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Dear Readers,

Earlier this year Prof. Dr. Bruno Mascello has taken a look into the crystal ball in order to predict trends in the legal market. But this was just before Covid-19 hit the world. And changed it in so many ways. Which is why our author is changing his predictions, too. Don’t miss out on a remarkable piece.

“The actions of leaders significantly determine the destiny of their teams”, as Timo Spitzer and Cedric Liesens believe. That is even more true in times like these. I would like to strongly recommend this article to you.

The M&A pipelines are empty? Yes, mostly, but there might be signs of hope means Dr. Tobias Will, and there might be a shift to distressed deals, too, say Dr. Ian M. Maywald and Volker Germann.

Sincerely yours,

Thomas Wegerich
A few months ago, I foresaw 10 trends in the legal market, not expecting it would already be time to assess whether Covid-19 had caused me to change these predictions (see, e.g., Deutscher Anwalt-Spiegel, Ausgabe 1, 08/01/2020 and 09/01/2019; Business Law Magazine of 27/02/2020 and 01/03/2018; HSG-Blog of 06/02/2020.

Today, we are all witnesses to a worldwide experiment triggered by a virus which in the end will have contributed much more to (digital) transformation in the legal market than any other development, CEO or digitalization and innovation officer before. Will there be a hysteresis after the hysteria, will this cause sustainable changes and shifts with different expectations and preferences of customers and employees, or is it just a temporary nuisance to be overcome like a runny nose or cough?

Without any doubt, Covid-19 is relevant to the legal market and its developments. It has not only caused a health crisis and had social and political effects, but will very likely turn into a financial crisis as well. The latter directly impacts the legal market and the various legal service providers. Some of the relevant points to reflect on are the following:

1. Companies focus on cost-cutting exercises: Working on the bottom-line is the most effective short-term measure to help stem immediate bleeding. It will be applied across the board to all business units and functions without any exceptions. Legal departments need to show that they are good corporate citizens, effective budget managers and contributors to the success and survival of their companies.

2. Revenue of law firms is lost forever: The real economy has been hit dramatically, and along with it the service sector. Considering that a country like Switzerland generates three quarters of its added value in the services sector, this certainly also impacts law firms and legal service providers. Legal services are considered to be services and not goods, i.e. whatever is not consumed at the time will not be additionally consumed later. Exceptions may certainly apply (e.g., last wills, divorces); however, some of the litigations are already settled or may not be possible anymore, and any Covid-19-related new ones will not compensate for the loss.

3. Loss of customers: Small and medium-sized law firms depend on SME customers. Many of the small enterprises may not survive the time during the crisis or the subsequent recession and may not spend their liquidity on legal services. Depending on how long the crisis lasts, big companies may shut their doors as well.

4. Law firms disappear: Law firms are no better than cottage industries: as cash-based organisations they do not own any assets, they have not accumulated any financial reserves to carry them through stormy times, and their stock in mandates lasts for a few weeks only. The pipeline dries up quickly, and this may force some law firms to close. Big Law may profit in the short term since in VUCA times, CEOs may “rush to brands” – this as a precaution in case they are blamed for having
made the wrong decisions during the crisis. Strong brands are more likely to survive since they sell additional value (call it “insurance protection”).

5. Layoffs and salary pressure: If revenue is lost, cost control will become key. Law firm partner income will be reduced, or partners will be requested to inject capital to preserve liquidity, while salary cuts for associates and a reduced size of workforces through furlough or layoffs are also to be expected, with timely billing and cash collection becoming more important.

6. Review of business model and strategy: This is the moment where business models and strategies need to show their durability, and if they fail, to be reviewed and changed.

7. Push for digitalization: The entire world has gone online: customers, providers, universities and even courts. Technology is being used more often and in a much better way. Some companies and law firms have been taken by surprise and discovered that they are not ready for remote work, use no VPN connections and have no business continuity plans. Virtual meetings and exchanges will become normal – remember those horrible conference calls with dozens of participants? They have suddenly disappeared with the advent of video call apps!

8. Push for legal tech: Because of the extent to which technology has helped us through this crisis, it may be embraced more readily in the future and not be perceived as a threat any more. Legal Tech companies have gained a convincing additional USP for their sales pitches, and customers are more willing to combine human capital and technology.

9. Acceptance of new work: With the push to online, new working models like remote work, flexitime and coworking have proved to function even without strict in-office face time. Unless an organization relies on paper, it will be difficult for employers to deny their employees the opportunity of working from home at least some of the time. The working environment and leadership style need to adapt as well. Finally, this...
opens up opportunities to recruit from less expensive regions or to allow part-time work, in particular for lawyers over 50 or parents.

