White Paper

Public Takeovers in Germany

How to acquire a publicly listed company in Germany

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For the successful acquisition of a publicly listed company in Germany, a bidder must carefully consider legal and strategic implications at each stage of the takeover process. This white paper explains the legal framework within which takeovers occur, and describes strategies for the effective implementation of a takeover bid.

Authors

Dr. Klaus W. Riehmer
Partner, Frankfurt
+49 69 7941 1020
kriehmer@mayerbrown.com

Dr. Ulrike Binder
Partner, Frankfurt
+49 69 7941 1297
ubinder@mayerbrown.com

Throughout Europe, takeovers of publicly listed companies are governed by the European Takeover Directive (2004/24/EC). Germany had passed specific legislation on takeovers prior to the Takeover Directive, following the Vodafone/ Mannesmann takeover. The German Securities Acquisition and Takeover Act (Takeover Act, or *Wertpapiererwerbs- und Übernahmegesetz, WpÜG*), which entered into force on 1 January 2002, is applicable to public offers for German target companies whose shares are listed in Germany. Parts of the Takeover Act will also apply to public offers for German Companies whose shares are listed on the Stock exchange of another member state of the European Union or the European Economic Area (which includes Norway, Iceland and Liechtenstein in addition to the member states of the European Union, but not Switzerland). Specific rules of the Takeover Act are also applicable on offers for non-German target companies which are listed in Germany. Note, however, that the Takeover Act only applies to offers for targets which are listed on a regulated market, and in Germany these would include in particular the Prime and General Standard of the Frankfurt Stock Exchange. Takeovers of targets whose shares are traded on unregulated markets, such as the Entry Standard or the Open Market of the Frankfurt Stock Exchange, are not governed by the European Takeover Directive or the German Takeover Act, and are therefore simpler to implement.

Takeovers are conducted under the surveillance of the German Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin*).

In Germany, takeovers are typically friendly and supported by the target. In hostile takeover bid situations, the target companies often come to support the offer. Only in a few cases competing bids were launched by competing bidders and prices increased in the course of the offer.

How to Implement a Takeover in Germany

PREPARATION

Information on the target

A takeover requires thorough preparation. Some information on the target is publicly available. In particular, financial statements and mandatory publications, such as ad hoc disclosures on important developments, can be obtained from the target's homepage. Targets which are listed on the Prime Standard of the Frankfurt Stock Exchange must publish this information in English; targets which are listed on the General Standard market segment need, however, only publish in German.

Information on the target's shareholder structure

Typically, German stock corporations issue bearer shares so that holders are not known to the company. Some companies issue registered shares and must keep a share register with the names of the shareholders. However, the share register is not public and even shareholders are only entitled to receive information on the data registered in respect of themselves.

However, the German Securities Trading Act (*Wertpapierhandelsgesetz, WpHG*) contains notification obligations for holders of major stakes of voting rights in publicly listed companies. Any person whose voting interest (either directly or by way of attribution, for example due to an acting in concert with other shareholders) reaches, exceeds or falls below 3 percent, 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 30 percent, 50 percent or 75 percent of the voting rights must inform the company and BaFin of the exact number of voting rights that shareholder holds, and of the details regarding how these voting rights are held (directly or by attribution). The company must publish the notification.

Notification obligations also exist for financial instruments which entitle their holders to acquire shares with voting rights in the future. These notification obligations cover call options and agreements which are subject to conditions which the holder of the instrument can control. The notification obligations extend to all instruments which result in the possibility to acquire shares with voting rights. Not only put options and all contingent agreements but also cash settled swaps must be notified. These notification obligations begin at a threshold of 5 percent. Shares with voting rights which the holder of the instrument holds, are taken into account in the calculation.

Any shareholder whose voting rights exceed the threshold of 10 percent must additionally notify the company of the goals which it pursues in respect of the company, and of the source of the funds used for the acquisition. The company must also publish this notification.

Additionally, the members of the management board and the supervisory board of a listed company must inform the company and BaFin of any direct or indirect dealings in company shares or derivates exceeding a value of EUR 5,000 within one calendar year. The directors' dealings notifications also have to be published by the company.

