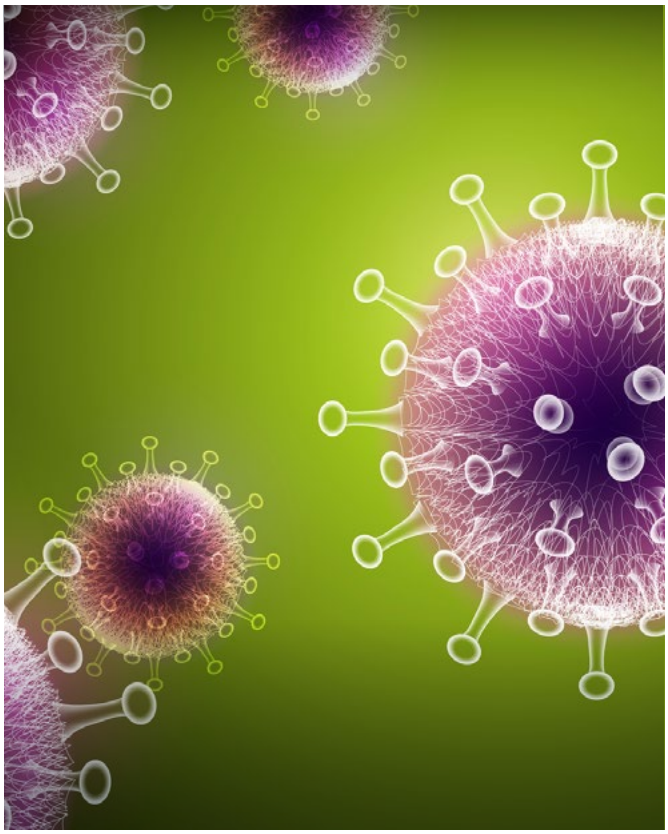
SQUIRE PATTON BOGGS

Coronavirus/COVID-19 Update

27 April 2020



In Germany, we have received an increasing number of enquiries about the coronavirus disease 2019 (COVID-19), commonly known as the "coronavirus", and what organisations should be doing to mitigate the impact of the virus on their business, staff, supply chains, etc.

Here is an overview of the key legal issues for businesses in Germany to consider, together with some practical steps for businesses to take.

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Hygiene Concept as a New Compliance Challenge for Companies

On 15 April 2020, the German federal and state governments adopted a new decision in the fight against the COVID-19 pandemic. Some measures have been relaxed in Germany for the first time. It should also be possible to (continue to) work safely in the industrial and medium-sized segments. The other aspects of public life should be restarted in Germany little by little. According to the federal and state governments, protection against infection and the necessary hygiene measures are, however, of the upmost importance for gradually restarting public life in Germany. New chains of infection must be avoided in order to continue to slow the speed of infection and thereby prevent the overloading of the healthcare system.

To achieve these goals, the reopening of companies and businesses is subject to conditions regarding hygiene, controlling access and preventing waiting lines. In addition, new duties of care will be imposed upon employers in the industrial and medium-sized segments in order to protect employees against infection and to be able to trace possible chains of infection more easily. According to paragraph 13 of the decision of 15 April 2020, companies are responsible for implementing a hygiene concept. Within the scope of the company's internal risk management, the potential health hazard of the operation must be reidentified and evaluated and a company pandemic plan must be developed. In this regard, unnecessary contact within the workforce and with customers should be avoided above all and, in the case of necessary contact, appropriate hygiene measures should be ensured.

