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COVID-19 in Germany: New Special Rules for Federal Investments in Stock Corporations

The German government has established a new ESF to counter liquidity shortages and strengthen the equity base of distressed companies.

A central part of the comprehensive support measures for the German economy to counter the effects of the COVID-19 pandemic is the Act on the Establishment of an Economic Stabilization Fund (*Gesetz zur Errichtung eines Wirtschaftsstabilisierungsfonds*, or WStFG) adopted by the Bundestag on March 25, 2020, and approved by the Bundesrat on March 27. The law extends the regulatory framework created during the 2008 financial crisis, which paved the way for federal investments in distressed banks. Going forward, the law will apply not only to the banking sector, but also to certain companies in the real economy. Article 1 WStFG amends the Financial Market Stabilization Fund Act and renames it the Stabilization Fund Act (*Stabilisierungsfondsgesetz*, or StFG). In addition to the Financial Market Stabilization Fund, which will continue to exist, a second economic stabilization fund (ESF) for companies in the real economy will be established. This ESF may provide guarantees for corporate liabilities (Sec. 21 StFG) and may also participate in the recapitalization of companies by, *inter alia*, acquiring debt instruments, entering into silent partnerships, and acquiring shares in companies (Sec. 22 StFG).

Article 2 WStFG amends the Financial Market Stabilization Acceleration Act and renames it the Economic Stabilization Acceleration Act (*Wirtschaftsstabilisierungsbeschleunigungsgesetz*, or WStBG). The WStBG modifies various corporate law provisions in order to facilitate a fast and effective implementation of recapitalization measures under the StFG.

This *Client Alert* focuses on the company law requirements for the implementation of capital measures of stock corporations for the purpose of a recapitalization under the WStBG.

Beneficiaries

Recapitalization measures under the WStBG may be implemented until December 31, 2021. Beneficiaries include companies that met at least two of the following three criteria prior to January 1, 2020:

1. A balance sheet total in excess of €43 million
2. Sales revenue in excess of €50 million

3. More than 249 employees (average annual number)

Other highly important companies (keyword: critical infrastructure) can also qualify.

The legislator's intention is that recapitalization measures with participation of the ESF shall be the *ultima ratio*. The following conditions must therefore be met for recapitalization measures under the WStBG:

- The company must not have access to any other financing measures.
- The recapitalization measures must provide the company with a clear, independent going concern perspective following the end of the pandemic.
- The company's need for capital must be attributable to COVID-19. In particular, the company in question must not have met the EU definition of an "undertaking in difficulty" (meaning companies that will, without intervention by the state, almost certainly be required to cease operations in the short or medium term).

The legal facilitations which have been extended to companies in the real economy relate to certain corporate law requirements for capital measures and transactions in connection with any recapitalization measures undertaken by the ESF (see Sec. 5 *et seq.* WStBG), in particular:

Capital increases

Facilitation of executing a capital increase against contributions by way of a direct resolution of the general meeting in connection with a recapitalization measure pursuant to Sec. 22 StFG (acquisition of a direct interest in the company by the ESF)¹ by:

- **Shortened convocation period** for the general meeting to 14 days (even if other agenda items are to be dealt with in addition to recapitalization measures) and the possibility of a virtual online general meeting.
- **Exclusion of risk of legal actions** against capital increase resolutions by stipulating that for the new shares issued, the share price is deemed appropriate in any case (unless it is below the nominal value of the shares or the arithmetical nominal value in case of no-par value shares).
- **Reduction of majority requirements under stock corporation law:**
 - A resolution to increase the share capital for the purpose of recapitalization measures requires only a simple majority of the votes cast at the general meeting. An exclusion of subscription rights can be decided with a two-thirds majority of the represented share capital (or a simple majority if half of the share capital is present). Majority requirements apply regardless of deviating provisions in the company's articles of associations.
 - The **exclusion of subscription rights** in favor of the ESF is always permitted and appropriate.
 - The ESF can act as a backstop investor (even at a lower purchase price).
- **Applicability without the involvement of the ESF, when new shares are subscribed by third parties**

