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Cash pooling and the COVID-19 Pan-
demic:

What do managing directors and board members cur-
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Cash pooling and the COVID-19 Pandemic: What do managing directors and board members currently have to be mindful of?

Securing liquidity and cash management - the advantages of cash pooling and the motives for setting up a cash pool

The group-wide control of payment processes and the bundling of liquidity across group companies by setting up a "central group account" can help to create transparency of the economic situation within groups of companies and to achieve cost-saving effects - cash surpluses and cash deficits are balanced, external credit lines can be lower with better conditions and lower costs.

However, a cash pool regularly implies complicated and legally challenging framework arrangements, which, even in "normal times", entail a variety of stumbling blocks. In

any case, physical cash pooling (physical as opposed to mere notional pooling) is subject to a tightly woven set of rules that results from the interaction of capital maintenance regulations, liquidity protection and high monitoring requirements in order to avoid undesirable liability situations and possibly far-reaching consequences under insolvency law.

At the same time, a merely fictitious cash pooling (notional cash pooling) does often not go far enough and the advantages associated with cash pooling can only be achieved to a very limited extent with this method. Virtual cash pool models, which bring about the desired effect usually resemble physical cash pooling in such a way that the same legal issues arise with the same intensity.

Current situation and problems

If - due to the Pandemic - all companies participating in a cash pool currently have increased liquidity requirements it may not be possible to cover these requirements in full or in part. In addition, the participation of individual companies in the cash pool can be associated with increased risks for all pool participants - especially where the cash pool participants are companies with a business model that may no longer be up-to-date or have very uncertain future prospects ("bottomless pit"). This raises the question of whether all companies can continue to be granted loans. Can or even must certain companies be excluded from the cash pool? Finally, there are more and more uncertainties for the contributors to the cash pool with regard to the return of the payments they have made and the stability of the cash pool as a whole.

How should the management bodies of the participating companies and the cash pool master managing the cash pool behave in this challenging situation?

Whether the companies participating in a cash pool can also cover liquidity gaps with state grants and subsidies or whether participation in the cash pooling currently conflicts with or even precludes the availability of these grants and subsidies cannot be answered conclusively and with certainty at this point in time. For example, the earmarking of the state grants and subsidies in question could already prevent the funds from being used in such a way that the liquidity supplied to a company could be "siphoned off" within the framework of cash pooling. In any case, according to the revised KfW provisions which now apply, loan agreements with final borrowers must generally include provisions to prevent an outflow of liquidity.

The (net) contributors to the cash pool

The contributors to a cash pool must ask themselves whether the loans they grant to the cash pool master on the basis of an account balance or the repayment claims resulting from such loans are of value. Can it be assumed with a sufficiently high degree of probability that the cash pool master will still be able to repay the corresponding outstanding loan amount (cash pool balance) to the company making the payment at all times?

Is the necessary information available to address these questions? Is the required information provided by the cash pool master and is the information sufficient for the requisite assessment? Frequently, the procurement and evaluation of information will also take some time. Is there therefore a right to suspend the cash pooling and the associated obligations in order to gain time for the necessary examination as to whether participation in the cash pool should or must be terminated?

The contributors and their management bodies are exposed to considerable risks in this respect: If the loans are not (no longer) of value, further payments into the cash pool may in any case violate the prohibition on the return of contributions on the



#cashpool
#covid19
#corona
#recover

share capital (Sections 30, 31 GmbHG / Section 57 AktG), which serves to protect and maintain the share capital, or may constitute an unfavourable legal transaction (Section 311 AktG). The consequence of such a payment in violation of this prohibition is not only an obligation on the recipient to repay the funds received, but also a possible personal liability of the management or the executive board (§ 43 GmbHG / § 93 AktG) of the contributor. The same applies if the management fails to constantly monitor the credit risk associated with a participation in the cash pool in order to be able to react to changing situations. Criminal law consequences, in particular for breach of fiduciary duty to the detriment of the company whose business they manage, cannot be ruled out (§ 266 StGB). These risks do not only exist in the case of genuine cash transfers: Similarly, there are cases in which assets of a participating company have been made available or are currently granted to the cash pool (and thereby, to other companies or the cash pool master) as (upstream) collateral.

In addition to the questions to be derived from the principles of capital maintenance, the question also arises as to whether, from the point of view of liquidity protection, the liquidity to be transferred to the cash pool can be dispensed with or is required by the contributor itself. Can it still or no longer be expected that the depositor's own liquidity needs will be satisfied from the cash pool?

The contributing company and its management bodies are also confronted with risks in this respect: Payments which ex post had to lead to the insolvency of the company or payments after occurrence of insolvency or over-indebtedness can (subject to the applicability of the special provisions of the COVID-19 Pandemic Act, to be discussed later) lead to a personal liability of the managing directors (§ 64 GmbHG) or the members of the management board (§ 92 AktG). Furthermore, it cannot be ruled out that the management or the executive board may also be held liable for participation in an act of unlawful interference by the Cash Pool Master. Criminal law consequences (§ 266 StGB - breach of fiduciary duty) are also conceivable here.

Against this background, continuous monitoring of the company's own solvency and balance sheet situation is just as indispensable as continuous monitoring of the situation of the company managing the cash pool, the cash pool master and individual cash pool participants.