10. Consulting online is accepted: Online consulting services will become much more acceptable and not be felt to be unfamiliar anymore.

Based on this, what are some consequences for the legal market?

11. Increase of insourcing and pressure to resource: To avoid layoffs in the legal department, outsourcing costs (e.g. law firms) will be reduced to the greatest extent possible. Tasks will be reassessed with regard to whether they should still be done by the legal department or by law firms, or whether new suppliers could do them more efficiently. Multi-sourcing concepts will be established to reduce cluster risks and increase risk diversification. Preferred providers will be willing and able to deliver more than “just” legal know-how (e.g., interdisciplinarity, international network, technology and process expertise, customer-centric business model).

12. Accelerated price negotiations: Service providers will be asked to reduce their costs and to provide free aid packages to show that they are serious about caring for their customers.

13. Communication by leaders is key: In a crisis you can show and prove that you are a real leader. You will be capable, for better or worse. Be present and show that you are a thoughtful and effective communicator, that you can stay calm and rational, and that you can communicate clearly and honestly. Be sympathetic and empathetic.

14. Customer focus is essential: Today, you can also demonstrate real interest in caring for customers and their survival, which means switching from an inside-out to an outside-in view. The customer comes first, and lawyers should not act like ambulance-chasers if they believe in long-lasting acquisition efforts and sustainable relationships.

15. Employee focus is vital: How you handle the situation will have a lasting effect on current employees and also be acknowledged in the future recruitment market. Do you lay employees off quickly or are you considered to be a trusted employer who engages in a reasonable activity level, including fostering the training and education of associates?

16. Procurement department gets appreciated: The expert in cost-cutting exercises is no doubt the procurement department. Their role will become much more important and listened to, even in legal departments with a defensive attitude.

17. Crisis as a selection tool: A crisis operates like an acid test. In times of great urgency, it is about doing the right thing and providing plug-in legal solutions for serious business challenges. A crisis also forges reputations both good and bad, and the outcome will have a lasting impact. Lawyers can demonstrate they are risk and crisis managers who can be relied on and who help to carry the burden of uncertainty. Customers are much more sensitive in critical times and communication becomes a real differentiator. The much-trumpeted trust relationship is at stake and law firms run the risk that unsatisfied customers will “vote with their feet” and switch to a competitor. Depending on how lawyers act and behave, they will have the opportunity to win new customers or they risk losing existing ones, forever.

18. “Make” has proven to be stronger: Today, legal departments are forced to do more on their own (less outsourcing), to take more risks (no second-guessing) and to show they can do the work more quickly and for less money (efficiency gains). This effect will remain and not bounce back, as we already noticed after the financial crisis of 2008.

19. New legal challenges: In the short term there might be a shift from transaction business (besides clarifying clauses around MAC, force majeure and termination) to insolvency and restructuring. In the long term, the questioning of globalization and specialization, the critical assessment of remote supply chains and the move of production closer to the end user, the dependencies of cluster risks and the related vulnerability of
customers, may all lead to new legal questions to be solved by the lawyers. This will offer new opportunities for the legal market.

20. Time for innovation: One can of course first wait and see and then simply react. However, the present day is also an opportunity and a time to optimize and innovate, and to position oneself as a first mover in the market. A crisis has the potential to accelerate changes (e.g., standards ready for download, click accept agreements, online resolution procedures, access to justice, changing court procedures). And it may change behaviour patterns and break down long-lasting silos as well.

In a nutshell, change and the adoption of technology have been accelerated and proved to be fit for purpose. Since everyone was forced to cope with the new situation at once and since there were no real options to choose from or time to wait, it had to function and it required rapid learning, flexibility and agility. The way lawyers work and interact with their customers and how we use technology have already changed and will continue to change – as will the mindset, too. A lot of routine and familiarity have gone, much of it for good, making way for something new. Post-corona, we will not return to the previous equilibrium. ←
As a team through the COVID-19 crisis to the “new normal” of work

Leading a team through the coronavirus crisis

The global COVID-19 crisis is shaking life as we know it right down to its foundations. It has left the relative stability and predictability of the past far behind and will accompany us into a “new normal” for our personal and professional lives. The actions of leaders significantly determine the destiny of their teams and, probably, of their own careers. The present state of emergency requires both effective management and leadership to complement one another. Management should address urgent needs, with fast-paced decision-making and resource allocation. Leadership, on the other hand, should guide the team to the best possible outcome, anticipating obstacles, whilst building up a state of preparation for what is yet to come.