These new duties of care to protect against infection are safety obligations, which companies must fulfil in the course of their business organisational duties. This means that companies now have the duty to take appropriate organisational and supervisory measures in view of the special requirements for the protection against infection in order to fulfil legal requirements. The required standard of due care will be measured against what is determined by the government, as is the case in the area of corporate governance. The decision of 15 April 2020 initially applies here, which is supplemented by the SARS-CoV-2 occupational safety standard. The occupational safety standard mostly includes already known measures, such as mandatory masks, implementing the safe distance rule at work, disinfection measures, home office rules, etc.). This standard was developed by the Federal Ministry of Labor and Social Affairs in cooperation with social partners, the federal states and Deutsche Gesetzliche Unfallversicherung e.V. (DGUV). The occupational safety standards can be adjusted dynamically to the developments of the pandemic and the federal states can also establish more concrete or additional standards for specific industries. If a company does not take any corresponding measures to fulfil these duties of care and damages occur (in the form of new chains of infection), there is

a risk of operational liability due to organisational fault.

Therefore, companies, as responsible employers, must now prepare a hygiene concept, similar to a data protection concept, as a new element of compliance in order to protect their own employees and to protect the company against liability risks. This should ensure that protection against infection is guaranteed during operational processes and the employees are instructed and monitored accordingly. This hygiene concept must contain the typical compliance processes: a person responsible for hygiene must be appointed, who instructs the employees with regard to the hygiene and safety measures required by the company during contact with customers and other employees. Compliance with these measures must then be checked, at least on a random basis, and action must be taken in the case of any violations in order to enforce proper implementation. Penalties for repeated breaches must also be established. As a sign of the good organisation of the company and to protect against liability risks, this should all be documented and formalised in a hygiene concept. The hygiene concept of each company must, of course, be tailored to the type of company, the on-site conditions, the deployment of personnel and customer contact. The responsibility to implement a hygiene concept applies for all companies or company departments (e.g. administrative areas), which did not have any need for regulations concerning protection against infection and hygiene within the scope of work safety up to now.

Through a comprehensive hygiene concept, a company can, on the one hand, fulfil its own duties of care with respect to its employees and make an important contribution to containing the spread of COVID-19. On the other hand, an individually tailored hygiene concept, which is implemented according to compliance rules within the company, allows the business activities to continue without the risk of business liability due to a breach of duties of care related to protection against infection.

Tightening of Investment Control by the Amendment of the German Foreign Trade and Payments Act

Takeovers or takeover attempts in the areas of robotics, high-voltage network operation, semiconductor production and most recently also research laboratories for vaccines have repeatedly drawn public attention to the need for national investment control. The extraordinary importance of vaccines or medical equipment in the context of the COVID-19 pandemic is providing politicians with new arguments for expanding the list of technologies worthy of protection. It is, therefore, not surprising that the previously announced initiative to tighten the control of investments in companies by non-EU investors has now materialised in the form of the draft act amending the Foreign Trade and Payments Act and Other Laws (BR-Drs. 181/20) of 9 April 2020. The purpose of the draft act is to adapt the German Foreign Trade and Payments Act (AWG) to the requirements of the so-called EU Screening Regulation (Regulation (EU) 2019/452) and to close the gap in the regulatory and investigation regime concerning the legal and factual execution during the screening phase. As a first step, the amendments to the AWG will create an extended framework for action for the amendments to the German Foreign Trade and Payments Regulation (AWV), which will follow in a second step.

Tightening and Extension of Review Standards

One of the cornerstones of the draft act is that the threshold for the adoption of measures restricting non-EU direct investments will be lowered.

The previous test criterion of an "actual and sufficiently serious threat" to the public order or security of the Federal Republic of Germany will be modified to "likely to affect" the public order or security. This will adapt the AWG to the EU Screening Regulation, which takes a proactive approach. In practice, this amendment of the previous definition of risk will allow an acquisition to be prohibited already on the basis of a predicted potential threat.

The draft act also expands the test criterion of "public order and security" by referring to the concrete definitions in the EU Screening Regulation, which include critical technologies as a fundamental interest worthy of protection, in addition to the impairment of (federal) security, public service provision and critical infrastructures. According to the understanding of the Federal Ministry of Economics and Technology (BMWi), this includes technologies, such as artificial intelligence, robotics, semiconductors, biotechnology and quantum technology. These specifications will be implemented as part of an amendment to the AWV.