Due diligence

If a bidder wants to obtain non-public information from the target or any of its shareholders, it must enter into negotiations with them. The management board of a target company can allow a due diligence without breaching its confidentiality obligations, if a bidder is seriously interested in an acquisition, the acquisition is in the best interest of the company, and the bidder agrees to keep the information obtained in the due diligence confidential. Therefore, target companies normally require bidders to enter into a confidentiality agreement and, additionally, a letter of intent, in order to be able to demonstrate that the bidder is seriously interested in the acquisition, before due diligence starts.

Agreements with shareholders and the target

In order to increase a takeover's chances of success, it is advisable for bidders to enter into agreements with major shareholders in advance. In such agreements, major shareholders can either directly sell their shares to the bidder (possibly subject to certain conditions, such as a minimum acceptance rate in the offer, though major shareholders often refuse to accept such conditions), or major shareholders can obligate themselves to accept the offer for their shares (so called irrevocable undertaking).

An irrevocable undertaking can trigger notification obligations for financial and other instruments because it results in the possibility to acquire shares in the future. Therefore, such undertaking should be entered into only when the takeover is made public (see below under "Offer Phase").

German law also allows target companies to enter into agreements with bidders and to agree to support the offer, provided that the offer is in the best interest of the company (for example because the new shareholder would bring new financing or help to develop new businesses). However, the conclusion of such agreements is not common practice in Germany.

STAKE BUILDING

Bidders can build stakes in the target by stock exchange or off-stock exchange acquisitions in advance of the bid. They must comply with the above mentioned notifications rules, i.e. inform the target and BaFin as soon as they acquire a stake of 3 per cent of the voting rights in the target. Due to the extended notification obligations for financial and other instruments, which cover also cash settled swaps, hidden stake building has become more difficult. In calculating the 5 percent minimum threshold which triggers notification obligations for such instruments, shares with voting rights held by the holder of the instruments must be taken into account.

Therefore, if an investor holds 2 percent of the shares in a company and additionally acquires cash settled swaps for further 3 percent, a notification must be made. Voting rights notifications can alert investors of the fact that someone invests in the target, and can increase speculation and stock exchange prices.

Additionally, bidders must observe insider trading rules. These rules prohibit the acquisition (and disposal) of shares by using inside information. Inside information is any non-public information which can materially influence the stock exchange price if it becomes publicly known. This is the case if a sensible investor would take the information into account when he makes his investment or divestment decision.

The intention of the bidder to buy shares in the target is not deemed to be inside information for the bidder himself. Although the fact that a subsequent public tender offer at a higher price is prepared can be inside information, the bidder itself may generally acquire shares and implement its acquisition decision. However, if the bidder obtained inside information within the due diligence this would make purchases illegal until the information becomes public. Therefore, the stake building should be thoroughly prepared in order to avoid any legal risks. Insider trading is a criminal offence which can be punished by fines or imprisonment.

The bidder can also make alongside purchases during the offer. Such alongside purchases are included in the regular reporting of the bidder which is obligatory during the offer phase.

OFFER PHASE

Publications by the bidder, procedure and timeline

The offer phase begins with the publication of the intention of the bidder to launch an offer. The bidder must make this publication as soon as it decides to make an offer. The decision is, however, only made once all internal approvals are obtained (such as board approval). Once this decision is passed, the publication must be made without undue delay via an electronic system for the systematic distribution of information (such as Reuters or Bloomberg). There exist service providers in Germany who organize proper distribution of such publications (for a certain, but limited, fee). The bidder must subsequently inform the management board of the target company of its intentions, and the target in turn informs its employees and employee representatives.

Once the publication is made, the bidder must implement the offer. It is generally not possible to withdraw the offer at this stage. Within a period of four weeks from the publication of the intention to make an offer, the bidder must submit the so called offer document to BaFin. The offer document describes the offer in detail.

