

# COVID-19: MEASURES UNDER THE ECONOMIC STABILIZATION FUND ACT AND THE LAW ON THE BAYERNFONDS TO MITIGATE THE ECONOMIC CONSEQUENCES OF THE COVID-19 PANDEMIC

Date: 28 April 2020

## Germany Corporate/M&A Alert

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In order to mitigate the serious consequences of the COVID-19 pandemic for the entire real economy, which are already becoming apparent, the German Parliament (Bundestag) decided on 25 March 2020 to set up an Economic Stabilization Fund (“WSF”) in addition to other measures. The law (the Economic Stabilization Fund Act (“WStFG”)) passed the Federal Council of Germany (Bundesrat) on 27 March 2020, was announced on the same day in the Federal Law Gazette (Bundesgesetzblatt), and could therefore already enter into force on 28 March 2020.

In addition to this, on 24 April 2020, the State Parliament of the Free State of Bavaria passed a law on the BayernFonds and the Bavarian Finance Agency (“BayFoG”) with the aim of stabilizing even medium-sized companies that are particularly relevant for Bavaria as a business location in case of a longer shutdown. The law comes into force on 1 May 2020.

According to the explanatory memorandum to the law, the Bavarian state law is based on the model of the WStFG, which in turn is based on the existing framework of the Financial Market Stabilization Fund Act, which was already tested in the financial market crisis of 2008–2009 and in which the supporting instruments were created for the first time. Companies in the financial sector, credit institutions, and bridge institutions are not covered by the WStFG and BayFoG.

The existing programs of the German state-owned development bank (“Kreditanstalt für Wiederaufbau - KfW”) and the emergency aid programs of the Free State of Bavaria (“Soforthilfe Corona”), which were launched in response to the COVID-19 crisis, will continue to exist.

This client information is intended to provide you with an initial overview of the stabilization aids provided at the federal level by the WSF and at the state level by the BayernFonds. In particular, the important temporary changes in German corporate law that are intended to ensure the effective implementation of the stabilization measures are also listed below.

## STABILIZATION MEASURES

### Stabilization Instruments

The WSF and the corresponding BayernFonds each provide for two complementary instruments to stabilize companies in the real economy:

### ***Guarantees***

First, the WSF, with a volume of up to €400 billion, and the BayernFonds, with a volume of up to €26 billion, will be authorized to provide guarantees for liabilities and debt instruments of companies in the real economy but only for new debt instruments or liabilities issued or created after the entry into force of the WStFG or BayFoG and only until 31 December 2021. The aim is to eliminate liquidity bottlenecks at companies and to support the refinancing of companies on the capital market. This is intended to strengthen the confidence of market participants in the value of guaranteed debt instruments and the liabilities of companies. The term of the guarantees and liabilities to be hedged may not exceed five years (60 months). A consideration in line with market conditions must be charged for the assumption of the guarantees.

Further details on the granting of guarantees will be regulated by legislative decree (type of guarantee and risks it may cover, calculation and crediting of guaranteed amounts, consideration and other conditions of the guarantee, and ceilings for the granting of guarantees for liabilities of enterprises, as well as for certain types of guarantees and other conditions necessary to ensure the stabilization purpose).

### ***Recapitalization***

The WSF or BayernFonds may also participate in the recapitalization of companies in the real economy, e.g., by making a contribution, acquiring shares or silent partnerships, or taking over other components of the equity of these companies. Profit participation rights and subordinated debt instruments can also be acquired. In particular, these are intended to serve the purpose of recapitalization in a crisis if they are subordinated, by which the claim for a period before and after the possible opening of insolvency proceedings is subordinated to the claims specified in Section 39 (1) nos. 1 to 5 of the German Insolvency Act (InsO). Since liabilities with such a subordination need not be taken into account in the overindebtedness balance sheet, this can prevent a company from being on the verge of insolvency after the end of the suspension of the obligation to file for insolvency due to overindebtedness. Recapitalization must be carried out at market conditions.