The cash pool master

The cash pool master must consider whether the liquidity available to the cash pool is sufficient to satisfy all drawdowns or whether the aggregate amount of drawdowns might exceed the liquidity of the cash pool and its own credit limit. Are credit limits agreed with the participants of the cash pool? Do the companies participating in the cash pool regularly have to submit their current liquidity planning and inform what liquidity they intend to draw from the cash pool, e.g. in a weekly period, in order to provide the cash pool master with a secure basis for decision-making?

If more loans have already been granted to the cash pool than have been drawn from the cash pool, (how) can it be ensured that the contributors to the cash pool are repaid their loans?

If the management of the cash pool master as shareholder of the companies participating in the cash pool or at their instruction violates its obligation to take the earmarking of the company assets of the cash pool participants which are subject to the priority satisfaction of creditors into account, then the cash pool master and the shareholder - subject to the applicability of German law - are easily exposed to the accusation of having unlawfully interfered with the interest of the (German) entities participating in the cash pool.

According to the prevailing opinion, an intervention is immoral - and can therefore be considered an unlawful interference - if only for participating in the cash pool a (German) company is deprived of assets which it needs to satisfy its creditors by priority. In any case, an intervention is immoral and to be qualified as unlawful interference if it violates the minimum standards of proper commercial conduct with regard to the earmarking of the company's assets and leads to or intensifies an insolvency situation. It must be considered that for an intentional immoral damage - as a topos of the concept of unlawful interference endangering a company's existence, deliberate action may suffice.

If a company withdraws large amounts from the cash pool on a permanent basis, special attention must be paid. If this becomes necessary, can this company be "decoupled" from the cash pooling system in order to protect the rest of the group? In order not to expose oneself to the accusation of unlawful interference, a termination of the cash pool participation combined with a conversion of the compensation claim resulting from the negative cash pool balance into a long-term subordinated loan may be advisable.

Facilitations through the COVInsAG?

For all payments (especially loan repayments) there is generally a risk of insolvency. All repayments of shareholder loans made by a German company within one year prior to such company filing for insolvency can be contested by the insolvency administrator of the insolvent company without further requirements; in the insolvency of a subsidiary this can affect all payments to the cash pool master.

The provisions of the COVID-19 Insolvency Suspension Act of 27 March 2020 (COVInsAG), which was enacted as part of the COVID-19 Pandemic Act, may prove to be helpful for the cash pool, the issues outlined and an effective limitation of the liability risks described above.

This Act provides for protection against contestation (and claw-back) for repayments of newly granted shareholder loans, provided that the repayment of the shareholder loan granted is made by 30 September 2023.

A newly granted shareholder loan within the meaning of COVInsAG is a loan that was or will be granted in the period between March 1, 2020 and September 30, 2020. In addition, according to the provisions of COVInsAG, there is no automatic subordination to other creditors for such a loan - unlike in the case of "normal" shareholder loans granted outside the scope of the Act - if insolvency proceedings have been applied for against the borrower's assets by 30 September 2023.

Against this background, it may be considered under certain circumstances whether a higher credit limit can be temporarily granted to companies participating in the cash pool or whether the (continuation of the) inclusion of a company in financial difficulties in an existing cash pool is possible - or whether the cash pool participation of a "wobbling candidate" can be discontinued.

The COVInsAG also contains relaxations for the above-mentioned payment prohibitions addressed to the respective management bodies (payments which had to lead to the insolvency of the company or payments after occurrence of the insolvency or overindebtedness) for the period of the so-called suspension period for mandatory insolvency applications: Payments in the ordinary course of business, in particular those payments which serve to maintain or resume business operations or to implement a restructuring concept, are deemed to be compatible with the diligence of a prudent and conscientious manager within the meaning of Section 64 GmbHG and Section 92 (2) sentence 2 AktG. Due to the provisions of the COVInsAG, the obligation to file for



insolvency is suspended until 30 September 2020. However, this does not apply if the insolvency maturity is not due to the consequences of the spread of the SARS-CoV-2 virus (COVID-19 Pandemic) or if there is no prospect of eliminating an existing inability to pay. However, if the debtor was not insolvent on 31 December 2019, it is assumed that the insolvency maturity is due to the effects of the COVID 19 Pandemic and that there are prospects of eliminating an existing insolvency.

General current recommendations for action

Existing cash pool arrangements should currently be subjected to a careful review. Do they contain, for example, provisions on liability for obligations of the parent and sister companies and provide for joint and several liability? Just like "crisscross offsets", such legal relationships that go beyond the relationship between the parent company and its subsidiary are particularly risky in view of the liability risks described above. Are sufficient information rights provided for? Are there rights of termination with short notice, is a right to suspend participation in the cash pool provided for? Does the agreement permit and/or require effective monitoring by means of mutual credit checks, regular reviews of the participants' own liquidity requirements by means of constantly updated liquidity planning? Is the verification of the existence of a separate sub-balance sheet imposed and the timely use of termination and suspension rights? In view of the regulations and solutions one would expect from cash pool arrangements, it is surprising that the agreements actually in place often only display extremely rudimentary features of that kind or not even these. The reason for this may be that in some jurisdictions, cash pooling is (merely) regarded as a financial instrument, which is why the arrangements are set up and maintained by the treasury function, and the fact that some jurisdictions give much higher priority to the group interest than is the case in Germany, and finally, that over the last decade we have been in a phase of seemingly unstoppable global growth, which is why default risks have been treated rather poorly.

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