BaFin has a period of ten business days to review the offer document. It can extend this period by up to five business days. Once BaFin has approved the offer document, it must be published without undue delay on the internet. The offer must be open for acceptance for a period of four to ten weeks. Generally, a longer acceptance period does not increase the acceptance rate. In particular, financial investors tend to make their decisions during the last days of the acceptance period only. Therefore, an offer phase of four to six weeks is advisable.

After termination of the offer phase, the offer is settled, i.e. the shares which were tendered by shareholders are transferred to the bidder for payment of the offer price.

Publications by the target

The fact that an offer is upcoming can substantially affect the target's share price. It is therefore inside information, as soon as it becomes sufficiently likely. Listed companies are obligated to disclose inside information which directly concerns them by way of an ad hoc disclosure. Therefore, the target company is generally obligated to make the fact that an offer will be made public. However, the company may be allowed to delay such disclosure if the delay is required to protect its interests, if there is no risk of markets being misled and if the target can ensure confidentiality. These rules generally allow a delay of the ad hoc disclosure until the bidder announces the offer in accordance with the above mentioned rules.

The management board members and the supervisory board members of the target are obligated to publish a reasoned statement regarding the offer. In this statement, they must report and comment on the adequacy of the offer price, the consequences of the offer for the target and its employees, the goals of the bidder, and their intention to accept the offer for shares they own. Usually, the statement contains a recommendation of the board members to accept or not to accept the offer. It is common practice and good corporate governance for board members to obtain a fairness opinion from a third party on the adequacy of the offer price and to refer to it in the statement.

The statement is generally published within a period of up to two weeks after publication of the offer document.

Offer document

The offer document contains all information which is necessary in order to enable shareholders to decide about the acceptance of the offer. In particular, it contains information on

- the offer (offer price, including explanation of the adequacy of the offer price, offer period, details on how to accept the offer and payment of the offer price by the bidder),
- prior purchases of target shares made by the bidder or a person acting jointly with the bidder during the last six months prior to the publication of the intention to make the bid or the publication of the offer document, including information on purchase prices,
- offer conditions,
- financing of the offer and consequences of the offer on balance sheet and profit and loss situation of the bidder and the bidder group,
- details on the bidder and the target,
- plans of the bidder regarding the target, its business, its seat, major business operations, employees, employee representation, the assets of the target, and its future liabilities,
- plans for the composition of management and supervisory board, and benefits to board members in connection with the offer,
- consequences of the offer for target shareholders who do not accept the offer.

The size of the offer document depends on the size of the bidder and the target and on the complexity of the transaction. Generally, such documents have a volume of approximately 40 to 50 pages.

The offer document is signed by the legal representatives of the bidder on behalf of the bidder. The bidder is liable for the completeness and accuracy of the offer document.

OFFER STRUCTURES

Voluntary and mandatory offers

If a bidder wants to acquire control over a German publicly listed company, it can either acquire no or only smaller portions of shares in advance and make a voluntary offer, or it can acquire 30 percent or more in the target in advance and thereby trigger the obligation to make a mandatory takeover offer to all outstanding shareholders. The voluntary offer structure is more flexible and therefore often preferable from the bidder's perspective. However, in most respects, voluntary and mandatory offer are governed by the same rules and the best suitable structure should be developed based on a case by case assessment.

In a voluntary offer structure, the conclusion of irrevocable undertakings with major shareholders is advisable. In this case, the bidder would publish its intention to make an offer on the day on which the irrevocable undertakings are concluded. If the bidder enters into a share purchase agreement (SPA) with major shareholders which is subject to conditions (such as anti-trust clearance), it is advisable for the bidder to announce a voluntary offer on the same day. The voluntary offer replaces a subsequent mandatory offer which would have to be made once all conditions are met. Note, however, that in this case, the SPA can only be subject to conditions which would also qualify as admissible offer conditions (see below). This structure ensures better control over the minimum offer price and would allow the purchase price in the SPA to be lower than the offer price.