Although the granting of stabilization measures is in principle limited in time, the duration and term of recapitalization measures is not. Recapitalization measures are not limited in time from the outset and an optimum exit date is not envisaged because this could jeopardize the purpose of the measure, i.e., to stabilize a company, or because it is not possible to determine an optimum exit date ex ante. It remains to be seen to what extent such time limits will have; nevertheless, it has become standard in the context of the implementation of individual recapitalization measures.

## **Eligible Companies**

### ***For Stabilization Measures under the WStFG***

In order to qualify for stabilization measures under the federal government's WStFG, companies must have met at least two of the following three criteria in the last two completed financial years:

- Balance sheet total of more than €43 million
- More than €50 million sales revenues

- More than 249 employees on annual average

Enterprises that do not fulfil these characteristics may also be taken into account if they:

- Are active in one of the sectors listed in Section 55 of the German Foreign Trade and Payments Regulation (Außenwirtschaftsverordnung), which mainly concerns companies that are of considerable importance for critical infrastructure; or
- Have been valued by private investors in at least one completed financing round since 1 January 2017 at a minimum of €50 million, including the capital raised by this round.

The law does not say anything about how the above requirements must be demonstrated when the application is submitted (e.g., by submitting the last annual accounts). Neither does the law say anything about whether the relevant number of employees must be exclusively employees in Germany or whether an overall view is relevant in this respect. It is apparently irrelevant where the company has its registered office.

### ***For Stabilization Measures According to the BayFoG***

The same criteria apply to stabilization measures of the Free State of Bavaria, but the thresholds are below those in the federal law and only refer to the last completed financial year:

- Balance sheet total of more than €10 million
- More than €10 million sales revenues
- More than 50 employees on an annual average

In addition, startup companies are also eligible for stabilization aid from the BayernFonds if they have been valued by private investors at a minimum of €5 million, including the capital raised through this round, in at least one completed financing round since 1 January 2017.

There are no upper limits with regard to the criteria for eligibility to apply; this means that overlaps with the federal government's concept are possible. However, stabilization from BayernFonds resources is to be ruled out if a company has already received federal assistance from the WSF or has not received a stabilization measure under the WStFG for reasons of state aid law (according to a press release by the Bavarian State Chancellery dated 31 March 2020). The pure wording of the BayFoG, on the other hand, does not seem to exclude the general possibility of parallel support by the federal government from the outset; however, this should in any case be taken into account in the exercise of discretion. Moreover, there are no provisions in the laws on whether and to what extent parallel recourse to European aid measures is ruled out.

### **Criteria and Conditions for the Granting of Stabilization Measures**

There is no legal claim to benefits from the WSF or BayernFonds. At the federal level, the Federal Ministry of Finance in agreement with the Federal Ministry of Economics and Energy will decide on applications of companies for the granting of stability measures. For Bavarian stability measures, the State Ministry of Economics, Regional Development and Energy in agreement with the State Ministry of Finance and Home Affairs will decide, at their due discretion, taking into account in particular:

- The importance of the company for the economy of Germany and Bavaria;
- The urgency;

- The effects on the labor market and competition or, according to BayFoG, additionally taking into account technological or economic sovereignty, security of supply, and critical infrastructure in Bavaria; and
- The principle of the most economical and efficient use of the resources of the WSF or BayernFonds or, under the BayFoG, explicitly also taking into account possible or already applied stabilization measures under the WStFG or comparable measures of other federal states.

In addition, in order to be granted the stabilization measures, the companies must each fulfill the following conditions:

- No other means of financing must be available;
- With the help of the stabilization measures, there must be a clear and independent continuation perspective for the company after the COVID-19 pandemic has been overcome;
- In principle, the liquidity and capital requirements must be due to the COVID-19 pandemic, i.e., the company applying for a measure must not have met the European Union definition of “companies in difficulty” by 31 December 2019;
- The company must guarantee a sound and prudent business policy; and
- The company must be able to contribute to the stabilization of production chains and the safeguarding of jobs.

### **Other Requirements for Beneficiary Companies**

By means of a legislative decree, more detailed rules may be laid down on the requirements to be met by the beneficiary undertakings in regard to:

- The use of the funds raised;
- The raising of further loans;
- The remuneration of its organization;
- The distribution of dividends;
- The measures taken to avoid distortion of competition;
- Sector-specific restructuring requirements;
- The way in which the WSF or BayernFonds is to be held accountable;
- The undertaking to be offered by the company;
- The period during which the requirements are to be met; and
- Other conditions that are appropriate to ensure compliance with the law.

