HENGELER MUELLER

India Desk Newsletter

The purpose of this newsletter is to highlight the key legal developments and business trends in Germany and other parts of Europe in the first half of 2020. We have also included a few transactions which we have recently advised on.

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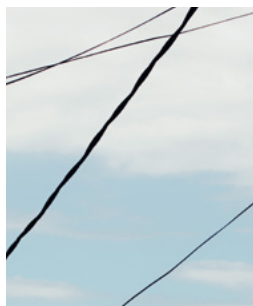
M&A in times of COVID-19

A lot has changed since our last newsletter; the global outbreak of the COVID-19 pandemic, which has seen governments passing state-of-emergency laws in an attempt to control the outbreak, has to a large extent shaped the M&A markets in Europe during the first half of 2020. As a result thereof, various M&A deals were put on hold and the amount of new deals decreased substantially in March and April during the peak of the pandemic in Europe.

However, there are also certain interesting targets, particularly in the sectors of e-commerce and technology, which have profited from the pandemic or not been largely affected thereby, where the dealmaking has continued in accordance with past practices characterized by a seller-friendly market. The outbreak has also further accentuated the rising trend of distressed M&A activities and presented new opportunities for consolidations and carve-outs in the market. Moreover, the economic crisis also offers new opportunities for purchasers, such as private equity players with committed but uncalled capital, who may be able to profit from lower prices.

Generally, the M&A market in Germany has slowly been picking up since May, and there seems to be an appetite and the liquidity on the markets to continue dealmaking despite the prevailing circumstances. However, the newly faced reality, in particular with regard to targets that have been more heavily affected by the pandemic, requires novel creativity from the parties. The challenging market environment for sellers facilitates buyers gaining more bargaining power, which in turn affects M&A agreements and structures of transactions.



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Consequently, the preferred valuation and purchase price mechanisms are changing – price adjustments on the basis of closing accounts and alternative purchase price mechanisms, such as vendor loans, earn-out mechanisms and re-investments, are becoming more popular. While purchase price mechanisms may play a larger role than before, it is equally important to acknowledge the importance of carefully drafted M&A agreements, particularly with regard to MAC clauses, interim covenants and warranties, to name a few key elements.

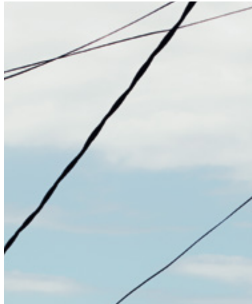
While we cannot predict how the German M&A market will look like in the post-COVID-19 times, the market outlook seems to be carefully optimistic; given that the German-speaking countries in particular have been perceived to contain various M&A opportunities, and that Germany has generally been considered to be well-positioned to recover from the effects of the COVID-19 pandemic, this may contribute to an increased deal volume towards the end of 2020.

Spotlight Merger Control and Antitrust Law during the COVID-19 Pandemic

Like most competition authorities worldwide, the European Commission ("**EC**") and the German Federal Cartel Office ("**FCO**") have struggled to keep their usual pace in merger proceedings during the COVID-19 lockdown. The EC has refrained from altering the statutory timeline for merger reviews, but has encouraged merging parties to delay merger notifications and to extend the pre-notification period. Meanwhile in Germany, the review periods for notifications submitted between 1 March 2020 and 31 May 2020 have been extended from one month to two months in Phase I and from three months to four months in Phase II.

Despite these extensions, in FCO merger proceedings on which we have advised, the parties were able to obtain early clearances within time frames of less than a month. Since the COVID-19 lockdown has been loosening gradually all over Europe, we expect the merger review to completely normalize in the upcoming weeks.

Regarding anti-competitive conduct, the EC and the FCO have repeatedly warned that they would remain vigilant during the COVID-19 pandemic. However, at the same time, they have indicated that they would be open for a flexible application of antitrust provisions during the COVID-19 pandemic and declared to temporarily accommodate collaborations between competitors to the extent that the applicable antitrust laws permit. Specifically for the automotive industry, the FCO declared to temporarily suspend the examination of certain exchanges of information on the solvency, credits or operational problems of the automobile manufacturers.