A mandatory offer must be made if a bidder acquires 30 percent or more of the voting rights in the target, either directly or by way of attribution of voting rights. However, financial and other instruments (cash settled swaps, contingent call options, put option) which may have to be notified are irrelevant in calculating the 30 percent threshold which triggers the mandatory offer. A mandatory offer would only have to be made, once these instruments are exercised, resulting in a shareholding of at least 30 percent. Thus, if shares are acquired from major shareholders and the acquisition is not subject to conditions (such as anti-trust clearance), a mandatory offer must be made. The mandatory offer must be unconditional. Once a bidder acquires 30 percent or more of the target's voting rights, it must publish this fact without undue delay (in the same way as the intention to make an offer is published, see above) and submit an offer document to BaFin within four weeks from the publication. After BaFin approval, the offer document must be published. The content of the offer document is identical for mandatory and voluntary offers.

Cash and share offer

In Germany, takeover offers are mostly cash offers because they are easier to implement than share offers. Share offers are admissible, provided that the shares offered in exchange are listed on a regulated market of a member state of the European Economic Area. Thus, shares of a NASDAQ listed company can only be offered besides cash (i.e. shareholders can choose between cash and NASDAQ listed shares). It should be noted that the London AIM market is not a regulated stock market pursuant to European law. Therefore, AIM listed shares do not qualify as admissible consideration, unless offered as an alternative to cash.

If shares are offered as consideration, the offer document must contain detailed information on these shares and the issuer of the shares. The offer document therefore includes a securities prospectus on the offered shares, prepared in accordance with the European Prospectus Regulation (No.809/2004/EC). This makes the preparation of the offer document time-consuming, unless the bidder has a recent prospectus available which can be used.

Minimum price rules

The Takeover Act contains rules on minimum prices which must be paid in the offer. These minimum prices depend on both, (a) the average stock exchange price of the target shares before the offer, and (b) purchase prices which the bidder paid before the offer. The consideration to be paid by the bidder must at least be the higher of:

- the average weighted stock exchange price of the shares of the target company during the three months prior to the publication
- of the decision to issue a *voluntary* takeover offer (not the publication of the detailed offer document itself), or
- in case of a *mandatory* takeover offer, of the acquisition of control (30 percent of the voting rights), and
- the highest consideration paid or agreed upon by the bidder, or any entity related to the bidder or acting jointly with the bidder for the acquisition of shares of the target company, during the six months prior to the publication of the offer document.

If shares are offered as consideration, the value of the offered shares must also comply with these rules.

Offer conditions

Voluntary offers can be made subject to conditions provided that the fulfillment of these conditions is outside the influence of the bidder. It is therefore possible to make an offer subject to the conditions that a minimum acceptance rate is achieved (for example, 75 percent of all outstanding shares). Thereby, a bidder can ensure that the offer is only implemented if it results in a majority which enables the bidder to implement planned restructuring measures at the target level.

It is also possible to make an offer subject to material adverse changes (MAC), provided that the MAC event is defined by objective criteria which cannot be controlled by the bidder.

Mandatory offers can generally not be made subject to conditions.

Financing of the offer

The bidder must pay the purchase price for the tendered shares after termination of the offer period. In the offer document, the bidder must describe how it finances the offer, i.e. from its own cash reserves, by a bank financing, or by any other means. The offer document must set out which effects the financing and the acquisition of the target has on the balance sheet and the profit and loss statement of the bidder and the bidder group (if it prepares group financial statements).

Additionally, the bidder must provide a bank confirmation which says that the bidder has taken all measures required to ensure that it can pay the purchase price under the offer when it becomes due. This bank confirmation must cover the purchase price for the acquisition of all outstanding shares which the bidder does not yet own when the offer is made. This includes shares for which shareholders have declared that they are not willing to accept the offer, shares which are subject to an irrevocable undertaking, and shares which the bidder will purchase outside the offer during the offer phase. Thus, in a voluntary offer situation, where the bidder did not make any purchases in advance, the bank confirmation would have to cover 100 percent of the outstanding shares.

