

ANTITRUST CLIENT BRIEFING

The German Federal Cartel Office's Comfort Letter on COVID-19 Related Restructurings

Antitrust Framework for Individual Restructuring and Coordinated Production Restarts

10 June 2020

COVID-19 Restructurings and Antitrust

- The COVID-19 crisis has led, and will continue to lead, to enterprise-threatening financial difficulties for many firms in many industries. In a worst-case scenario, firms might have to file for insolvency/bankruptcy and might ultimately leave the market.
- These enterprise-threatening financial difficulties are seldom due to firms lacking a competitive business model. Losing firms as market players due to the COVID-19 crisis could therefore result in a long-term loss of competition. In addition, if firms are “systemically relevant”, their market exit could significantly harm other market participants, especially their customers.
- It is therefore important to restructure financially distressed firms and to avoid their market exit — generally prior to the commencement of formal insolvency or bankruptcy proceedings. This can require a number of stakeholders (including shareholders, suppliers, creditors, and customers) to contribute in one form or another to the “fresh start” of any given financially distressed firm.
- When different stakeholders must make contributions to a financially threatened firm, the allocation of contributions can be difficult. Ensuring a successful restructuring typically requires discussions among the members of a stakeholder group as well as between different stakeholder groups. To allow for a fair and objectively balanced allocation of contributions, discussions need to go into considerable detail, which can, in turn, implicate antitrust issues. The members of stakeholder groups, e.g., the creditors, suppliers or customers, are typically competitors (within their stakeholder group). These groups therefore require guidance on what details they are allowed to exchange in their common goal to restructure a financially distressed firm.

The FCO's Comfort Letter (1/2)

On 9 June 2020, the head of the German Federal Cartel Office's (FCO) 4th decision division — responsible for the automotive industry — sent a comfort letter to the German Association of the Automotive Industry (VDA).

The comfort letter responds to measures the VDA presented to the FCO, with a view to overcoming certain challenges caused by the COVID-19 pandemic in the automotive industry. Following a review of the suggested measures and discussions with the VDA and the European Commission, the FCO decided to refrain from further scrutiny.

The measures now endorsed by the comfort letter include (a) a model process for individual restructurings and (b) conditions for coordinated production restarts.

- (a) The model restructuring process aims at facilitating swift restructurings of firms that are in financial distress due to the COVID-19 pandemic.

Under the model process, financially distressed firms may establish groups of stakeholders including shareholders, customers, creditors, employees, and public authorities that would be able to exchange relevant information on topics such as solvency, credits, aid measures or operational problems in order to quickly and jointly develop effective restructuring measures.

The comfort letter provides non-exhaustive guidance on how to ensure antitrust law compliance:

- Scope. The model process can be used by firms that, in their own assessment, are in financial distress during the COVID-19 pandemic. The model process applies to firms (i) headquartered in Germany or (ii) headquartered abroad, provided that such foreign firms have distressed subsidiaries or production facilities in Germany. The model process is available for firms invited to an initial stakeholder meeting to be held prior to 31 December 2020. The restructuring negotiations should be concluded by end of 2021.
- Information exchanges have to be limited to what is necessary for the restructuring.
- Information exchanges must occur within a clean team pursuant to confidentiality and “Chinese Walls” rules. The clean team may consist of external advisors, such as accountants or restructuring advisors. Internal representatives may be part of the clean team as well. However, to the extent that members of a customer’s procurement department attend negotiations, they must not engage in purchasing negotiations with the relevant supplier for a period of one year following the end of their participation. Moreover, information received in the negotiations must not be used for future procurement from other suppliers. Clean team members and representatives of the distressed firm must sign an NDA (which includes severe sanctions for infringements). Furthermore, “Chinese Walls” must ensure that confidential data is not disclosed by stakeholders to persons uninvolved in the negotiations or are not part of the clean team; though reportings for decision-making within the stakeholder’s hierarchy remains possible.
- Aggregation still required. Information and data required for the restructuring should be exchanged on an aggregated basis. This applies to all conditions stipulated in agreements between stakeholders and a distressed firm. In particular, specific data and information must be aggregated with regard to parts prices and supply volumes (towards customer stakeholders) or interest rates and factoring costs (towards creditor stakeholders). This aggregation helps to ensure that parties will not receive data specific to their competitors.
- Individual contributions. Customers may contribute to the restructuring in different ways (e.g., through personnel support, relocation of production, waiver of termination or minimum order quantities). To the extent that price increases are necessary, these must be strictly limited in time and should not go beyond the duration of the overall contractually contemplated end date of the restructuring.