Due to the coronavirus, teams have been physically torn apart, confined to their homes, sometimes across borders. Team members have needed to quickly adapt to remote working, without the usual human interaction, where context and subtext often were equally as important as the spoken word. A team leader should acknowledge this additional hurdle in communication and appreciate that his or her colleagues are human beings with their individual ideas, emotions and insecurities. A leader has to be approachable and listen to all team members, making sure they feel that they have been fully heard. To gain the trust of a team, the leader should be candid and available, and provide the team with timely information and support, reducing potential speculations, suspicions and professional fears. A leader makes sure that the team members not only know but also genuinely feel that we are all in this crisis together, rowing in the same direction.

Working from home without friction

Technological advances enable many of us to work from home. If handled well, remote working can boost employees’ morale by enabling us to save personal time otherwise lost during the usual daily commute. Employees should be empowered to structure workdays to optimize productivity and efficiency. Remote-working sometimes can help teams to better balance domestic and family needs by not having to be in the office during specified hours.

Where physical contact enables the spread of the coronavirus, remote-working often is a practical necessity to keep employees safe and in controlled spaces. By practising social-distancing and by leaving home only for the most significant reasons, we can easily support the real heroes in the health and food supply sector who are fighting on the front line. But working from home leads to a key challenge: how to strike the right balance between office and personal life, now that they are both concentrated in the same space. To avoid friction, all members of a team should, of course, continue to communicate clearly with...
one another. Equally important, everyone should try to adhere to an availability schedule. Often this means that we need to temper the feeling that we need to be available and online at any and all times. Nonetheless, if things come up regularly that require us to log on outside of our agreed schedules, working hours should be adjusted accordingly.

The elimination of time spent commuting and in office chatter gives people working from home more time to get the work done whilst also attending to domestic needs. At the same time, remote working might induce loneliness. Personal errands or activities should be viewed as breaks throughout the day to keep employees balanced and less prone to burn-out and depression. When working from home, it is imperative that leaders show trust in their team members and continuously express real appreciation and gratitude for their hard work.

Staying on top of relevant legal changes

German legislators promptly reacted to the current crisis by enacting, inter alia, the Law to Mitigate the Consequences of the COVID-19 Pandemic in Civil, Insolvency and Criminal Procedure Law. As always, legal teams must stay on top of developments to understand the impact of legislation on business. For example, they should be able to explain in practical terms how to interpret the temporary suspension of the obligation to file for insolvency upon an event of default or a breach of representation.

The new situation also brings contractual “boilerplate” clauses like force majeure to the forefront. These clauses, which previously were rarely negotiated, are now under heavy scrutiny. Whether a party can be excused under a contract for a failure to perform or a delay in performance due to COVID-19 depends on the drafting of the relevant clause, on the specific facts of the underlying situation and on the applicable governing law. Additionally, Material Adverse Change (MAC) clauses addressing COVID-19 are emerging.

Continuing to network with relevant stakeholders

Corporate counsels ideally are ambassadorial networkers and public spokespersons for their organisations. In times of enforced social distancing, the classic form of physical networking with external stakeholders has temporarily come to a halt and has needed to evolve to a virtual level. A continued interaction through telecommunication with
peers increases mutual respect and understanding, and also prepares the community to emerge stronger together.

When colleagues are not physically together in an office space, tele-networking with internal stakeholders is equally important. In-house lawyers should be proactive and should ensure that they remain trusted advisors to the business, whose counsel is sought on many levels. The legal team should be a commercial partner whilst maintaining its guardian function. Legal teams must lead by example by advising pragmatically on applicable legal and commercial rules, strongly abiding by ethics and employee values such as honesty, fairness and transparency.

Preparing for the “new normal” of work after the crisis

Leadership means preparing corporations for the “new normal” of work. As the crisis is still raging in large parts of the world and a resurgence of the virus is lurking behind the corner, it is uncertain what the “new normal” will look like. A return to the life we had before the crisis seems highly unlikely. Since office life came to a standstill, employees have proven that remote working functions better than some managers may have anticipated. Most of us are experiencing how practicable working from home can be. COVID-19, as painful as it is, can be a real driver for innovation and digitalisation in corporations.

Leaders should come to the conclusion that offering team members the choice to work either fully or to a large extent from home is a great way to motivate employees and also to protect those colleagues who have already returned to the office physically. Corporations might become even more cost-efficient when remote working is more widespread and accepted after the crisis subsides, as office spaces can be transformed to more flexible co-working spaces, thereby facilitating internal networking.

When colleagues are not physically together in an office space, tele-networking with internal stakeholders is equally important.