Draft legal ordinances are not yet available.

The requirements may differ depending on the type and addressees of the stabilization measure and may be determined on the basis of the WStFG or BayFoG and the respective statutory regulations issued in this regard

by contract, voluntary commitment, or administrative act. The legal ordinances should also be able to regulate the legal consequences of noncompliance with the aforementioned requirements.

### **Significant Changes to Corporate Law**

In order to ensure that the stabilization measures are implemented as flexibly and quickly as possible, the WStFG provides for special privileges under German corporate law, particularly for stock corporations, which are to apply accordingly to other institutions set up by domestic regional authorities, in particular federal states, which are comparable to the WSF. The BayernFonds is such an institution of the Free State of Bavaria comparable to the WSF. This is made clear in Art. 2 para. 3 of the BayFoG. Thus, the modifications are also applicable to companies receiving stabilization measures under the BayernFonds.

The amendments concern, in particular, the following points:

#### ***Relief for capital increases in a German stock corporation (Aktiengesellschaft (“AG”))***

- Annual general meetings can be convened with a shortened notice period of only 14 days, as previously provided for the special case of the annual general meeting under takeover law.
- The resolution on the capital increase for the purpose of implementing a stabilization measure requires only a simple majority of votes, in contrast to general stock corporation law and possible stricter provisions in the articles of association.
- Only a two-thirds majority (instead of a three-fourths majority) is required for an exclusion of subscription rights within the framework of the stabilization measure. If half of the share capital is represented at the annual general meeting, even a simple majority is sufficient. The exclusion of subscription rights in favor of the WSF or BayernFonds is considered permissible and appropriate in any case, so that any risk of rescission is excluded in this respect.
- In order to enable a rapid inflow of liquidity, the WSF or BayernFonds can also make the contribution to the new shares in advance, i.e., before the capital increase resolution. This applies even if the new shares are to be issued from authorized capital yet to be created by the annual general meeting.
- Shares may be issued with a preferential right to profits or with priority in the distribution of company assets or as nonvoting preference shares. However, the issue of nonvoting preference shares is limited to a maximum of half of the share capital. Shares issued to the WSF or BayernFonds shall lose their preferential rights if they are transferred to third parties. These shares then become normal ordinary shares without special rights. If the WSF or BayernFonds initially acquires nonvoting preference shares, the WSF or BayernFonds may, at its own discretion, determine whether these nonvoting preference shares are converted into normal ordinary voting shares upon transfer to a third party.
- In contrast to general statutory law or the articles of association, a capital reduction only requires a two-thirds majority (instead of a three-fourths majority) of the share capital represented. If half of the share capital is represented at the annual general meeting, a simple majority of votes is again sufficient.
- The creation of special authorized capital for the purpose of implementing a stabilization measure is not limited to 50 percent of the existing share capital but is in principle unlimited, thus enabling very large stabilization measures in terms of volume. The corresponding resolution of the annual general meeting to create authorized capital requires only a simple majority of the votes cast. If, at the same time, an

authorization to exclude the subscription right is to be granted, a two-thirds majority is required or, if half of the share capital is represented, a simple majority.

- Transaction security is further enhanced by the fact that shareholders who delay or thwart stabilization measures in order to secure unjustified advantages for themselves are burdened with the risk of liability for damages.

### ***Facilitated participation as silent partner***

- The WStFG makes it clear that the participation of the WSF or BayernFonds does not constitute an intercompany agreement and therefore does not require registration in the commercial register. This privilege also applies to stabilization measures in which the silent participation of a third party is established. The privilege also applies to any subsequent changes to such a silent participation.
- The silent partner may be granted the right to convert the silent partnership into new shares of the company. Subscription rights are expressly excluded for these conversions. However, the granting of this conversion option requires an authorizing resolution at the annual general meeting, which in turn must be adopted by a two-thirds majority (or simple majority if at least half of the share capital is present).
- The premature return of a capital contribution by the WSF or BayernFonds or the amicable dissolution of a silent partnership does not constitute a prohibited return of contributions.

