. These comprise a statutory payment deferral for initially 3 months. If during those 3 months no agreement can be negotiated, another deferral by 3 months will apply as a matter of law (each subject to deviating agreement by the parties). During the period, lender's termination rights based on payment default and deterioration of financial conditions will be excluded by mandatory law.

For loan agreements with consumers concluded before 15 March 2020, claims of the lender for repayment, interest or principal payments due between 1 April 2020 and 30 June 2020 are automatically deferred by law for a period of three months from the due date if the consumer has lost income due to the extraordinary circumstances caused by the spread of the Covid-19 pandemic, which make it unreasonable to expect the consumer to meet the obligations (Article 240 section 3 para. 1 sent. 1 EGBGB-E). In particular, it is not reasonable to expect the consumer to make the payments if the consumer's reasonable subsistence or the reasonable subsistence of the consumer's dependants is endangered. The consumer is entitled to continue making contractual payments during the period between 1 April 2020 and 30 June 2020 at the performance dates originally agreed. To the extent the consumer continues to make the payments in line with the contract, the deferral is deemed to not have occurred.

Article 240 section 3 para. 2 provides that the parties to the loan agreement may agree on conditions deviating from the automatically applicable consequences, in particular regarding possible partial payments, interest and repayment adjustments or debt rescheduling.

Article 240 section 3 para. 3 EGBGB-E excludes termination by the lender due to payment default, significant deterioration of the financial circumstances of the consumer or the value of collateral provided for the loan until the end of the deferral. The parties must not deviate therefrom to the detriment of the consumer.

The lender is obliged to offer the consumer a discussion on the possibility of an amicable arrangement and on possible support measures (Article 240 section 3 para. 4 EGBGB-E; remote means of communication may also be used for this purpose).

If no mutual agreement is reached for the period after 30 June 2020, Article 240 section 3 para. 5 EGBGB-E extends the term of the contract by three months. The respective due dates of the contractual obligations are postponed by this period. The lender must provide the consumer with a copy of the contract which reflects the agreed amendments to the contract or the amendments resulting from Article 240 section 3 para. 5 sent. 1 or Article 240 section 3 para. 1 sent. 1 EGBGB-E.

Pursuant to Article 240 section 3 para. 6 EGBGB-E the aforementioned paragraphs 1 to 5 of Article 240 section 3 EGBGB-E shall not apply if the deferral or exclusion of termination is unreasonable for the lender taking into account all circumstances of the individual case including the changes in general living conditions caused by the Covid-19 pandemic.

Pursuant to Article 240 section 3 para. 7 EGBGB-E, Article 240 section 3 paras. 1 to 6 EGBGB-E apply accordingly to the balance and recourse among joint and several debtors pursuant to section 426 German Civil Code (*Bürgerliches Gesetzbuch*, BGB).

Article 240 section 3 para. 8 EGBGB-E entitles the German Federal Government to change by ordinance the personal scope of application of Article 240 section 3 para. 1 to 6 EGBGB-E and to extend it, in particular but without limitation, to micro enterprises within the meaning of the Annex to Article 2 para. 3 of the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises.

Pursuant to Article 240 section 4 para. 1 no. 3 EGBGB-E, the German Federal Government is entitled to issue an ordinance to extend the period in Article 240 section 3 para. 1 EGBGB-E until 30 September 2020 and to extend the extension of the term of the contract under Article 240 section 3 para. 5 EGBGB-E to up to 12 months if it is to be expected that the social life, the economic activities of multiple companies or the employment activities of multiple persons remain to be impaired in a substantial manner. Article 240 section 4 para. 2 EGBGB-E entitles the Federal Government to extend by ordinance (with approval of the German Parliament (*Bundestag*)) the deadlines in Article 240 section 4 para. 1 EGBGB-E beyond 30 September 2020 if the impairments continue to exist following the entering into force of the regulation under Article 240 section 4 para. 1 EGBGB-E.

## **REGULATORY CONSEQUENCES FOR CREDIT INSTITUTIONS**

A deferral of loan payments triggers potential consequences and questions to be addressed by regulators and credit institutions in particular with respect to capital and liquidity requirements.

The German Federal Financial Supervisory Authority ("**BaFin**") has clarified in its FAQs on Covid-19 (see the BaFin's Covid-19 FAQs [here](#)) that a deferral of loan payments (*Stundung*) would not result in the borrower being considered defaulted, if the agreed interest rate remains applicable to such deferred payments. According to BaFin, such deferral would not result in a diminished financial obligation pursuant to Article 178 para. 3 lit d) of Regulation (EU) No 575/2013 (CRR).

To address negative effects of a deferral of loan payments on capital and liquidity, the European Central Bank ("**ECB**") and BaFin have each also clarified that credit institutions can fully use capital and liquidity buffers and may operate temporarily below the level of capital defined by the Pillar 2 Guidance (P2G), the capital conservation buffer (CCB) and the liquidity coverage ratio (LCR). Credit institutions will also be allowed to partially use capital instruments that do not qualify as Common Equity Tier 1 (CET1) capital, for example Additional Tier 1 or Tier 2 instruments, to meet the Pillar 2 Requirements (P2R) which brings forward a measure that was initially scheduled to come into effect in January 2021, as part of the latest revision of the EU Capital Requirements Directive (CRD V).