The FCO's Comfort Letter (2/2)

- The restructuring process must be concluded by way of a framework agreement describing the stakeholders' contributions in a general way. Individual contributions are negotiated exclusively on a bilateral basis with the relevant stakeholder.
 - Each stakeholder must be free to opt out of the restructuring negotiations or reject the result of the negotiations. Parties to the framework agreement must not agree to disadvantage stakeholders who are not a party to the agreement.
 - Implementation of the framework agreement must be monitored either by a neutral third party (e.g., an external accountant or legal advisor) or by the distressed firm itself.
- (b) For a coordinated production restart, the VDA will issue a best practice guide explaining ways to avoid a misallocation of resources at a time when capacities are scarce.
- Automotive suppliers remain free to choose when and in what way they would like to restart their activities, and whether they would like to publicly announce this restart. Automotive suppliers are not obligated to restart their production at a specified point in time.
 - The best practice guide will be non-binding and will not include company-specific information relating to amounts of goods or contracts, for example. Existing contractual obligations remain unaffected. Suppliers are not obligated to adhere to specific supply volume requirements.

For further guidance and to reconcile the basis of the FCO's assessment, the underlying submissions by the VDA provide relevant explanations, assumptions and examples. Links to these resources are included on the last page of this briefing.

A Great First Step

- As a general point, the FCO deserves a lot of recognition for its pragmatic and helpful dialogue with many companies during the COVID-19 crisis. The FCO's openness to discuss companies' concerns and also provide guidance to them benefits all of the parties involved; the FCO can develop a better understanding of industry specific issues.
- More specifically, the FCO's comfort letter on COVID-19 related restructurings is not only helpful for the automotive industry. While the automotive industry has many suppliers that can be considered systemically relevant, the comfort letter's guidance is not limited to systemically relevant companies and its logic can be applied to other industries.
- While the comfort letter is expressly limited to financially distressed companies in Germany, there is no reason why its logic should not be applied in other EU member states. Indeed, the FCO has discussed the adoption of the comfort letter with the European Commission. Moreover, in the context of the reform of its horizontal guidelines, the European Commission also considers information exchange issues in restructuring processes. Now that the FCO has provided a first milestone in the form of a comfort letter for Germany, it would be both important and beneficial if the European Commission provided guidance on the topic as well. Such guidance should be general and not limited to the COVID-19 crisis.
- The FCO's guidance on information exchanges during restructurings essentially targets two elements:
 - Control over who is involved. The FCO's guidance that expressly allows representatives of the involved stakeholders to be members of the clean team is positive, as is the (necessary) reporting by these clean team members within their company's hierarchy. However, the one-year exclusion from sourcing negotiations with the restructured company seems too broad, both in terms of duration and product scope. The "Chinese Walls" provision and the requirement not to use the information with regard to other suppliers make sense.
 - Control over what is exchanged. The FCO relies on standard measures to prevent a restriction of competition, especially the "need" requirement and the aggregation of competitively sensitive information. By expressly mentioning parts prices and supply volumes towards customer stakeholders and interest rates, and factoring costs towards creditor stakeholders, the FCO clearly considers these types of information to be particularly sensitive.
- For more general guidance, it appears possible to generally work with more flexible concepts. In addition, the more restrictive the "who is involved" element is handled in a concrete case, the more flexible the "what is exchanged" element can be handled. Furthermore, while the VDA members likely focused on customer stakeholders in their discussions with the FCO, more general guidance will likely also have to focus on the supplier and creditor stakeholder. Specific needs of these stakeholder groups should be reflected in more general guidance, too.
- Ultimately, the comfort letter provides good comfort to all stakeholders that their restructuring discussions, if conducted along the lines of the comfort letter, will not expose them to significant risks under antitrust law in Germany.

References

- FCO, 4th decision division, comfort letter dated 9 June 2020: [here](#)
- FCO, press release on “Crisis management measures in the automotive industry - Bundeskartellamt supports the German Association of the Automotive Industry (VDA) in developing framework conditions under competition law aspects” dated 9 June 2020: [here](#)
- VDA, press release on FCO comfort letter and download area for underlying materials submitted to the FCO on 22 April 2020: [here](#)

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