### ***Accelerated effectiveness of annual general meeting resolutions at an AG***

- The validity of resolutions on capital increases or resolutions to create conditional and/or authorized capital is independent of their entry in the commercial register; actions do not have a blocking effect.
- The resolutions shall also become effective vis-à-vis third parties upon publication of the resolution applied for registration on the company's website, but at the latest upon publication in the Federal Gazette (Bundesanzeiger).

### ***Facilitated issue of profit participation rights and bonds***

- The board of management of a company is authorized to issue profit participation rights and bonds with a "qualified subordination" to the WSF or BayernFonds until 31 December 2021. The supervisory board's approval is required for this authorization to be exercised. However, the issue of profit participation rights and bonds does not require the approval at the annual general meeting unless the profit participation rights and bonds provide for the right to convert them into shares.

### ***Analogous application to partnerships limited by shares (KGaA), European Companies ("SE") and cooperatives (Genossenschaften)***

- The rules of the German Stock Corporation Act apply mutatis mutandis to companies that have the legal form of a partnership limited by shares or a an SE.
- The fund may become a member of a company in the legal form of a cooperative. Amendments to the articles of association of cooperatives whose purpose is to bring about a capital increase through the fund must be notified for entry in the register of cooperatives without delay and entered without delay, unless the underlying resolution is obviously null and void.

### ***Significant changes to the law on limited liability companies (“GmbH”)***

- If a GmbH makes use of the stabilization measures, shareholder resolutions on a capital increase against contributions, on a capital reduction or the creation of authorized capital, including an exclusion of subscription rights in connection with the stabilization measure, require only a simple majority of the votes present, notwithstanding possible stricter provisions of the articles of incorporation.
- As in the case of a stock corporation, resolutions amending the articles of association take effect as soon as they are published on the company's website (or, at the latest, when published in the Federal Gazette).
- A squeeze-out option is introduced by which shareholders can decide with a three-fourths majority to squeeze out shareholders in return for a cash settlement if this is “necessary for the success of the stabilization measure.”

### ***Limited partnerships (Kommanditgesellschaften (“KG”))***

- For resolutions of companies in the legal form of a limited partnership with the sole general partner being a limited liability company (“GmbH & Co[KL2] KG”) or limited partnership to accept the WSF or BayernFonds as a limited partner, a simple majority of the shareholders participating in the resolution is sufficient.

### ***Relation to other provisions***

- No duty to inform: Economic Committee Section 106 (2) sentence 2 and (3) number 9a and Section 109a German Works Constitution Act (BetrVG) do not apply to the acquisition of shares by the WSF or BayernFonds.
- No duty of disclosure for major holdings: Section 43 of the German Securities Trading Act (“WpHG”) does not apply to the acquisition of shares by the WSF or BayernFonds.
- No disclosure obligation for major holdings: Section 2c German Banking Act (KWG) does not apply to the acquisition of major holdings by WSF or BayernFonds.

### ***Securities acquisition and takeover offers; exclusion of minority shareholders***

- If the federal government, the WSF or BayernFonds, or their respective subsidiaries acquire control of a target company in connection with a stabilization measure, the German Federal Financial Supervisory Authority (BaFin) exempts them from the obligation to submit and publish a mandatory offer pursuant to Section 35 of the German Securities Acquisition and Takeover Act (“WpÜG”)
- If the federal government or the WSF or BayernFonds submit a takeover offer, a shortened acceptance period of two weeks applies; the further acceptance period does not apply. The threshold for a squeeze-out under takeover law has been lowered to 90 percent. There are also simplifications for the offer document.
- The threshold value for the squeeze-out under stock corporation law has also been lowered. The WSF or BayernFonds can already demand such a squeeze-out if it owns shares in the company amounting to 90 percent of the share capital. Further simplifications also apply in this respect.

In addition, the WStFG provides for further exemptions in order to achieve the desired acceleration effect. Significant restrictions of corporate law and other areas of law do not apply, such as the provisions on hidden contributions in kind, stock exchange listings, and in the context of the avoidance of insolvency.

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