FAQ on labor law aspects of insolvency

1. What forms of insolvency are there?

Standard insolvency proceedings are the most common type of proceedings under German insolvency law. The aim is usually to restructure the enterprise by way of transferring assets (asset deal) to another company (e.g. NewCo) or through insolvency plan proceedings (sections 217 ff., German Insolvency Statute (InsO)). Unlike restructuring by way of transferring assets, the latter option means that the business is not separated from the previous legal entity, but continued within the insolvent enterprise itself.

In addition to standard insolvency, debtor-in-possession management (sections 270 ff., German Insolvency Statute) is now also common. Under certain conditions, the executive bodies/management of the enterprise have the option here of remaining authorised to manage and dispose of the debtor's assets under the supervision of an insolvency monitor (sections 270c, 274 ff., German Insolvency Statute). Both restructuring by way of transferring assets and insolvency plan proceedings are also restructuring instruments that can be used in debtor-in-possession management. The protective shield procedure pursuant to section 270b of the German Insolvency Statute as a special variant of debtor-in-possession management combines this with insolvency plan proceedings. The primary aim is timely restructuring by way of an insolvency plan.

2. What effects does insolvency have on labor law provisions?

Insolvency proceedings are generally divided into two phases: provisional and opened insolvency proceedings. Regardless of the specific procedural variant, "normal" labor law applies initially. However, in all variants this is subject to special aspects of insolvency law that are significantly disadvantageous to employees in some regards. Under insolvency law, employees are "part of the entirety of creditors". The privileges under labor law described below are generally contingent on the opening of insolvency proceedings, which is why staff reductions under insolvency law are usually only implemented after proceedings have been opened.

3. Do employees receive state support when wages are no longer being paid?

In the case of employees who are only receiving part of their pay or no pay at all due to insolvency of the employer, the Federal Employment Agency pays the outstanding remuneration entitlement for up to three months in the form of insolvency benefit, which thus generally amounts to the lost net income. This also applies in debtor-in-possession management if the court subsequently orders the opening of insolvency proceedings or rejects the petition to open insolvency proceedings due to a lack of

assets. If the employment relationship is not terminated, however, insolvency benefit is paid only after insolvency proceedings have been opened, meaning that there is no insolvency benefit during provisional insolvency proceedings. In order to be able to continue operations, the interim insolvency administrator or debtor in possession must therefore normally find a way of funding insolvency benefit up front.

4. What is the relationship between insolvency benefit and short-time allowance?

Filing a petition for insolvency does not preclude the payment of short-time allowance, even given the more detailed instructions issued by the Federal Employment Agency in April 2020, if and insofar as the conditions for paying short-time allowance continue to apply (note that there is no entitlement in the event of a complete closure of the business). In principle, it is also possible to introduce short-time working after a petition for insolvency has been filed. However, in such cases the Federal Employment Agency will closely scrutinise what led to the loss of work and whether the problem is indeed of a temporary nature.

In the event of short-time working during the period of entitlement to insolvency benefit, insolvency benefit is only payable in the amount of the remaining actual remuneration. Thus, if the requirements for receiving insolvency benefit and short-time allowance are met, both forms of support can be used in parallel, according to the instructions issued by the Federal Employment Agency.

5. What is the situation regarding termination of employment?

Under section 113 of the German Insolvency Statute, employment relationships can always be terminated ordinarily with a maximum notice period of three months to the end of the month during opened insolvency proceedings, unless a shorter notice period applies. Longer notice periods, whether prescribed by statute or by individual or collective agreements, no longer apply. This is also the case with fixed-term employment relationships and prohibitions or restrictions on termination under (collective) agreements. However, section 113 of the German Insolvency Statute does not exclude any existing special statutory protection against unfair dismissal for employees, such as that applicable to persons with severe disabilities.

As a form of compensation for the "shortened" notice period resulting from insolvency, section 113 sentence 3 of the German Insolvency Statute grants a no-fault liability claim for damages due to premature termination of the employment relationship, i.e. the remuneration from the insolvency termination date (pursuant to section 113 sentence 2, German Insolvency Statute) until expiry of the notice period the employer would have had to comply with had it not been for the insolvency. However, the employee must file

this claim for inclusion in the list of claims as a simple insolvency claim. It is therefore often not recoverable.

6. Is there any relaxation of the social factor test?

Pursuant to section 125 (1) of the German Insolvency Statute, there is a special option of concluding an agreement on a reconciliation of interests that includes a list of names. The consequence of agreeing such a reconciliation of interests in insolvency proceedings is that dismissal is presumed to be for operational reasons and the burden of demonstration and proof is essentially shifted to the employee bringing the action. In addition, judicial scrutiny of social selection of the employees is limited to gross errors. This limited criterion applies both to the social data and formation of the comparison groups and to the exclusion of top performers from the social factor test. Furthermore, section 125 of the German Insolvency Statute not only allows the maintenance of a balanced personnel structure, but also the creation of such a structure.

7. What special aspects apply to the reconciliation of interests procedure?

Pursuant to section 111 of the German Works Constitution Act (BetrVG), a reconciliation of interests on a planned change of operations must be negotiated with the works council if the establishment normally has more than twenty employees. This also applies in insolvency proceedings. The insolvency administrator must therefore inform the works council of the planned change and seek to achieve a reconciliation of interests.

If no reconciliation of interests on the planned change is reached, the insolvency administrator or the works council must submit the case to the conciliation committee pursuant to section 112 (2) sentence 2 of the German Works Constitution Act. The conciliation committee must then either reach an agreement with the works council or declare that the negotiations have failed. It is not legally permissible to implement the change without such an attempt to reconcile the parties' interests; if the change goes ahead nonetheless, this will trigger claims by employees for compensation for disadvantages suffered, among other consequences.

The possibility that exists outside of insolvency for each party to request mediation by the executive board of the Federal Employment Agency in the absence of agreement on the reconciliation of interests and social plan is not available after insolvency proceedings have opened (section 121, German Insolvency Statute), but does not play a major role in practice anyway.

Alternatively, however (and of greater practical relevance), the insolvency administrator may also, pursuant to section 122 (1) sentence 1 of the German Insolvency Statute, after three weeks of unsuccessful negotiations or three weeks after a written request to begin negotiations on the reconciliation of interests, request the approval of the labor court to implement the change without prior proceedings under section 112 (2) of the German Insolvency Statute. The labor court will grant its approval if the economic situation of the enterprise, taking into account the social concerns of the employees, warrants implementation of the change without prior conciliation proceedings pursuant to section 112 (2), German Works Constitution Act.

8. How much money should be allocated to a social plan?

The size of the social plan is limited under section 123 (1) of the German Insolvency Statute to a maximum of two and a half monthly salaries (within the meaning of section 10 (3), German Act on Protection Against Unfair Dismissal (KSchG)) of the employees affected by dismissal. This means that the total size of the social plan is generally limited to two and a half gross monthly salaries of all relevant employees. In addition, no more than a third of the assets that would be available for distribution to insolvency creditors without the social plan may be used to meet social plan requirements (section 123 (2), German Insolvency Statute). Individual distribution within the workforce must then be agreed between the works council and the insolvency administrator/debtor in possession within the framework of the social plan, taking into account these limits.

9. Can works agreements that are a burden on assets be terminated?

If there are claims arising from a works agreement against the assets, such agreements can be terminated with a notice period of three months pursuant to section 120 of the German Insolvency Statute, irrespective of the terms and notice periods agreed. Prior consultation with the works council on agreeing a reduction of benefits should be attempted, but is not compulsory.

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