The bank confirmation must be submitted to BaFin together with the offer document and must also be published as an annex to the offer document. The bank would be liable to outstanding shareholders if the confirmation proved to be incorrect. Therefore, banks must generally comply with standards for issuing guarantees before issuing the confirmation. The timetable for a public takeover should ensure that agreements with the bank that finances the offer and with the bank that issues the confirmation (often, but not necessarily identical) are in place when the offer is made public.

Exemptions from the obligation to make a takeover bid

Any person acquiring at least 30 percent of the voting rights in a German listed company must make a mandatory offer (Pflichtangebot) to the other stockholders. In specific cases, BaFin can exempt the acquirer from this obligation. The most important exemption applies in restructuring cases. If the target company is in need of restructuring, the purchaser presents a plausible restructuring concept and contributes a substantial amount to the restructuring, BaFin can grant the exemption. According to BaFin's administrative practice, a company is in need of restructuring if "existence threatening risks" exist. It is not necessary that insolvency is immediately impending. The purchaser must present a restructuring concept to BaFin together with an auditor's opinion on the suitability of the concept. BaFin neither requires proof that the restructuring will most probably be successful nor the examination of alternative concepts. The contribution by the purchaser to the restructuring can, for example, consist of a subscription of new shares in a capital increase, the provision of loans, or a waiver of claims. The required amount and form of the contribution depends on the situation of the target. It must be suitable to restructure the target.

The application for exemption can and should be submitted to BaFin prior to the acquisition of control. In order not to burden the purchaser with the risk of having to implement a mandatory offer, it is advisable to execute the share purchase agreement subject to the condition that BaFin issues the exemption.

Strategies after the Offer

CONTROL AND INCREASE OF SHAREHOLDING

After a takeover offer, the bidder controls the target company. Depending on the number of shares that were tendered or sold in connection with the offer, the bidder controls resolutions of the general meeting which require a simple majority or also a super majority of 75 percent of the votes cast. It should be noted that in a German stock corporation, ordinary decisions, such as election of supervisory board members, distribution of dividends, or election of auditors, are passed with a simple majority of the votes cast, whereas corporate restructuring measures and capital increases in which subscription rights of shareholders are excluded, or capital decreases, generally require a majority of 75 percent of the votes cast, but not of the existing votes. Since not all free float shares are represented at general meetings (because the shareholders neither participate nor grant proxies), a majority shareholder can normally control these decisions already before it owns 75 percent of the shares. If, for example, the majority shareholder owns 60 percent of the shares, it would control decisions which require a majority of 75 percent of the votes cast so long as no more than 80 percent of the shares are represented at the general meeting.

In order to increase its stake in the target, the bidder can acquire additional shares and/or implement capital increases.

If the bidder acquired shares within one year following the expiration of the offer period in an off-stock exchange transaction and for a price above the offer price, it would be obligated to pay the difference between the offer price and this higher purchase price to all shareholders that accepted the offer. In contrast, stock exchange purchases do not trigger a subsequent increase of the offer price.

Capital increases only increase the bidder's stake in the target if outstanding shareholders do not participate pro-rata to their shareholding. Shareholders of a German stock corporation are entitled to participate in capital increases pro-rata to their shareholdings. These shareholders' pre-emptive rights can be excluded for a capital increase of up to 10 percent and in general for capital increases against contribution in kind. However, even if a capital increase is implemented with shareholders' pre-emptive rights, minority shareholders often do not exercise their pre-emptive rights. Thus, such a capital increase can be a means to increase the stake of the majority shareholder.

CONTROL AND PROFIT AND LOSS POOLING AGREEMENTS

In order to increase its influence in the target, the bidder can enter into a so called control agreement with the target. Additionally, it can conclude a profit and loss pooling agreement with the target which allows it to receive all annual profits from the target.

A majority shareholder can, pursuant to German law, not give binding instructions to the target company or its management. It exercises its shareholder's rights in general meetings. The general meeting has, however, only limited competencies. In particular, the general meeting does not decide about the day to day business of the company. The majority shareholder can indirectly influence the management board by electing, in general meetings, the supervisory board which controls, elects, and removes the management board in the German two tier board system. However, the supervisory board cannot issue binding instructions to the management board, and supervisory board members must act in the best interest of the company rather than in the best interest of the majority shareholder.