Moreover, the point of reference for a threat will be extended to include all EU member states. These changes are based on the consultation mechanism created by the EU Screening Regulation. Under this mechanism, when screening non-EU direct investments, which will affect the public order and security of multiple EU member states or projects or programs of Union interest, the comments of each EU member state concerned or of the EU Commission are to be taken into consideration. In this connection, the BMWi

should be assigned the authority to act as the national contact point within the meaning of the EU Screening Regulation. This tightening and extension of the test criterion for non-EU direct investments will increase the intensity of screening and extend the scope of transactions covered. Depending on the staff increases at the BMWi and the efficiency of the new consultation mechanism, the periods for screening may also be exhausted more frequently. The estimation contained in the draft act of 20 new cases as a result of the regulatory changes seems optimistic in light of the significant extension of the test criteria.

Extension of the Status of Temporary Invalidity

An additional cornerstone of the draft act is that all transactions subject to notification requirements will be temporarily invalid. In the past, only those transactions in the area of war weapons, other key military technologies or products with IT security functions (so-called sector-specific audit area) were temporarily invalid until their approval or the assumption of their approval after the expiration of three months.

In the future, transactions across sectors will, therefore, be temporarily invalid if they are subject to notification requirements according to the AWV. This currently includes the operation of critical infrastructures, the development of software for operating critical infrastructures, telecommunications, Cloud computing services, telematics infrastructure and media. Taking into consideration the intended extension of the test criteria, this will also include critical technologies, which will be added from the EU Screening Regulation in the future. According to the draft act, temporary invalidity will not apply only to transactions, which solely fall under the general scope of application of the cross-sector audit and are not subject to notification requirements.

New additions will be made in the form of accompanying prohibitions related to temporarily invalid transactions during the screening process. Accordingly, allowing the buyer to directly or indirectly exercise voting rights, granting the buyer an entitlement to the payment of profits associated with the acquisition or disclosing to the buyer information about the areas of the domestic company, which establish the relevance of screening within the meaning in the AWG and AWV, is prohibited. In addition, the BMWi will have the competence to classify certain information as relevant for screening in order to prevent the premature execution of a transaction.

In practice, extending the status of temporary invalidity will lead to a higher number of notifications and, therefore, more investment screening. In addition, the signing and closing of transactions may increasingly fall on different dates depending on the extent to which the BMWi exhausts the periods for screening. During the due diligence phase, the parties involved will have to examine more carefully which information of the target company can be made available to a potential buyer. Otherwise, there is a risk of breaching the new prohibitions.

Sanctions and Penalties

The enforcement of the new prohibitions during the period of temporary invalidity for the duration of the screening process will be ensured by additional sanctions and penalties, which will now also apply for any violations of prohibitions or orders of the BMWi. For an act to be punishable, it is necessary that the violation of the prohibition was committed intentionally. The penalty imposed can be imprisonment of up to five years.

MAC Clauses and Other Pitfalls in Acquisition Agreements in the Context of the COVID-19 Pandemic

Uncertainty about the further course of the COVID-19 pandemic and its impact on the economy in general and on the target company in the context of a corporate transaction means that the parties have an increased interest in reducing their risk through appropriate contractual agreements. In this situation, the clauses explained below and the rights of management associated with them are of particular importance in acquisition agreements. Even if their individual form depends largely on the individual negotiating situation and the circumstances of the respective target company, there are nevertheless a number of points which should be taken into account from the buyer's and seller's perspective when drafting or interpreting existing contracts.

MAC Clauses

In acquisition agreements, so-called material adverse change or MAC clauses usually provide for a contractual right of withdrawal in the event of a material deterioration of the target company's net assets, financial position or results of operations between the date of signing the agreement (*signing*) and its execution (*closing*).