Corporations should embrace technological innovation, enabling employees to be more agile. Throughout this pandemic, employees have shown that that are highly resilient. They protect and advance the interests of their companies whilst at the same time dealing with personal matters, creating tomorrow through actions taken today. This crisis can function as a real turning point in the evolution of a healthy work-life balance, especially when managers learn to appreciate that the way forward often begins at home. ✏
Hopes pinned on second half of year

The seller is (still) king in M&A transactions

By Dr. Tobias Will

The world is in the grip of the coronavirus pandemic. Companies’ priorities are shifting – away from transactions and towards ensuring their own ongoing viability. But as soon as the economy starts up again, corporate transactions will be back on the agenda. The CMS European M&A Study provides decision-makers with an important resource in this respect.

The coronavirus dominates the pages of every newspaper, magazine and professional journal at present, leaving little room for other news. Especially in times like these, it is often worth looking back in order to identify the right way forward. The transaction market is no exception. The key finding of the recently published CMS European M&A Study is that Europe is still a sellers’ market. In 2019, sell-
ers were again able to agree on key aspects of risk allocation in M&A transactions in their favour. It is doubtful whether this trend will continue in 2020, though, not least because of the coronavirus pandemic and its impact on the economy.

Each year, the CMS European M&A Study examines contractual provisions in M&A transactions handled by CMS (a total of 466 share and asset deals in 2019) and compares them with the previous year’s results. It also presents the trend over the entire twelve-year period since the inception of the study, and a nine-year reference period (2010 to 2018) based on more than 3,300 evaluated transactions. This comparison in particular shows that both buyers and sellers have become increasingly sophisticated and demanding. It is therefore even more important for deal participants and their advisers to prepare carefully and rigorously in advance of any transaction. The size of the deal sample and range of countries involved means that the study is a uniquely valuable and rich resource for all M&A practitioners across Europe and provides useful guidance.

Trend continues: market remains seller-friendly

The existing market trends across Europe continued in 2019. They included deal participants again tending to allocate risk in favour of the seller. This can be seen especially in the use of provisions that are generally considered to be seller-friendly, such as liability caps, de minimis, basket and locked box arrangements. Warranty & indemnity insurance (W&I) has become even more prevalent as a replacement for, or an addition to, warranty coverage by sellers. In many respects, market practice has remained broadly unchanged over the last five years, particularly with regard to purchase price adjustments, locked box structures, liability caps, earn-outs and security for warranty claims. It is noteworthy, however, that deal drivers have shifted significantly compared to the previous year. Some 46% of the evaluated deals involved the buyer seeking to enter a new market – a substantial increase over the previous year (32%). The acquisition of know-how or skilled employees (acqui-hire) also played a much more prominent role in 2019 (41% compared with 23% in the previous year). Whether or not this constitutes a trend can probably only be established with any certainty in a year’s time.

Locked box provisions increasingly popular

Buyers insist on purchase price adjustment clauses to ensure that they pay the right purchase price for the target company at the closing date. Locked box arrangements, on the other hand, are intended to provide the seller with certainty about the purchase price. Purchase price adjustment clauses are being used less often overall (45%), whereas locked box provisions are on the rise (56%). Where a purchase price adjustment is agreed, the parties increasingly use adjustment parameters that are as simple as possible and difficult to manipulate – in particular the cash-free/debt-free position (50%). This reflects a desire by sellers and buyers to obtain certainty as to the amount of the purchase price when signing the transaction documentation and to minimize the potential for dispute if the purchase price has to be adjusted.

Record year for W&I insurance

W&I insurance is in particular demand where sellers only accept a low liability cap, as in the case of private equity sellers, or where there is an insufficient amount of coverage provided by the warrantors. The year-on-year rise in popularity of W&I insurance continued, climbing 2 percentage points to 19% of all deals in 2019, while almost half of deals worth more than EUR 100 million now involve a W&I insurance policy. As premiums have decreased, the W&I market has become more accessible and particularly for larger deals the seller is now able to offload liability to the W&I insurer. Real Estate & Construction is the most popular sector for W&I insurance.
Liability caps depend on deal size

The concept of limiting the seller's aggregate liability under the company sale and purchase agreement is absolutely standard in M&A contract practice. The issue during contract negotiations is usually merely the exact level of the liability cap. In 2019, the cap was below the purchase price in the majority of transactions (65%). Overall, liability caps are increasingly determined by deal size. The purchase price is most likely to be the overall cap for a smaller transaction (30% of transactions worth under EUR 25 million), while for larger transactions the cap is most likely to be significantly less than the purchase price – often just 10% to 25% of the purchase price.