A control agreement between majority shareholder and subsidiary allows the majority shareholder to give binding instructions to the management board of the target. The target's management board must follow these instructions, even if they are disadvantageous for the target company. A control agreement therefore allows the integration of the target company into the bidder group before the bidder owns 100 percent in the target.

A profit and loss pooling agreement has the effect that all annual profits are directly transferred to the majority shareholder without profit participation of the minority shareholders. Such an agreement has advantages from a tax perspective if the majority shareholder is a German entity, because it allows the set-off of profits and losses within a German group of companies.

As control agreements and profit and loss pooling agreements result in disadvantages for the minority shareholders, minority shareholders must be compensated for these disadvantages. The majority shareholder must (1) offer to buy the shares of the minority shareholders at an adequate price, and (2) pay a fixed annual dividend to those minority shareholders who stay in the target company for the lifetime of the agreement. (3) Additionally, the majority shareholder must compensate all annual losses of the target company.

The adequacy of the offer price and of the fixed annual dividend must be verified by an independent, court appointed auditor. In accordance with jurisprudence of German courts, the auditor applies a valuation method developed by the German institute of accountants (so called IDW S1 standard) for the valuation of companies. This valuation method aims at finding an "objective" company value and has some features which deviate from discounted cash flow or multiple based valuation methods. Therefore, the resulting price may exceed the price which was calculated pursuant to valuation methods applied by the bidder in order to determine the offer price in the takeover. Also, it should be noted that the three months average stock exchange price of the target shares before the publication of the fact that a control and/or profit and loss pooling agreement shall be concluded is the minimum price to be offered.

SQUEEZE-OUT

The bidder can conduct a squeeze-out of minority shareholders of the target company once it has acquired 95 percent of the share capital of the target company. In the squeeze-out, minority shareholders are forced to sell their shares for adequate compensation. The adequacy of the compensation which is offered by the bidder must, again, be verified by an independent, court-appointed auditor. The above mentioned rules for determining the adequacy of the price apply.

The squeeze-out requires a resolution of the general meeting of the target company which is passed with the votes of the majority shareholder. It becomes effective upon registration in the commercial register. Minority shareholders can delay registration by filing actions against the squeeze-out resolution. Actions against the adequacy of the compensation are, however, dealt with in separate proceedings after registration and effectiveness of the squeeze-out.

If the squeeze-out is combined with a merger on the parent company, it can already be implemented with a majority of 90 percent. However, the parent company must in this case be a stock corporation.

Facilitated squeeze-out proceedings are available if the bidder holds 95 percent of the share capital after the takeover offer and if the offer was accepted for at least 90 percent of the shares that were subject to the offer. While shares which were tendered in the offer due to an irrevocable undertaking would help to reach the 90 percent threshold, shares sold under an SPA in connection with the offer would not count in this respect. If the thresholds are met, the bidder can apply to the court in order to resolve on the squeeze-out of minority shareholders for payment of the compensation offered in the prior takeover offer. Past experience demonstrates that it is difficult to reach these thresholds.

DELISTING

By way of delisting, the trading of the target shares on the stock exchange can be terminated. As a consequence, obligations resulting from the listing, such as disclosure obligations, become obsolete. The delisting itself does, however, not result in a change of the shareholder structure.

Rules and prerequisites of the delisting have undergone material changes under German law during the past years. While for some time, the delisting was granted simply upon application by the target company to the stock exchange after a waiting period of six months from such application, the German legislator has enacted stricter rules in October 2015. As a result, a delisting now requires, besides the application to the stock exchange by the target, that an offer is made to the target shareholders to buy their shares at a cash price not falling below the weighted average stock exchange price of the target shares during the six months before publication of such offer. The delisting does not require a resolution of the general meeting. Each shareholder can freely decide whether or not to accept the offer. A prior takeover offer does not make an offer required for purposes of the delisting obsolete.

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