The inclusion of MAC clauses in acquisition agreements is a concept that originated in the US and is customary there, but has not been very widespread in Germany to date, except for transactions with a specific connection to the US. If such clauses are agreed, they usually concern specific effects on the target company. However, adverse changes in connection with *force majeure* or negative developments of the overall economy are often excluded from the scope of a MAC clause (so-called *Carve-Outs*) and, thus, do not provide for a right of withdrawal. Therefore, it must be examined in each individual case according to the specific content of the MAC clause whether the circumstances caused by the COVID-19 pandemic would constitute a material deterioration in the sense of the respective clause.

In view of the uncertainties associated with the COVID-19 pandemic, a potential buyer should insist on comprehensive protection against negative developments at the target company and negotiate a watertight MAC clause. The contractually agreed MAC clause should sufficiently define the meaning and cases of "material deterioration." For these purposes, MAC clauses should contain a catalogue of events that are either explicitly covered or excluded from their scope of application. Thus, so-called Business MAC clauses can be used to refer to the occurrence of a circumstance arising from the business operations of the target company (e.g. deterioration of the financial key figures of the company, insolvency, loss of a necessary operating license or the termination of important contracts). With so-called Market MAC clauses, however, the parties may also base the termination rights on circumstances outside the internal business operations, e.g. events in the business environment of the target company or specific market developments.

From the buyer's perspective, it is advantageous to also include cases affecting the general market environment of the company, in particular in connection with the outbreak of a new pandemic or the extension of an existing pandemic and the resulting deterioration of the business prospects of the target company. For example, business-related events, such as a significant interruption in the supply chain, a considerable decline in orders or market-related events like falling below certain thresholds, e.g. in the case of the DAX, can be included here.

From the seller's perspective, it is advisable to limit the MAC clause as far as possible – if its inclusion in the contract cannot be avoided completely – and to accept such a clause only in the form of a Business MAC clause. Ideally, pandemics or other crises caused by disease should be explicitly mentioned as part of the carve-outs. In principle, it is advisable to always define concrete amounts for the effects of an unforeseeable event, which define the threshold of the materiality of such effects. For example, the deterioration may be based on predefined key financial figures of the target company. In this case, the parties often define a revenue shortfall of 20% or more compared to the business plan in a given period. In addition to financial thresholds, temporal thresholds can also be agreed, such as the minimum duration of the interruption in a supply chain or the deterioration of the agreed financial key figures.

In order to further accommodate the seller when using a MAC clause, it is advisable to agree a so-called *Break-up* fee. Accordingly, in the event of any withdrawal from the contract on the basis of the MAC clause, the seller will receive adequate compensation from the buyer in the form of a previously agreed amount.

Including and invoking a MAC clause does not necessarily have to lead to the rescission of the acquisition agreement. Instead, the parties can agree to adjust the contract, for example, by adjusting the purchase price, in the aforementioned cases.

Frustration of Contract – Section 313 of the German Civil Code

In the event that the parties cannot reach an agreement on a MAC clause or the parties simply have not included a MAC clause in the agreement, the buyer could attempt to rescind the acquisition agreement due to the coronavirus outbreak on the basis of a statutory right of withdrawal due to frustration of contract (Section 313 of the German Civil Code (BGB)).