Outlook: Distressed M&A transactions set to be a major factor

Existing market trends continued in 2019, especially with regard to seller-friendly provisions and W&I insurance. But what will the M&A market look like after the coronavirus pandemic has abated? Although transactions are now largely at a standstill, it is highly likely the second half of 2020 will see a rebound. Having said that, distressed M&A will probably dominate. The recent very high valuations can be expected to fall, or at least stop rising. Many buyers have put transactions on hold for the time being, but they will want to spend their funds this year, or may be compelled to do so. In the process, they will encounter sellers who are under increased selling pressure due to the coronavirus crisis, especially in cases where they need to restructure.
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Pre-insolvency M&A

Practical considerations from seller’s and purchaser’s perspective in a transaction involving distressed targets

By Dr. Ian M. Maywald and Volker Germann

By applying the right measures, a pre-insolvency transaction may provide certain advantages to the parties compared to the acquisition post insolvency petition.
In current times, both investors and divesting shareholders will increasingly need to deal with targets close to or already having filed for insolvency. Both the sale and the acquisition pre-insolvency petition from the shareholder/business owner and post insolvency petition from the insolvency administrator do entail specific advantages and risks for every party involved. Due to the fact that the seller may try to not only minimize its risks but also to prevent the crisis becoming public, the acquisition pre-insolvency is in some cases to the advantage of the purchaser as he faces less competition and potentially has the chance to get a bargain. The seller will typically approach strategic investors with which he already has an established business connection; thus, in many cases the purchaser will - despite of certain risks – benefit from an exclusive situation for the acquisition. However, in these scenarios the parties have to be well aware of the setup in order to avoid relying solely on insolvency laws to be safeguarded from the risks deriving from the distressed situation. The parties are well advised to apply appropriate measures to significantly minimize the (legal) risks of a pre-insolvency transaction for both the seller and the purchaser.

This article provides a short legal background to pre-insolvency transactions, explains the general positions of the seller and the purchaser and suggests potential safeguarding measures.

Background

The major concern in case of a pre-insolvency transaction is the application of German insolvency laws in case of the opening of insolvency proceedings post acquisition, in particular the right to contest prior business transactions (such as the acquisition itself).

If the legal prerequisites for a contestation are met, the insolvency administrator can challenge the antecedent transaction.

The starting point for any insolvency proceeding is usually the company’s management obligation to file for insolvency without undue delay, however within a maximum period of three weeks starting from the occurrence of a reason for the insolvency. The delay or omission of the insolvency petition can lead to civil and criminal liability. Generally speaking, with the opening of the insolvency proceedings the management (and thus the shareholders) lose control over the target and an insolvency administrator will be put in place in order to administer the insolvency proceedings. The insolvency administrator will i.a. assess potential contestation rights and clawback rights resulting therefrom under insolvency law in respect of transactions negatively affecting the insolvency estate and made within certain periods prior to the target’s petition for insolvency.

If the legal prerequisites for a contestation are met, the insolvency administrator can challenge the antecedent transaction (section 129 et seq. German Insolvency Code). In particular, the insolvency administrator may try to challenge the following transactions:

- Payments of obligations which were not (yet) due (inkongruente Deckung) (i) within a period of one month prior to the filing of the insolvency petition, or (ii) within a period of three months if (A) the company was illiquid at the time of payment or (B) the recipient was aware of the disadvantage to the insolvency creditors arising from such payment on its date.

- Payments of due obligations (kongruente Deckung) made within a period of three months prior to the filing of the insolvency petition, if the recipient knew at that that the company was illiquid.

- Payments of the company on shareholder loans (or similar claims) within a period of one year before the insolvency petition.

- Payments made within a suspect period of ten years before the insolvency petition with the intent to cause detriment to creditors, provided that special subjective elements are satisfied, and with a reduced period of four years before the insolvency petition if the transaction granted or facilitated a security or satisfaction to the insolvency creditor.

As a consequence of the challenged transaction, the claim of the investor for repayment will generally be treated as an ordinary insolvency claim and as such will be subject to the general quota with all other non-preferred creditors.
Asset deal vs. share deal

The pre-insolvency transaction can be structured both by way of a share deal or asset deal. Both options entail certain advantages and risks. In order to minimize the respective risks, generally speaking, purchasers tend to prefer acquiring the target’s assets, with sellers preferring to sell the target’s shares.

Inter alia in case of a share deal, past mistakes and latent liability risks may still be existing in the distressed target and consequently must be dealt with after acquisition. However, in case certain contractual relationships of the target are key or if the investor seeks to gain control over the target (as it is e.g. the holder of certain permits or licenses) the investor will try to avoid an insolvency, thus, a share deal may be the preferred option. Contrary to an asset deal, no consent of the contractual parties to the key contracts is required and control is obtained by simply stepping in as new shareholder.

The seller’s perspective

The seller may have numerous reasons to prevent the target going into insolvency after the transaction.

