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Column

Insolvency – High risks for managers

Board members and executives face existence-threatening risks in case of insolvency of their company. The origin of these risks lies in the insolvency administrator's reproach of delaying insolvency proceedings. Especially problematic is the fact that the managers' risks are partly not insured.

If a company files for insolvency, an insolvency administrator is appointed who will at first examine whether a reason for insolvency is given (inability to pay or over-indebtedness). If the insolvency administrator finds a reason for insolvency, insolvency proceedings are initiated. Within the context of such insolvency proceedings it will be examined whether managers of the company (board members resp. executive managers) have filed for insolvency in time. If the insolvency administrator gets to the result that executive boards have belatedly filed for insolvency – that is not within three weeks since over-indebtedness or inability to pay – the insolvency administrator will claim against former board members for compensation. The enforcement will be performed by the insolvency administrator's attorneys.

Thus, the insolvency administrator has an interest in the assertion of damage claims due to his interest in fees. The "business model" is even more lucrative the more managers are claimed against for damages. Especially in case of corporations, there will often be a two-digit number of former managers who may be claimed against for damages.

Particular problem for executive managers and affiliates

Particular liability problems arise for executive managers of affiliates. If, within a corporation (or group of companies), the holding or a company of economic importance files for insolvency, this will often lead to an insolvency of the entire group. The individual companies of a group are often financially and economically closely connected and are not viable on their own.

The affiliate of a corporation though regularly finances itself via the corporation's cash pooling, legally among others regulated in the profit and loss transfer agreement.

The „financing source“ of the affiliate of a corporation will then be the holding company of the corporation resp. the group company which generates the cash flow.

In order to fulfill his obligation to file for insolvency in time, the executive manager does not only need to have an eye on the solvency and the balance sheet of his own (affiliate) company but also on the solvency and over indebtedness of the group holding.

If the executive manager of an affiliate for example knows about financial difficulties of the holding, this might result in his personal obligation to file for insolvency in time for the affiliate as well.

On the grounds that the executive manager of the affiliate breached these obligations, insolvency administrators do recently not only claim against the board members of the holding or individual group companies in case of insolvency of the corporation, but claim against the executive managers of (almost) all affiliates.

Impacts of claims brought forward by the insolvency administrator

The claim in terms of civil law against a former board member by the insolvency administrator regularly has criminal law impacts.

In this context it is problematic that according to our experience the prosecution often agrees to the findings of the insolvency administrator – that a delay in filing for insolvency is given – without any further examination. Even a conclusiveness test by the prosecution will sometimes not take place. It is relied upon the insolvency administrator as “neutral institution”.

Beyond this, prosecution and courts are overstrained in terms of time in complex proceedings with the presentation of their own investigation in detail.

Insurance law problems

If an insolvency administrator raises the reproach of delay in filing for insolvency, the responsible managers will be claimed against in terms of civil law and criminal law.

The defense against these claims is expensive since it requires the consultation of specialized lawyers which may still not be sufficient. If an insolvency report exists which “determines” the breach against the obligation to file for insolvency, the former manager has to ensure equality of arms by means of a counter expert opinion. Such counter expert opinion of an audit company causes high costs, up to a six-digit Euro amount.

Board members and executive managers should therefore take care that a D&O-insurance with sufficient coverage is concluded on their behalf which also pays in the described cases. In this context the coverage of criminal defense lawyers' fees is important as well. The obtaining resp. preparation of (among others insolvency law) expert reports should be insured as well.

Conduct in practice

Already with first signs of a financial crisis of their company or the group, board members and executive managers should ensure that they are personally protected. A protection may be realized in such way that an auditor or a specialized lawyer examines whether the company is obliged to file for insolvency. If the manager has initiated such examination, he is, in case of a respective result, obliged to file for insolvency within three weeks if he wants to avoid the reproach of an intended delay in filing for insolvency.

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