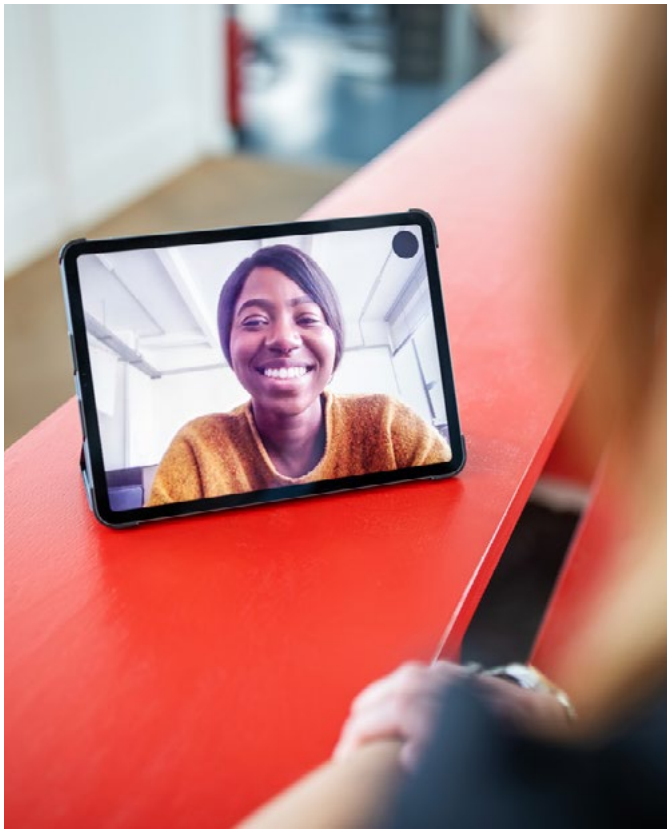
Frustration of a contract takes place when circumstances, which have become the basis of the contract, have changed so significantly after the conclusion of the contract that the parties would not have entered into the contract in the way they did if they had foreseen this change. The withdrawal

from the purchase contract is, however, only possible as a secondary measure if an adjustment of the contract is not possible or is unreasonable for one of the parties.

The chances of this plea succeeding depend on the specific individual case. In addition, the possibility of invoking this statutory provision is regularly excluded in acquisition agreements. It should be noted that the courts have imposed very high standards on the adjustment of the terms of a contract up to now and that a right of rescission on the basis of Section 313 BGB is only successful in rare exceptional cases. Whether and under which conditions circumstances related to the coronavirus could justify a right of rescission is still unknown and probably will only be possible in particularly difficult cases.

Non-occurrence of Closing Conditions

In most cases, the non-occurrence of closing conditions agreed in the acquisition agreement (e.g. approval under antitrust law, approval in accordance with the Foreign Trade and Payments Regulation, consent of important contractual partners or other permits) is also associated with certain legal consequences, which above all include the possibility of withdrawing from the contract. The parties usually set a so-called *Long-Stop Date* by which the closing conditions must have been fulfilled in order to avoid the possible termination of the contract. This constellation warrants particular attention in the current COVID-19 pandemic. This is because many authorities are working under restricted conditions with a reduced staff level, which in turn can lead to longer processing times with regard to the required permits. Furthermore, it cannot be ruled out that some authorities will make use of their right to request further information or to open an investigation procedure in individual cases, so that relevant default approval times do not apply.



For merger control proceedings before the German Federal Cartel Office, the period for uncomplicated examinations has recently been extended from one to two months. The period for more complex cases during the main examination proceedings has been extended from four to six months. This currently applies for all merger notifications submitted to the Federal Cartel Office up until 31 May 2020.

When drafting the contract, special attention should, therefore, be given, especially from the seller's perspective, to ensuring that a sufficiently long period is chosen for any longstop date and that any delays on the part of the buyer eliminate the buyer's right of termination. From the buyer's perspective, the primary concern in the current situation will be to avoid so-called hell or high water clauses under which the buyer agrees to accept all obligations and conditions of the authority for antitrust clearance.

Breaches of Principal Performance Obligations, Guarantees or Covenants

Other termination rights are also regularly included in acquisition agreements, e.g. in the event that one party does not fulfil its principal performance obligations under the acquisition agreement. From the seller's perspective, it is important to ensure that the breaches of principal obligations, which trigger a right of termination, are defined narrowly and exhaustively. This is because a buyer could take advantage of any wording that is too broad in order to use other breaches of duty as a means for exercising a right of withdrawal.