Soft factors may include the intention of the seller to guarantee continued site operations and jobs of the target’s employees in order to not only avoid reputational damages but also to take care of its (former) employees. In other cases, the seller may plan to keep the target as a supplier or to maintain other important contractual relationships with the target. Finally, the seller will try to avoid a situation where past transactions or other legal acts between the seller and the target are challenged by the insolvency administrator. Potentially challenged transactions or other legal acts typically relate to standard group financing measures such as profit and loss transfer agreements, cash pooling agreements and shareholder loans. Balancing out of cash pooling between the seller and the target as well as repaying shareholder loans in connection with the transaction may be challenged by the insolvency administrator if these occur within a period of one year before the insolvency petition, even if the seller e.g. assigned the shareholder loan to a third party. Further, the insolvency administrator may try to challenge past loss compensation claims based on the argument that the losses totalling the loss compensation claim were not calculated adequately.

The pre-insolvency transaction can be structured both by way of a share deal or asset deal.

In order to avoid these risks, the seller should try to negotiate respective protective measures under the transaction documents (e.g. ring fencing). Such measures may, depending on the case, include obligations of the purchaser in relation to the continuance of business operations, the site and the staff, certain legal relationships or future divestments of the target. In order to avoid future situations in which an obligation to file for insolvency arises, the use of proceeds or the funding of the target post acquisition should be negotiated in the transaction documents. If negotiable, the seller should try combining these obligations with corresponding indemnifications. Ultimately, the effectiveness of contractual safeguarding measures depends on the solvency of the purchaser, which may be backed by a parent or other guarantee if considered insufficient.

In some cases, the seller may not be able to sell the target without providing the target with additional funding prior to the transaction, which entails certain additional risks for the seller. Any measures, such as insufficient funding for the restructuring of the distressed company (target), which delay a mandatory insolvency petition to the detriment of other creditors may result in a civil (para. 823 II, 830 II and 826 German Civil Code in connection with para 15a German Insolvency Code, para. 64 German Limited Liability Companies Act) and even a criminal liability (para. 15a German Insolvency Code, para. 283, 27 German Criminal Code). These risks can be avoided if the purchaser integrates the distressed target after acquisition into its group and is sufficiently solvent to prevent the insolvency of the target. The risks involved in this prerequisite can be avoided by the seller by drawing up a restructuring concept for the target confirming the capability for a restructuring and the adequate measures required therefore. Furthermore, the target and – to a certain degree – the purchaser have to obligate themselves to comply with such a restructuring concept. The standard widely used for such restructuring concept is IDW S6 of the German Institute of Public Auditors in combination with the corresponding legal principles developed by German Federal Court (BGH). Consequently, such a restructuring concept confirmed by an expert opinion in accordance with IDW
S6 and complying with the requirements defined by the German Federal Court (BGH) provide the basis for exculpation of the seller.

The purchaser’s perspective

Once the purchaser has acquired the target, it is usually in control over potential risks which may lead to insolvency. Still, the purchaser should consider certain specifics when acquiring a distressed target.

From a practical perspective, the purchaser should take into consideration that the target’s management, and in many cases also the shareholders, are under significant pressure. The purchaser may be the only chance for the management and the owners to avoid the company’s insolvency, and in case of e.g. financial guarantees granted by the shareholders, even avoiding personal liability or the insolvency of the shareholders might be relevant issues significantly influencing the decisions of and actions taken by the seller. Such pressure increases the risk of “window dressing” and even fraud, which should be considered carefully and taken into account during the legal due diligence review.

In many cases creditors will need to be involved in the transaction, which causes further complexity. Part of the restructuring plan for the target may be a new financing or to convince the creditors to accept a haircut. Both measures should be well planned and negotiated prior to (or at the latest concurrently with) the acquisition. The leverage on creditors prior to the acquisition is significantly higher and there is no pressure on the target’s management post acquisition, which may be forced to file for insolvency in order to avoid a personal liability if the negotiations with the creditors take longer than three weeks. Further, in order to convince creditors or banks to provide additional financing, a restructuring concept confirmed by an expert opinion in accordance with IDW S6 considerably facilitates the negotiations as such expert opinion minimizes the risk of creditors of being held significantly responsible if the restructuring should fail later for any given reason.

Conclusion

Acquiring a distressed target requires both the seller and the purchaser to be specifically aware of insolvency law provisions in order to avoid pitfalls and to minimize the risks associated with any such transaction. By applying the right measures, a pre-insolvency transaction may provide certain advantages to the parties compared to the acquisition post insolvency petition.
In exceptional times

Protection of foreign investments during the COVID-19 pandemic

By Arne Fuchs, LL.M. and Pauline Walde

Numerous states around the world have adopted strict measures limiting and sometimes even altogether suspending the most fundamental rights of residents and companies operating within their respective territories. This includes travel restrictions, import and export restrictions, business closures, lock-down orders and even seizures. These measures often have devastating economic effects on companies across sectors.