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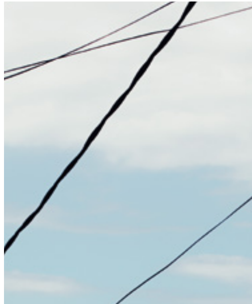
Shareholders' Meetings Modernized by COVID-19 Legislation

Since German stock corporations require an in-person annual general meeting, the contact restrictions following the COVID-19 outbreak were a challenge for various companies' operations. Consequently, several large German public companies postponed their annual general meetings when the social distancing rules were introduced mid-March this year. As a result, similar to many other European countries, the German legislator responded by passing a COVID-19 Act to deal with the issue.

The Act, allowing for fully virtual general meetings, has become effective as of 28 March 2020 and is currently in place until 31 December 2020. Since passing the Act, management boards have been able to elect to hold their general meetings without physical presence of the shareholders, irrespective of whether such authorization is contained in the company's articles of association. However, such virtual shareholders' meeting is subject to the approval of the company's supervisory board and compliance with certain prerequisites, such as live broadcasting of the entire general meeting, casting of shareholders votes electronically or by proxy and the chance to ask questions through an electronic Q&A tool.

While German law had already allowed for a "hybrid" annual general meeting, whereby shareholders have been allowed to attend in person or via the internet, companies have generally held back in fear of technical glitches, which could result in legal challenges, and out of tradition – a long-standing heritage of carefully prepared physical meetings. Accordingly, the concern was eliminated under the COVID-19 Act: The legislator eased the rules associated with the technical difficulties and largely eliminated the right to file a legal challenge related to technical disruptions. Additionally, the far-reaching right to information was condensed into a simple right to ask questions, including a clear legal notification that there is no right to an answer – both changes play a crucial role in bringing the annual general meetings to the digital age.

Since the Act took effect, we have seen companies such as Deutsche Telekom utilize this new option and we advised Commerzbank as the main shareholder on the first ever squeeze-out in a virtual annual general meeting. While we cannot predict how the current circumstances will affect the future of German annual general meetings, there is certainly no lack of discussion and ideas related thereto, and the momentum should be seized to rethink the concept of the annual general meeting in the digital age.



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Temporary Lay-off of Employees and Short-Time Work during the COVID-19 Pandemic

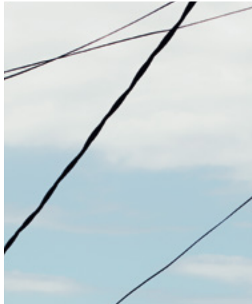
The COVID-19 pandemic has a significant impact on the labor and employment market in Germany. On the one hand, as part of the overall cost and liquidity management, many employers are looking to reduce their personnel costs on a temporary basis. On the other hand, depending on the business industry, we see that some employers are at least considering or preparing for more fundamental personnel restructurings with long-term effects.

As regards a temporary shortfall of work during the COVID-19 pandemic, there are a number of options available to employers in Germany, such as using overtime credits from the past or releasing employees from their duty to work with pay but also encouraging employees to take sabbaticals or other forms of unpaid leave. However, in general, such measures require the individual employee's consent.

Another option called "short-time work" (*Kurzarbeit*) has proven most popular in Germany: In May 2020, around 7.3 million people were working short-time, which corresponds to about 16% of the total workforce in Germany. Short-time work under German law is a temporary reduction of weekly working hours (up to zero hours) along with a reduction of the salary and can be implemented for all employees of a company or certain groups. To compensate the employee for the (partial or complete) salary loss, the German Federal Employment Agency pays an allowance of up to 87% of the employee's net salary loss for a period of up to 24 months. Short-time work is available to employers of all industries in Germany in order to cut personnel costs temporarily while retaining skilled workers during an economic slowdown.

Since March 2020, the German government has reacted to the COVID-19 crisis and has passed several laws and regulations effective from 1 March 2020 through 31 December 2021 to facilitate employers' access to short-time governance allowances and to increase the amount of short-time work compensation provided by the Federal Employment Agency. The reduction of employees' working hours and compensation cannot be implemented unilaterally by the employer, but requires a contractual basis, whereby the most common way to introduce short-time work is via a collective agreement with the competent works council. Where no works council exists, the implementation of short-time work requires an individual agreement with, and thus the consent of, each concerned employee.