In principle, the seller will be interested in excluding a right of termination in the case of other breaches of duty, in particular breaches of guarantees or other rules of conduct (so-called *Covenants*). Otherwise, there is a risk that a hidden MAC clause will be introduced in this way. This is because, in the context of the COVID-19 pandemic and the associated financial impact, as well as shortfalls within the supply chains, a breach of a guarantee, for example, concerning the material contracts (termination due to failure to achieve minimum sales volumes, default in payment, etc.) can quickly occur which is at least partially beyond the control of the seller.

Particular caution should, therefore, be taken when drafting so-called preclosing covenants (the rules of conduct that apply between the signing and closing of the acquisition agreement). The purpose of such preclosing covenants is to ensure for the buyer (in particular in the context of locked-box purchase agreements without a subsequent purchase price adjustment mechanism) that the business of the target company will continue to be conducted without any changes and in a value-preserving manner until closing.

However, it should be considered, especially in view of the special circumstances of the COVID-19 pandemic, that management measures may also be necessary outside the normal course of business (e.g. taking on additional liabilities, encumbrance of assets, deferring payment obligations, etc.). This is the only way to avoid, in individual cases, major defaults in the area of customers or suppliers or other consequences for the business of the target company that might jeopardise its existence. In addition, a seller must ensure that it only agrees to such rules of

conduct whose effects are completely under its control. If, for example, the authorities order the shutdown of a plant or any other measures, its effects must not lead to a breach of a contractually agreed rule of conduct on the part of the seller between the signing and closing.

The aforementioned measures relating to guarantees and covenants also apply outside of the context of terminations as a legal consequence of a breach of duty. From the seller's perspective, it is important to avoid the situation in which the buyer uses a breach of guarantee or covenant as a bargaining chip to adjust the purchase price that goes beyond the mechanisms provided for in the purchase agreement.

Conclusion

The current situation, which is characterised by the risks of the COVID-19 pandemic, can serve as an occasion for the parties to an acquisition agreement to review not only any obvious MAC clause, but also other contractual clauses (e.g. closing conditions, breaches of guarantees or covenants) in terms of the potential legal consequences. In addition to the right of withdrawal, which usually only applies in a very limited number of cases in acquisition agreements, claims based on breaches of guarantee may also play an important role when it comes to contractually safeguarding against the risks of the COVID-19 pandemic.

International and EU Market Surveillance

IOSC and EMA

Members of the International Organization of Securities Commissions (IOSC), who regulate over 95% of the world's capital markets, are cooperating closely on their responses to the disruption in capital markets resulting from the macroeconomic impact of COVID-19 crisis on the global economy.

For the purposes of European securities and market supervision, ESMA has in the meantime taken further measures or clarified the situation. In particular, ESMA states that issuers should disclose, as soon as possible, any relevant significant information concerning the impacts of the COVID-19 crisis on their fundamentals, prospects or financial situations in accordance with their transparency obligations under the Market Abuse Regulation (MAR).

Further, ESMA recommends that national supervisory authorities should temporarily refrain from pursuing issuers that are required to publish their financial reports under the Transparency Directive in the event of late compliance due to the pandemic. With this statement, ESMA takes into account possible difficulties in financial reporting due to the pandemic. At the same time, ESMA stresses the importance of timely and transparent financial reporting and points out that issuers must inform their investors of the length of any delays. Therefore, issuers should provide transparency on the actual and potential impacts of COVID-19, to the extent possible based on both a qualitative and quantitative assessment on their business activities, financial situation and economic performance in their 2019 year-end financial report if these have not yet been finalised or otherwise in their interim financial reporting disclosures.

Additionally, ESMA has clarified that NCAs should not prioritise backloading reporting obligations (i.e. the reporting of securities financing transactions entered into by market participants before reporting obligations entered into force). A similar rule already applies to securities financing transactions concluded by market participants between 13 April 2020 and 13 July 2020. Again, NCAs should not prioritise the monitoring of reporting obligations.