Looked upon in isolation, many of the measures imposed would violate a number of standards for the protection of foreign investments commonly contained in bilateral and multilateral investment treaties, for example the obligations of the host state to accord fair and equitable treatment to foreign investors and their investments and to grant them full protection and security as well as the rules on (indirect) expropriation.

However, these measures do not stand in isolation but in the context of the prevailing COVID-19 pandemic. With more than 1.5 million confirmed cases of COVID-19 around the world and steadily growing numbers, the measures are usually implemented to slow down the spreading of the coronavirus and protect the health of millions of people living in a state’s territory, i.e. for a legitimate public interest. International law, including investment protection law, recognizes the state’s right to regulate in such a context without incurring international liability.
Practical examples

For example, some (more recent) investment treaties contain express carve-outs for measures implementing legitimate public welfare objectives (See, e.g., Article 9.11 of the China-Australia Free Trade Agreement which provides that “[m]easures of a Party that are non-discriminatory and for the legitimate public welfare objectives of public health, safety, the environment, public morals or public order shall not be the subject of a claim” by an investor). Where such an express exception does not exist in the specific treaty, international liability may still be excluded under customary international law defences such as force majeure, distress, necessity, or the so-called police powers doctrine. In particular the latter has already been applied in a factually similar scenario, a smallpox epidemic in the late 19th century. In the Bischoff case (1903), a Mixed Claims Commission (Germany-Venezuela) unanimously found that the seizure of a German carriage by Venezuelan authorities after it had carried two persons infected with the disease did not constitute a wrongful taking under international law. In this regard, it noted that “[c]ertainly during an epidemic of an infectious disease, there can be no liability for the reasonable exercise of police power.”

This general rule notwithstanding, the COVID-19 pandemic is also not a defence that can be invoked by states “no matter what”. Where the pandemic serves as a pretext, the state cannot escape international liability. While a state generally enjoys a wider margin of discretion in times of crisis and recognized state of emergency, it must still – and arguably particularly then – exercise its regulatory powers with due regard to the most fundamental principles of the rule of law such as good faith, non-discrimination and proportionality. In line with this principle, the Mixed Claims Commission in the Bischoff case also confirmed that even “where the original taking was lawful, [the] government is liable for damages for the detention of the property for an unreasonable length of time and injuries to the same during that period.”

Numerous states around the world have adopted strict measures limiting and sometimes even altogether suspending the most fundamental rights of residents and companies operating within their respective territories.

Similarly, the Iran-US Claims Tribunal stressed in Too v. Greater Modesto Insurance Associates (1989) that "a State is not responsible for loss of property or for other economic disadvantage resulting from bona fide […] action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price.”

Investors and states: What to do now

Investors who suffered serious economic damage as a result of a state’s COVID-19 measures therefore must analyse the specific facts applicable to them and determine with the help of experienced counsel whether the measures taken were in compliance with the state’s international law obligations. Sometimes, so-called compensation for losses clauses (see, e.g., Article 12 of the Energy Charter Treaty ) also establish a separate obligation of the host state to provide prompt, adequate and effective compensation for losses suffered in the context of a national crisis and/or stipulate that the host state must grant foreign investors the same treatment that it grants to its own nationals or nationals of a third state with regard to restitution, indemnification, compensation or other settlement resulting from losses suffered in this context (most often, the relevant wording refers to “losses due to armed conflict, war, state of national emergency or civil disturbance”. Sometimes “acts of God” or “force majeure scenarios” are also specifically mentioned).

States, on the other hand, are well advised to take their international law obligations into consideration early on to ensure that their measures are not only effective but also withstand legal scrutiny if subsequently challenged.


Never-ending story?

German Constitutional Court stops the European Union’s Unified Patent Court system

By Dr. Boris Uphoff and Daniel Reich

On 13 February 2020, the German Federal Constitutional Court (Bundesverfassungsgericht) sealed the fate of the European Union’s Unified Patent Court (“UPC”) for the foreseeable future. According to this decision, the Constitutional Court deemed the German law ratifying the agreement on the introduction of the UPC (“UPC Agreement”) to be null and void. Without Germany’s ratification of the UPC Agreement, neither the UPC Agreement nor the EU Regulation (“UP Regulation”) introducing a European Unified Patent (“UP”) will enter into force.

