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Suspected COVID-19 insolvency – what to do?

Consequent to the recent COVID-19 Emergency Measures Ordinance, many enterprises are faced with another „hard" lockdown. Entrepreneurs are well advised to regularly examine their own economic situation and keep an eye on the credit standing of their business partners.

The COVID-19 crisis and the measures for its containment stipulated by the Austrian Federal Government have confronted numerous Austrian businesses – from one-person enterprises to major corporations – with serious economic challenges. For the time being, rental reductions, state grants, payment respites and the partial deferment of the obligation to file an insolvency petition are preventing a wave of insolvencies, yet these measures simply stave off problems and distort the actual economic situation, both within the company and for the entire economy. In addition to taking measures to fight own crisis-caused problems, entrepreneurs should endeavour to minimise the risk of losing outstanding receivables.

COVID-19 and the obligation to file an insolvency petition

When a business is in an economic situation that requires it to file a petition for insolvency – the so-called "material" insolvency – it must file it promptly without any culpable delay. This obligation applies to private individuals, individual businesses, partners in partnerships, statutory representatives of legal entities (such as manager of a GmbH) and controlling shareholders of incorporations which temporarily have no statutory representative (e.g. due to the manager's retirement).

When COVID-19 is the cause of the insolvency, the maximum period allowed for filing the petition is 120 days rather than the customary 60 days. It should, however, be noted that this is a **maximum period** and that the obligation to file the petition "without culpable delay" continues to apply. A delay is, i.a., not culpable when diligent efforts at reorganisation have been made during the period or when reorganisation proceedings without personal management have been instituted with due care.

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P) PRESLMAYR RECHTSANWÄLTE

Natural persons (private individuals or entrepreneurs) and partnerships are "materially insolvent" when they are **illiquid** ("Zahlungsunfähigkeit") and do not expect to obtain the requisite financial means to pay all their due debts in good time. Illiquidity thus means that the due debts are greater than the liquid means, unless there is reason to expect sufficient liquidity in the near future (e.g. when a customer has announced payment or there is a valid prospect of receiving a state grant). The state of illiquidity may be terminated (in addition to receipt of liquid funds) by the reduction of due debts, e.g. by a respite, which delays the due date. This is currently the case in the form of large-scale schemes of respites granted by the internal revenue authorities and social insurance institutions.

Legal entities (such as GmbH and stock companies ("AG")) and partnerships where none of the fully liable partners is a natural person (e.g. GmbH & Co KG) are not just a case of illiquidity, but are also materially insolvent when they are **over-indebted**. This is the case when they suffer from debt overload (negative equity) and there is no positive perspective of being able to continue operation. In this case it is irrelevant whether liabilities are or are not due.

The second COVID-19-Justice-Accompanying Act ("2. COVID-19-Justiz-Begleitgesetz") suspends the obligation to file a petition for insolvency on the grounds of debt overload, for a period from 1 March 2020 until 31 January 2021. During this period, no petitions for insolvency on the grounds of debt overload may be filed (except in the case of simultaneous illiquidity) even if a creditor files the petition. However, it is still possible for the debtor to file a petition for insolvency on the grounds of debt overload. It is an unsettled issue whether payments made during this period by a business partner who is in debt overload but not illiquid can be contested by the administrator in later insolvency proceedings, because there are no accompanying statutory regulations in avoidance law.

When debtors are (still) in debt overload after 31 January 2021, they need to file a petition for insolvency proceedings within 60 days after 31 January 2021, but not later than 120 days after having succumbed to debt overload.

The logical conclusion to this provision is that an unknown but continuously growing number of actually insolvent businesses will be active in Austria for a whole year. Added to these are enterprises which are not (yet) illiquid solely due to – inevitably temporary – measures such as payment respites. There are companies operating on the market which would, under normal circumstances, need to reorganise or disappear from the market due to bankruptcy. It is thus advisable to look twice before entering into a new business relationship and to take action as soon as a business partner shows signs of delaying payment.

Measures to guard against debt losses

So, what to do if you suspect a COVID-19 insolvency? Quick response is of the essence. Several options are available in the case of an ongoing business relationship:

- change to sale against cash in advance;
- ship only subject to retaining ownership until the debt has been fully paid;
- solely contemporaneous performance.

Retention of ownership grants the entrepreneur the right to have the goods supplied segregated from the bankrupt's estate. Contemporaneous performance means that each party performs at the same time and, next to avoiding the risk of non-payment, has the added advantage that the legal transaction is secure against avoidance.

Moreover, the partners may agree on information obligations (by individual contracts or in the General Terms and Conditions), so that they are obliged to report on an ongoing basis or upon reaching specified business indices (e.g. regarding equity rate or fictitious debt repayment period), thus establishing a sort of "early warning system".