National COVID-19 Crisis Measures

BaFin, the German Federal Financial Supervisory Authority, emphasises that, even under the changed working and general conditions, issuers subject to reporting requirements under Art. 16 (1) and (2) of the MAR must have suitable systems and processes for market abuse monitoring in order to identify suspicious orders and transactions and to transmit them to BaFin. Suspicious transaction reports must be made within a reasonable time, taking into account the current challenges of the COVID-19 crisis and the circumstances of the individual case. BaFin assumes that a high number of alarms will be raised by the system among those obliged to report. When assessing whether these alarms are actually due to suspicious orders or transactions, the current special market conditions must be taken into account, within the framework of the manual review.

In addition, BaFin is of the opinion that the postponement of the dividend payment resolution as a result of the postponement of the annual general meeting does not

constitute insider information subject to ad hoc requirements with regard to the shares issued by the respective issuer due to the lack of significant potential to influence the share price. Such postponement of the cash outflow for the dividend payment in itself generally has no significant effect on the issuer's net assets, financial position and results of operations, nor is it otherwise taken into account by a prudent investor in his investment decision regarding the share. Independent of a postponement of the annual general meeting, however, a (planned) change in the amount of the originally announced dividend payment may constitute ad hoc insider information. If, for example, it is already predominantly probable at the time of the postponement of the annual general meeting that there will be a significant reduction in the dividend, this in itself regularly constitutes ad hoc insider information.

Furthermore, according to BaFin, it should be noted that an annual general meeting may also have to decide on agenda items for which the time of the resolution is very important and which may, therefore, have a significant impact on the asset, financial and earnings positions of the issuer as a result of the postponement of the resolution itself. Accordingly, insider information subject to ad hoc requirements may also consist of the fact that the decision on an agenda item of the annual general meeting can only be made at a later date due to its postponement. This could be the case, for example, if a decision on urgently needed capital is to be made at the annual general meeting. Further examples of potential insider information could be the postponement of the approval of the payment to outside shareholders in the event of a squeeze-out in connection with the cancellation of the annual general meeting or the postponement of an intercompany agreement (e.g. a control and profit and loss transfer agreement for lack of effectiveness by way of an annual general meeting resolution, Section 293 AktG).

With regard to a possible change in the forecast, it should be noted that BaFin recommends that this should only be published when it is sufficiently probable.

If the effects of the COVID-19 crisis are not yet foreseeable, the issuer has the right to maintain its old forecast. Also, it may not yet be possible to predict how the COVID-19 crisis might affect the quarterly figures. Insofar as the COVID-19 crisis has a determinable effect on the assets, financial and earnings positions of the issuer with the result that the financial figures deviate significantly from their relevant benchmark, these may constitute insider information for the issuer and be subject to ad hoc disclosure. It is often difficult to examine the considerable potential for influencing the share price. In the opinion of the BaFin, the standard of what is to be regarded as "significant" in this context should be subject to increased requirements in individual cases. However, whether the effects of the COVID-19 crisis on the net assets, financial position and results of operations may only be one-off is irrelevant for the assessment. In addition, the BaFin points out that a strong price fluctuation alone following the publication of business figures does not automatically mean that the information is to be classified as relevant to the price. Rather, the valuation of the information with regard to its price relevance must be based on an exante forecast.

Finally, BaFin states, in accordance with ESMA recommendations, that in the case for securities financing transactions concluded by market participants between 13 April 2020 and 13 July 2020, it will not prioritise the monitoring of reporting obligations for backloading. BaFin will apply their supervisory powers in a proportionate manner and take a risk-based approach when enforcing applicable legislation.

Further Updates

We will continue to monitor the situation carefully and keep this advice note under review. We have also set up a dedicated resource centre for businesses on the legal, regulatory and commercial implications of coronavirus COVID-19 on our website.

This is to provide you with the very latest guidance on the practical steps to take, given that the situation is an evolving one and the government and health authorities' guidance and advice may well change.

If you would like to discuss any of the issues raised in this advice note, please contact any of our team listed below.

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