Background

There have been attempts to unify the various European national patent systems since the 1960s. The existing European Patent (“EP”) system, introduced in the 1970s, bundles and thereby facilitates the application procedure for different national patents in one application. Those national patents remain subject to their respective national jurisdictions, which is also the main issue with the current EP system. Patent infringement and validity disputes may only be litigated separately for each national part of an EP. The resulting simultaneous litigation of national parts of one EP in different jurisdictions results in high litigation effort and costs as well as in the risk of diverging decisions.

In theory, the EU’s new UP system should have delivered the solution to those problems. It should have provided for both a single patent valid in all countries of the EU, the UP, and a unified patent court, the UPC, to decide upon UP infringements and the validity of UPs in a centralised way. As the EU treaties do not provide the EU with the
power to set up such a court, the UPC was to be introduced through a multinational agreement amongst most of the EU countries. The countries’ governments agreed to such a UPC concept in 2011. In 2013 the agreement was signed by 24 EU countries, with only Poland, Spain and Croatia failing to sign. To come into effect, the UPC Agreement needed the ratification of at least 13 countries including the three countries that had the most patents in force in 2013. These three countries were Germany, the UK and France. As of now, 16 countries have ratified the UPC Agreement including France and the UK – despite Brexit. The only ratification missing for the UPC Agreement to enter into force has been Germany’s.

After nearly three years, the Constitutional Court found the Ratification Law null and void. In its opinion, the Constitutional Court resorted to the formalistic argument that the Ratification Law had not been passed by the German Parliament with the necessary quorum.

Under the German Constitution (Grundgesetz) the transfer of power to supranational bodies like the UPC is equivalent to a change of the Constitution itself. Therefore, the Ratification Law had to be passed with a majority sufficient to change the Constitution. This means a two-thirds majority in both German legislative chambers, the Parliament and the Federal Council. However, when the Ratification Law was passed in Parliament on 10 March 2017 at 1:30 a.m. only 35 of its 630 members were present, when the vote of at least 420 members was necessary. As the necessary quorum was not reached in the Parliament, the Ratification Law violates the complainant’s constitutional rights and could be declared null and void.

This majority requirement does not come as a surprise as it is expressly stipulated in Article 23(1)(3) of the German Constitution since 14 July 1992. Only, no one seemed to care.

Further substantive arguments of the complaint regarding the conformity of the UPC Agreement with principles of the rule of law and other constitutional principles were not assessed by the Constitutional Court as it deemed the complaint inadmissible.

The Consequences

A law that is declared null and void by the Constitutional Court cannot come into force in Germany and, without Germany’s ratification, the UPC system is on hold for all contracting states to the UPC Agreement. Nevertheless, the final word on Germany’s ratification of the UPC Agreement has not been spoken. As the Constitutional Court only tossed the Ratification Law for a formality, the members of the Parliament and the Federal Council could theoretically pass the same law again – this time with the necessary two-thirds majority in both chambers. For now, this remains a theory, as neither the government nor one of the political parties yet have made a statement pro or contra such an approach.

The Future of the UPC and Brexit

To assess the realistic chances of Germany repeating its vote on the Ratification Law, one has to look at the UPC project from a broader perspective. Another unsolved question besides Germany’s ratification is the future role of the UK under the UPC Agreement.

The function of the UPC is to rule over EU law, more specifically to apply the UP Regulation on disputes. With the UK having left the EU, the UP Regulation will never become valid in the UK – at least not as an EU regulation. This means no cases for the UPC from the UK. Still, the UK is a contracting state to the UPC Agreement and is theoretically entitled to delegate judges to the UPC. It is absurd that judges from a country that intentionally left
the EU would still influence the interpretation of EU law. Understandably, the UK Government announced its intention on 28 February 2020 to withdraw from the ratification of the UPC Agreement.

Sadly, the UK’s withdrawal will create yet another problem for the UPC. As described above, the UPC Agreement needs the ratification of the three EU members that had the most patents registered in 2013, which includes the UK. With the UK also leaving the UPC Agreement, Italy would have to step in as the country with the next most patents. Whether this is possible and feasible is up for discussion. For years, the UK has been the second largest patent litigation forum in Europe after Germany. Should the UK leave the UPC system, the UPC would suffer a major blow, which Italy – as a minor patent infringement litigation forum – could not counterbalance.

As this reality slowly sinks into the German patent community, approval rates of the UPC system are in free fall. According to a recent study with 600 participants, most of them lawyers and patent attorneys, only 33.6 per cent were still in favour of ratifying an unchanged UPC Agreement. Should an unchanged Ratification Law be passed, it is almost guaranteed that someone will file another constitutional complaint. This time, the Constitutional Court could no longer hide behind formalities and would have to decide upon substantive arguments against the UPC Agreement, provided such a constitutional complaint would state the substantive law arguments in a more conclusive manner. The outcome of such a complaint is hard to predict.
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