Similarly, speed is of the essence when it comes to collecting unsettled debts because the priority principle (first come first serve) rules outside insolvency proceedings. If no quick out-of-court settlement is possible, the creditor should sue at once and if necessary, foreclose, so as not to be left empty-handed.

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COVID-19: entitlement to special care leave

The COVID-19 pandemic has given rise to numerous measures within the scope of employment law. On 20 November 2020, the Austrian National Council introduced an entitlement to special care leave.

In simplified terms, the special care leave under Section 18b AVRAG (Act Governing Adjustments to Employment Law) is to ensure care of children, disabled persons, and dependents in need of care if the carer has no other claim to care leave. Previously, the special care leave required an agreement between employee and employer subject to specific prerequisites, but the amendment of 20 November 2020 provides for the employee to be legally entitled to such leave for the period from 1 November 2020 to the end of the 2020/2021 school year without the need for an employer/employee arrangement.

The entitlement to special care leave with continued pay commences when schools and childcare facilities are partly or fully shut down by the government authorities. In addition to the previous care situations, the act covers quarantine for the child imposed by a government authority under the Austrian Epidemics Act. The entitlement to special care leave may be asserted in stints (e.g. per day), but is limited to a total of four weeks up to the end of the school year.

Previously, employers were refunded only a third and, more recently, half of what they paid the employee during the special care leave period, but the new Act stipulates full refunding from the COVID-19 Crisis Fund.

A critical feature of the Act is that the entitlement is granted only when a facility is partly or fully shut down by government authorities. If a school does not close but offers supervision in addition to distance learning, parents are not entitled to special care leave because, under Section 18b AVRAG, employees must take every reasonable step to perform in accordance with their employment contract. Nevertheless, the entitlement applies when a child is forbidden to leave home because s/he is put under quarantine by the authorities. If the child succumbs to COVID-19, the parent is entitled to regular care leave.

Employees can still agree a special care leave with their employer, in which case the latter is similarly refunded the entire wages/salary paid to the employee.

Delay in harmonising the dismissal regulations of white- and blue-collar workers

The same act that regulates special care leave also delays by six months harmonisation of the dismissal rules of wage earners and salaried employees. The provisions adopted some time ago (see P) News issue of March 2018) are now to be applied to notices of termination given after 30 June 2021.

This delay is quite reasonable given the current crisis, especially when considering that aligning the dismissal rules for wage earners to those applicable to salaried employees means seriously meddling with contracts for wage earners: periods of notice are considerably prolonged and termination by the employer is possible only at the end of a quarter. Although new contracts can agree the 15th and the last day of a month for giving notice (as is customary for salaried employees), this is possible in existing contracts only with the wage earner's consent.

If the new rules were to apply as of 1 January 2021, crisis-ridden employers would have to think deeply, especially with the second lockdown in place, whether to grant their employees short-time work or fire them (in line with the old rules) if the company's continued existence is threatened by an excessive wage bill. The delay now decided on provides more time for enterprises to continue to use the COVID-19-short-time work scheme as an important tool to safeguard jobs during the crisis.

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Continued uncertainty after Privacy Shield becomes invalid

In its judgment C-311/18 the European Court of Justice (ECJ) invalidated the European Commission's decision regarding the Privacy Shield which allowed the transfer of personal data based on self-certification by recipients in the US. However, the Commission's decision on standard contractual clauses (SCCs) for the transfer of personal data to processors established in third countries still stands (at least in theory) also with regard to data transfer to the US. Nevertheless, even in these circumstances transfer is legitimate only when the guarantees of the SCCs (especially prevention of access by government agencies) are complied with. Whether this is the case needs to be assessed by the responsible operator/data exporter jointly with the recipient/data importer.

Given the ECJ's deliberations, scepticism is the order of the day: simple contractual obligations will not prevent access by state agencies acting on US laws just as little as the self-certification under the Privacy Shield did. The European Data Protection Commission Board has so far restricted itself to vague promises of additional measures to be taken in order to ensure a protection level in accordance with the EEC. Options would be comprehensive damages, strict encryption technologies or the prompt notification if a government authority threatens to access data, including a termination option. Still there is no certainty whether and which additional guarantees will ultimately be perceived to be adequate. Until the advent of a (harmonised) recommended procedure, new SCCs or a practicable alternative, data transfer to the US (whether direct or via processors) should therefore be avoided as much as possible on the grounds of security.

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In spite of the difficult times,
we wish you a merry Christmas,
continued success and, most of all,
good health in the new year!
Your team of Preslmayr attorneys at law

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