To what extent short-time work and other temporary measures sustainably prevent more drastic options in the medium and long term, including redundancies and restructuring, depends on the business environment of the individual employer. While German law places very strict requirements on the termination of employment relationships, the termination of freelance agreements and of the use of employees leased for temporary employment is less restricted and would thus typically be considered first by employers who aim at adjusting their workforce.



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Easements to Insolvency and Loan Restructuring Rules in the wake of COVID-19

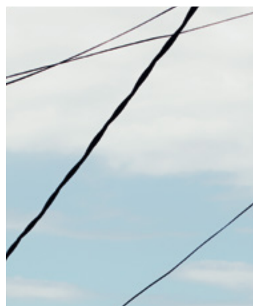
As in many other countries globally, in Germany the negative economic impact of the COVID-19 pandemic is causing a high and ever-increasing risk of insolvency for many companies across all sectors. In response thereto, the German legislator has passed emergency legislation (the "**COVInsAG**"), which aims to facilitate the continuation and prevent the insolvency of companies affected by the COVID-19 pandemic.

While, in principle, managing directors of German companies have an obligation to file for insolvency in the event of illiquidity or over-indebtedness, this obligation has been suspended by the COVInsAG until at least 30 September 2020. However, such suspension is not applicable if (i) the illiquidity is not due to the effects of the COVID-19 pandemic or (ii) there is no prospect of avoiding an existing illiquidity. Managing directors are, however, protected by statutory assumptions and allocation of burden of proof.

Additionally, the granting of loans to distressed companies is significantly facilitated. The COVInsAG provides for a far-reaching privileged treatment of new loans to encourage the provision of additional liquidity. The scheme protects creditors of such new loans (including trade credits) and addresses concerns of such creditors being obliged to return interim repayments or lose access to collateral provided due to avoidance actions, if efforts to rescue the borrower's business subsequently fail and the borrower falls into insolvency. The aim is to remove any doubts about the insolvency-proof nature of such new loan agreements, or the collateral provided for third-party lenders, when granted for the purpose of rescuing companies. However, these privileges only apply to granting of new loans, as opposed to a mere novation or prolongation.

The COVInsAG also aims to offer incentives for shareholders to provide the company with additional liquidity during the crisis; the repayment of new loans made by shareholders is also protected under the same conditions as the repayment of third-party financing (except that collateralisation for shareholder loans is carved out). For the same purposes, the statutory subordination of shareholder loans under insolvency law is temporarily suspended. A number of groups are already making use of these incentives, particularly where a restructuring of cash-pools is required.

Despite these statutory facilitations, some companies including automotive suppliers, fashion labels and retailers have chosen to restructure by means of insolvency proceedings. These companies often employ protective shield proceedings (*Schutzschirmverfahren*), a type of debtor-in-possession proceedings which leave the management in control of the company (instead of an insolvency administrator taking over) and which, inter alia, provide reputational advantages.



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New Foreign Direct Investment Rules

On 25 March 2020, in the wake of the COVID-19 outbreak, the European Commission issued guidance on the screening of foreign direct investments ("**FDI**") by EU member states under the framework of the EU FDI Screening Regulation. The Commission called upon the 14 EU member states with FDI screening schemes to use available tools to the full extent and appealed to the other 13 EU member states to establish screening schemes to prevent a sell-off of strategic EU assets. Several EU member states (and the UK) have recently introduced (or initiated) tightened FDI screening rules, including France, Hungary, Italy, The Netherlands, Poland and Spain.

Under the current German FDI screening regime, the Federal Ministry for Economic Affairs and Energy can screen both asset deals and share deals (above certain thresholds) of non-European investors. Any non-German investment can be screened in the defense sector. The number of German FDI screening proceedings has been rising steeply in the recent years, i.e. 40 in 2016, 65 in 2017, 80 in 2018, and 105 in 2019 (rounded numbers). The authorities may only prohibit a transaction to guarantee security or public order. When deciding on transaction bans and mitigation orders, the authorities' discretion is broader in case of transactions in the defense sector.

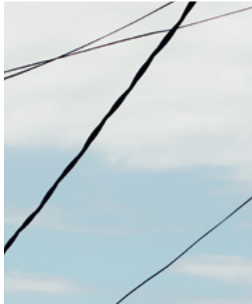
The German Parliament voted through tightened FDI screening rules in mid-June. Key changes include clearance as a statutory closing condition, gun jumping rules for transactions involving critical infrastructure, and eased requirements for prohibiting transactions as well as issuing security-related mitigation orders.

