Payments During Corporate Distress – Still a Legal Minefield

When advising companies in financial distress, the question of whether certain payments may or should still be made arises time and again.

Such decisions often need to be taken under immense time pressure and with an incomplete picture of the facts. Company directors frequently find themselves torn between trying to maintain normal business operations on the one hand, and safeguarding creditors' interests on the other – interests that typically stand in opposition to further depletion of the company's assets.

This article aims to offer directors of distressed companies some practical guidance – set against the backdrop of an unresolved legal landscape, particularly in relation to the controversial issue of paying social security contributions – on how to proceed in a legally compliant and commercially sensible manner.

Legal Background

Under German law, companies in the legal form of a corporation are subject to an obligation to file for insolvency, which is coupled with a general prohibition on making payments. As a rule, directors are personally liable for payments made after the company has become insolvent (see the former versions of § 64 GmbHG and § 92(2) AktG in particular).

However, under the previous legal framework, directors could avoid liability by demonstrating that the payments in question were consistent with the "care of a prudent and conscientious business manager." Over time, the courts developed stringent criteria for satisfying this standard, only allowing justification in very limited circumstances, such as where the payment:

- Averted the immediate collapse of operations within the statutory three- (or six-) week filing period under § 15a(1) InsO (known as emergency management; see e.g. BGH judgment of 5 November 2007 – II ZR 262/06, para. 6),
- Satisfied the claim of a secured creditor, thereby releasing the underlying security (BGH, judgment of 26 January 2016 – II ZR 394/13), or
- Was exchanged for an equivalent benefit to the company (BGH, judgment of 4 July 2017 – II ZR 319/15).

Reform through the SanInsFoG

As part of the corporate insolvency law reform introduced by the "SanInsFoG", the above provisions and the relevant case law were incorporated – on a legally neutral basis – into the new § 15b(1) InsO, which took effect on 1 January 2021. According to this new provision, payments that "serve to maintain business operations" are deemed consistent with the care of a prudent and conscientious director – at least for the duration of the statutory insolvency filing periods (see § 15(3) InsO).

In addition, § 15(8) InsO exempts directors from personal liability under § 69 AO for not settling the company's tax liabilities (including payroll taxes) during the insolvency filing period.

According to the government's explanatory memorandum ("RegE SanInsFoG", p. 229), § 15b(1) InsO was also intended to ease the strict limitations previously applied to emergency management. For instance, the courts had generally not considered payments for services as privileged, on the grounds that they do not increase the company's asset pool (see BGH, judgment of 4 July 2017 – II ZR 319/15, para. 18). Such rigid constraints could render the extended filing period for over-indebtedness (see § 15a(1) sentence 2, Article 5(8) of the draft bill) ineffective, as continuation of the business over a longer period would simply be unfeasible under those limitations.

Ongoing Uncertainties

It remains to be seen how the Federal Court of Justice (BGH) will apply this broader scope of exempted payments as intended by the legislature.

To date, the Court has regarded payments for labour and services, as well as payments to energy and telecom providers, as violating the payment prohibition (again, see the ruling from 4 July 2017). However, based on the new legislative reasoning, it seems likely that payments to advisors – particularly legal and restructuring professionals – should now be exempt from liability. Whether and to what extent this also applies to wages and salaries remains uncertain.

Another unresolved issue is how directors should handle payments of social security contributions during corporate crisis. While, as mentioned above, the law now clearly exempts non-payment of taxes (including payroll taxes) within the filing period from liability under § 15(8) InsO, it remains silent on the mandatory contributions to social security institutions under § 28e SGB IV.

Complicating matters further, directors are criminally liable under § 266a StGB for failing to pay the employee's share of social security contributions. This imposes even greater pressure than before the reform regarding taxes, where only civil liability was at stake.

This already difficult situation is exacerbated by the fact that § 283c StGB imposes criminal penalties for unauthorised payments to creditors, while case law on the matter remains inconsistent.

The government's draft (see p. 195) refers to a decision by the BGH's 5th Criminal Division (decision of 30 July 2003 – 5 StR 221/03), which found that non-payment of social security contributions during the insolvency filing period could be justified by the general payment prohibition (now § 15a(1) InsO).
Some legal scholars interpret this as evidence of the legislature's intent to extend the exemption in § 15b(8) InsO to include employee contributions to social security. However, later court decisions have cast doubt on whether the cited criminal law precedent still holds.

Conclusion

Unsurprisingly, the reform of the payment prohibition rules following insolvency triggers continues to raise further questions. These are due in part to the time pressure the legislature was under during the drafting process, which left key issues unresolved.

Moreover, the interpretive “instructions” the legislature has now handed down to the courts – aimed at widening the previously restrictive scope for liability exemptions – are themselves a source of fresh legal uncertainty.

A key question is whether the BGH will revert to its earlier, more permissive stance regarding the justification of payments during insolvency (e.g. in BGH, judgment of 8 December 2015 – II ZR 68/14).

Practical Guidance

For directors of companies in financial distress, legislative wishful thinking is of little use – what’s needed is practical, workable guidance. Based on recent experience in practice, the following points should be borne in mind:

- Despite the pressure (particularly time-related), directors must prioritise comprehensive written documentation when making decisions about payments during a crisis – if only because of the burden of proof.
- Directors should seriously assess the viability of a company turnaround. If, in extreme cases, even continuation in provisional insolvency seems unlikely, decisions around which liabilities to pay will differ significantly from situations where prospects for restructuring outside insolvency remain strong.
- As part of this strategic assessment, directors must determine which payments they are still willing and able to justify. In light of the broader payment scope now deemed acceptable by law, payments to utility and ICT providers should, in most cases, be defensible.
- Decisions regarding the payment of wages and salaries should be guided by the above considerations, especially bearing in mind that insolvency wage benefits (“Insolvenzgeld”) cover employee pay. While an increasing number of voices in the legal literature support the payment of wages and salaries even after insolvency has technically arisen, strong counterarguments remain. As such, wage payments continue to carry a degree of liability risk and should be carefully weighed.
- Once a decision to make wage payments has been made, the corresponding payroll tax and social security contributions must generally be paid as well.

BMJ, “Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts” – SanInsFoG
RegE SanInsFoG

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