To support initiatives such as introduced by the Federal Government which aim at providing sustainable solutions to temporarily distressed debtors, the ECB has introduced supervisory flexibility regarding the treatment of non-performing loans (NPLs) as follows:

- Flexibility by supervisors regarding the classification of debtors as "unlikely to pay" when credit institutions call on public guarantees granted in the context of coronavirus.
- Loans which become non-performing and are under public guarantees will benefit from preferential prudential treatment in terms of supervisory expectations about loss provisioning.
- Full flexibility by supervisors when discussing with credit institutions the implementation of NPL reduction strategies, taking into account the extraordinary nature of current market conditions.

## **PRODUCT SPECIFIC ISSUES**

### **Securitisations**

While the proposed measures are unlikely to be relevant to capital markets transactions generally, they are likely to have an effect on securitisations. The general moratorium only applies to material continuing obligations which relate to the provision of essential goods and services (such as the provision of electricity or gas). Receivables stemming from such obligations are usually not subject to a securitisation.

However, consumer loans which may be subject to a payment deferral as described above are frequently securitised in Germany. Accordingly, the

statutory deferral of payments may apply to a receivable which is subject to a securitisation. In this case the securitisation issuer will be deprived of incoming cashflows which, as a consequence, means that the securitisation issuer will not be in a position to make payments under the notes which are issued in the context of a securitisation. Securitisation issuers benefit from limited recourse and no-petition arrangements but non-payment under the notes constitutes a default under the respective transaction documentation.

## **Lending**

The observations below are focused on German law LMA style loans and assume that Article 240 section 3 EGBGB-E will be expanded by ordinance to also apply to loans to corporates. Whether it will be so expanded cannot be predicted at this point and will probably also be judged based on the experience to be gained over the next couple of weeks as to whether an expansion is necessary to protect corporates in the current circumstances.

The law as drafted (Article 240 section 3 para 3 EGBGB-E) seems to *prima facie* exclude termination rights for drawn and undrawn loans, as the existing German statutory termination right in section 490 para 1 of the German Civil Code applies to both scenarios. The question will be whether lenders can still invoke contractually agreed draw stop events resulting from a material deterioration of the financing conditions as these are not technically termination rights. Note that because of the deferral of payments until 30 June 2020 as described in Article 240 section 3 para 1 EGBGB-E a payment default can technically no longer arise. As a result, German law collateral will no longer be enforceable for the time the payment is so deferred.

Another question is whether termination rights based on Events of Default resulting from financial covenant breaches or cessation/suspension of business can still be invoked or at least the insolvency related events of default. What can be assumed is that it is not the intention of the German Federal Government for these kind of Events of Default to be invoked. Certainly the law aims to allow for sufficient time for borrowers to solve their liquidity needs, e.g. by applying for any of the governmental protection schemes for which they may be eligible. With respect to insolvency related Events of Default, case law from the Federal Court of Justice (*Bundesgerichtshof*) based on section 119 of the German Insolvency Code (*Insolvenzordnung*, "**InsO**") may also limit lenders' ability to rely on those at least where the loan is not fully disbursed.

Further, where the Event of Default results from the material deterioration of the financial conditions of the borrower the question is whether this qualifies as an Event of Default for example in the "transfer and assignment" provisions where usually agreed transfer restrictions such as the borrower's consent no longer apply after an Event of Default has occurred which is continuing.

Finally, the law also raises broader questions about how to ensure that borrowers will treat all creditors the same, i.e. they do not pay some while invoking the statutory deferral vis-à-vis other creditors.

## **Derivatives**

Given the scope of application of the draft law as regards the general moratorium to consumers and micro enterprises, this is unlikely to be relevant to payment and delivery obligations under derivatives and securities financing

transactions, such as the German Master Agreement for Financial Derivatives Transactions (*Rahmenvertrag für Finanztermingeschäfte*), as well as the German master agreements for repurchase and securities lending transactions (the "**German Master Agreements**").

However, the proposed law also modifies mandatory insolvency laws, in particular the obligation of a debtor to file an application for the commencement of insolvency proceedings is suspended until 30 September 2020 unless the reasons that would require such filing do not occur as a result of the SARS CoV-2 pandemic or if there is no prospect of eliminating an existing inability to pay (see Article 1 Section 1 of the Corona Insolvency Suspension Act (*Corona-Insolvenz-Aussetzungsgesetz*, "**CorInsAG**"). This suspension of insolvency filings in principle applies to a broader range of entities. The German Master Agreements provide for an automatic termination without notice of termination in the event of insolvency. An event of insolvency exists, where an application for the commencement of an insolvency proceeding or any other comparable proceeding is filed in respect of the assets of a party, and such party has either (i) filed the application itself or an authority or public entity which is entitled to file for such proceedings in relation to this party has filed for such proceedings, or (ii) the relevant party is generally unable to pay its debts or is otherwise in a situation that justifies the commencement of such proceedings.

Upon the opening of insolvency proceedings, section 104 InsO provides for a mandatory automatic termination of those derivative transactions which fall within its scope provided the relevant date for early termination falls after the opening of insolvency proceedings. Pursuant to the draft law, where a creditor (rather than the debtor itself) files for insolvency of the debtor during a period from the entering into force of the law and a date falling three months after the date of the law, it is a precondition for the opening of insolvency proceedings that the reasons for opening the proceedings were already present on 1 March 2020 (see Article 1 section 3 CorInsAG) (for details see our separate newsletter on insolvency measures).

As a consequence, where the CorInsAG is applicable, delaying insolvency filings can be justified, so that an automatic termination of the relevant German Master Agreement may not arise, and, without a filing insolvency proceedings cannot be opened, so that the consequences of section 104 InsO will also not apply in those circumstances. The CorInsAG does not exclude any other termination rights, including on the basis of a payment default (unless in the unlikely event the conditions of the aforementioned moratorium were to be met).

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