- The described facilitations for capital increases by way of a direct resolution of the general meeting and by using the “Stabilization Authorized Capital,” as defined below, apply only if the ESF also participates in the measure or if the capital measure is in connection with a recapitalization measure of the ESF.
- The WStBG therefore modifies the legal framework for recapitalization measures with state participation. Otherwise, the regime for capital measures remains unchanged. In particular, prospectus-free capital increases of up to 10% of the existing share capital which exclude existing shareholders’ subscription rights in order to enable participation of a new anchor investor (so-called private investment in public equity (PIPE) transactions) must still comply with the existing legal and statutory framework.
- Since the provisions of the WStBG only require a “connection to recapitalization measures” under the StFG, it can be assumed that third parties may participate in a capital increase, in addition to the ESF, either by a direct resolution of the general meeting or by using the Stabilization Authorized Capital.²
- The possibility of a backstop participation of the ESF (Sec. 7 para. 3a WStBG) also indicates that the capital measures do not have to be undertaken exclusively by the ESF.
- However, according to the explicit wording of the law, individual exemptions apply only to the participation of the ESF. For example, Sec. 7 para. 3 sentence 3 WStBG stipulates that the exclusion of the subscription right within the framework of the direct resolution to admit the ESF is permissible and appropriate in any case.
- Third parties must **accept** that the state has extensive governance rights by imposing investment conditions which are secured by a company **declaration of commitment** (see below) (e.g., restrictions with regard to the use of funds, remuneration of board members, and dividend payments).

Creation of authorized capital

Simplifications for the creation of special authorized capital for capital increases in connection with recapitalization measures (“Stabilization Authorized Capital”) in which the ESF participates include the following:

- Authorized capital may be created by the general meeting by **simple majority in unlimited size** (usual limitation of up to a maximum of 50% under German stock corporation law of the existing share capital not applicable).
- If the resolution authorizes the management board to exclude subscription rights, a two-thirds majority is required for the authorization resolution (or a simple majority if half of the share capital is present).

Creation of conditional capital

Simplifications for the creation of special conditional capital for capital increases in connection with recapitalization measures, including for conversion or subscription rights to the ESF as a silent partner include the following:

- Conditional capital may be created by the general meeting by a **simple majority in unlimited size** (usual limitation of up to a maximum of 50% under German stock corporation law of the existing share capital not applicable).

Effectiveness of resolutions

- **Resolutions passed by the general meeting** in connection with capital measures for the purpose of recapitalization must be filed for registration with the commercial register without delay and registered immediately, unless obviously null and void.
- Registration with the commercial register is not a condition for the effectiveness of the resolution; the publication of the resolution filed for registration on the company's website is sufficient.
- **Actions or applications for interim measures** do not impede the registration of resolutions or the implementation of related resolutions that do not require registration.

No stock exchange listing

- The provisions for a required stock exchange listing of the new shares (Sec. 40 para. 1 of the German Stock Exchange Act (*Börsengesetz*) and Sec. 69 of the German Stock Exchange Admission Regulation (*Börsenzulassungsverordnung*)) shall apply only if the shares subscribed by the ESF are transferred to third parties.

Declaration of commitment

- Companies which the ESF stabilizes by the described measures must ensure a sound and prudent business policy. In particular, authorized representatives should, with the consent of the supervisory body, issue and publish a declaration of commitment to comply with the requirements).

Silent partnership

- The WStBG privileges the participation of the ESF (also jointly with third parties) as a silent partner.
- An investment by the ESF as a silent partner in a company is not considered to be a company agreement (*Unternehmensvertrag*) and does not require the approval of the general meeting or registration in the commercial register.
- These regulations apply if, in the context of a recapitalization, third parties also participate as silent partners in addition to the ESF, or the silent partnership is transferred to third parties in whole or in part after the contribution has been made.

Conclusion

The WStFG is a first rapid response by the German federal government to the current crisis. The establishment of the ESF to counter liquidity shortages and strengthen the equity base of distressed companies is a well-known instrument from the financial crisis. It remains to be seen how many companies will participate in these far-reaching recapitalization measures under state participation and when the German federal government will make use of its rulemaking authorization to adopt more detailed provisions on restructuring measures.

Latham & Watkins will closely monitor the latest developments related to the ESF.

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Endnotes

¹ In addition to the WStBG, the new German Act on measures in corporate, cooperative, association, foundation and home ownership law to combat the effects of the COVID-19 pandemic (COVID-19 Act) is also generally applicable and establishes additional facilitations for stock corporations and limited liability companies, such as the possibility of holding a virtual general meeting (Sec. 1 COVID-19 Act) or the possibility of passing resolutions in text form or by written vote, without the consent of all shareholders (Sec. 2 COVID-19 Act, whereby notarization requirements remain unaffected).

² According to Sec. 7e WStBG, the aforementioned facilitations in connection with the implementation of a capital increase by direct resolution or the Stabilization Authorized Capital (see below) expressly apply *mutatis mutandis* to capital measures in connection

with a recapitalization measure pursuant to Sec. 22 StFG if the new shares from the capital measure are also or exclusively subscribed by third parties. This applies in particular if the capital measures establish the conditions for a measure under the Stabilization Fund Act. Examples include the exit of a previous state participation, when new shares are issued in return for contributions from silent partnerships entered into by the ESF or raising capital for the purpose of returning such contributions.