The Federal Government plans to implement further changes soon, for example by widening the definition of critical infrastructures/technologies, to encompass robotics, AI, quantum technology, semiconductors, and biotechnology.

Recent Transactions

May 2020: Siemens AG published key details of the spin-off of its energy business, together with the invitation to the Extraordinary Shareholders' Meeting on 9 July 2020, whereby Siemens shareholders are to receive one share of Siemens Energy AG for every two shares of Siemens AG and fifty-five percent of Siemens Energy will be spun off to Siemens shareholders. Hengeler Mueller advised Siemens on the transaction.

May 2020: Commerzbank AG acquired an equity stake in comdirect bank Aktiengesellschaft ("**comdirect**") from institutional investor Petrus Advisers Ltd. through its subsidiary Commerzbank Inlandsbanken Holding GmbH. As a consequence, Commerzbank held more than 90 percent of the shares of comdirect, reaching the required investment threshold for the merger of comdirect into Commerzbank by means of a squeeze-out under merger law. In May 2020, the annual general meeting of comdirect has approved the squeeze-out merger. It is the first decision ever in a virtual annual general meeting enabling a squeeze-out without the physical presence of shareholders or their authorized representatives. Hengeler Mueller advised Commerzbank AG on the acquisition and on the squeeze-out merger.



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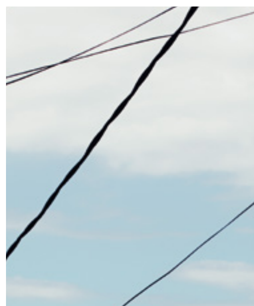
April 2020: Schneider Electric signed agreements on the acquisition of ProLeiT AG, a solution provider for industrial automation, process control technology and manufacturing execution systems for the food and beverage industries. The closing of the transaction is subject to necessary antitrust approvals. Hengeler Mueller advised Schneider Electric on the transaction.

March 2020: Oetker group entered into an agreement with Hauck & Aufhäuser on the sale of Bankhaus Lampe, a private bank founded in 1852 and headquartered in Bielefeld, Germany. Hengeler Mueller advised Dr. August Oetker KG on the transaction.

February 2020: Knorr-Bremse, a leading supplier of braking systems and other rail and commercial vehicle subsystems, signed an agreement to acquire R.H. Sheppard Co., Inc., Hanover, USA, one of the leading manufacturers of steering systems for commercial vehicles on the North American market. The closing of the transaction is subject to closing conditions and regulatory approvals. Hengeler Mueller advised Knorr-Bremse on the transaction in an integrated team with US firm Cravath Swaine & Moore.

January 2020: Axel Springer SE has signed an agreement with Traviata B.V., a holding company owned by funds advised by investment firm Kohlberg Kravis Roberts (“**KKR**”), to withdraw from the Frankfurt Stock Exchange (delisting). Before the application for delisting by Axel Springer SE, KKR will submit a public purchase offer for all remaining shares of the company with an offer price amounting to EUR 63 in cash per share. Additionally, Axel Springer and KKR entered into an investment agreement for a strategic partnership in 2019. In this context KKR has acquired almost 45 percent of Axel Springer's share capital mainly through a public purchase offer and formed a consortium with the main shareholder Dr. h.c. Friede Springer and shareholder and CEO Dr. Matthias Döpfner. Hengeler Mueller advised Axel Springer SE on the delisting.

January 2020: Funds advised by **Oaktree Capital Management, L.P.** (“**Oaktree**”) acquired RAFI GmbH & Co. KG (“**RAFI**”). Sellers are the two managing partners Gerhard Schenk and Albert Wasmeier. Oaktree is a global investment manager specialising in alternative investments, headquartered in Los Angeles/USA. RAFI group develops and produces electromechanical components and systems for human-machine interaction. Hengeler Mueller advised Oaktree on the transaction, including acquisition financing.



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About the firm's India Desk

The India Desk advises Indian companies on their business activities in Germany and throughout Europe and in accompanying German companies to India. Members of the India Desk regularly visit India to meet corporates, law firms, banks and auditors and also to attend conferences based on different topics like IT and foreign investment in India.

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