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KNOWLEDGE NUGGETS

PAYMENT PROHIBITIONS AFTER THE ONSET OF INSOLVENCY—WHEN
PAYMENTS BECOME A LIABILITY RISK

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I. WHY THIS TOPIC IS IMPORTANT

When a company finds itself in financial distress, management faces not only the operational challenge of stabilizing the business but also far-reaching statutory obligations. A central and often underestimated issue in this context are the payment prohibitions triggered once the company becomes insolvent (*Insolvenzreife*) pursuant to Section 15b of the German Insolvency Code (*Insolvenzordnung*, InsO). These payment prohibitions serve to protect creditors and to preserve the insolvency estate.

Management finds itself caught between competing pressures: Managing directors who continue to make payments after the onset of insolvency expose themselves to significant personal liability risk, both under civil law (where the consequence of violating the payment prohibition is a personal obligation of the managing director to reimburse the company for the amount of the prohibited payments) and under criminal law. Conversely, if all payments are suspended, business operations come to a standstill and the prospects for a successful turnaround diminish further.

II. PREREQUISITES AND EXCEPTIONS TO THE PAYMENT PROHIBITION

The payment prohibition under Section 15b InsO is triggered by the onset of insolvency (*Insolvenzreife*), but provides for important exceptions for payments that serve to maintain business operations:

- **Onset of Insolvency (*Insolvenzreife*):** The payment prohibition takes effect upon the onset of insolvency, i.e., upon the occurrence of illiquidity (*Zahlungsunfähigkeit*) or over-indebtedness (*Überschuldung*). A company is illiquid if it is unable to meet its payment obligations as they fall due. Case law presumes this to be the case if the liquidity shortfall amounts to 10% or more and cannot be resolved with a probability bordering on certainty within three weeks. A company is over-indebted if its assets do not cover its liabilities, unless the continuation of the company is more likely than not (*überwiegend wahrscheinlich*).
- **Definition of Payment:** The term “payment” is to be understood very broadly and encompasses not only cash payments but all transactions that reduce the company’s assets. This includes, among other things, transfers of assets, setoffs, and the granting of security interests.
- **Payments Consistent with the Diligence of a Prudent Business Manager:** Exceptions apply to payments that are consistent with the diligence of a prudent and conscientious business manager. This is particularly the case when the payment is made in the ordinary course of business, especially when it serves to maintain business operations, i.e., when an objective creditor would have made the payment in order to preserve the existing estate through (provisional) continuation of the business. The distinction is often difficult. Typically

permissible are wage payments (to employees needed for continuation), rent payments for operationally necessary premises, and payments for goods or services required for the continuation of the business. **Not** privileged, however, are the satisfaction of legacy liabilities (*Altverbindlichkeiten*) or the repayment of shareholder loans.

- **Distinction Based on Time Periods:** The permissibility of payments depends on the time period in which the payment is made:
 - During the period from the onset of insolvency until the timely filing of an insolvency petition, payments are permissible if parallel measures are being taken to sustainably eliminate the insolvency or to prepare an insolvency petition.
 - During the period of delayed insolvency filing (*Insolvenzverschleppung*), i.e., the time during which an insolvency petition should already have been filed, generally no payments whatsoever are permitted.
 - During the period between filing of the petition and the opening of insolvency proceedings, payments are permissible in particular if they have been approved by the provisional insolvency administrator (*vorläufiger Insolvenzverwalter*).

III. RECOMMENDATIONS

- **Institutionalize Liquidity Planning:** Establish a rolling 13-week liquidity forecast and update it weekly. Designate a responsible person (e.g., CFO or head of financial accounting) to maintain the figures and immediately report any material deviations to management.
- **Prioritize Payments During Cash Flow Crises:** Note that certain liabilities must be paid first even during a crisis, particularly social security contributions (employee portion) and wage taxes, as failure to pay may result in criminal penalties.
- **Documentation and Legal Advice:** Continuously document the key background information and considerations regarding the risk of insolvency and the permissibility of payments made, so that an objective third party can understand them. Given the difficulty in distinguishing between permitted and prohibited payments, close coordination with legal counsel specializing in insolvency law is advisable.
- **Early Warning System and Immediate Measures:** Define specific thresholds (e.g., account balance, overdue liabilities > 14 days) that, when reached, automatically notify management. If multiple warning signs occur, seek expert advice immediately—an experienced restructuring advisor or insolvency lawyer can objectively assess your options for action—whether it be an out-of-court restructuring, restructuring proceedings under the StaRUG (*Unternehmensstabilisierungs- und -restrukturierungsgesetz*), or the orderly preparation of an insolvency petition.

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