

European requirements set forth in the EU Takeover Directive and their impact on German takeover law

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I. Introduction and outline

The currently applicable takeover law in Germany is based on an initiative the German federal government took in response to the public takeover battle between the German Mannesmann AG (provider of telecom services) and the UK-based Vodafone Airtouch plc, which finally terminated in Vodafone taking over Mannesmann AG. The deficiencies of the law that were revealed in this public battle prompted the federal administration to charge an expert committee with the drafting of a Takeover Statute. Yet another draft of a Takeover Directive on the EU level having failed, the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz, WpÜG) was adopted in 2001 and came into force on 1 January 2002.

On a EU level, partly parallel efforts were being made to establish a legal framework for takeovers of enterprises. Efforts within the EU had started as early as 1974 already, and after three decades of tactical maneuvering, the main issue being whether the management board of the target company should be under a neutrality obligation, the EU Justice and Home Affairs Council on 30 March 2004 finally adopted the European Takeover Directive. The German legislator has to transpose its provisions into national law by 20 May 2006, which will necessitate amendments of the WpÜG.

II. German Securities Acquisition and Takeover Act (WpÜG)

Following tough negotiations, the German Securities Acquisition and Takeover Act (WpÜG) took effect on 1 January 2002, providing for the first time in Germany as in numerous other countries statutory regulations for takeover bids. According to the legislator's explanatory report, the WpÜG is to establish a basic legal framework for public takeover bids and other public offers for the acquisition of securities in Germany, which takes adequate account of the requirements of globalization of the capital markets, with the aim to further boost Germany as a business location and financial center also among international competitors.

1. Scope

The Securities Acquisition and Takeover Act applies to public bids for the acquisition (that is purchase or exchange) of securities issued by a stock corporation or partnership limited by shares domiciled in Germany, provided the securities are approved for trade in an organized market. The definition of "organized market" extends to the official trade and regulated market at a German stock exchange, as well as to regulated markets in any other Member State of the European Economic Area. The term "securities" includes, besides shares, securities comparable to shares, share-equivalent certificates as well as securities the subject-matter of which is the acquisition of shares, securities comparable to shares or share-equivalent certificates.

2. Structure

The WpÜG first of all distinguishes between voluntary and mandatory bids. Mandatory bids have to be placed if a company, directly or indirectly, holds or has obtained 30 % of the voting rights in another company. As for voluntary bids, a second distinction needs to be made whether it is first directed towards obtaining control (30 % or more of the voting rights) over the target (takeover bid) or not (voluntary purchase bid). The result is a division under the WpÜG into three types of bids: voluntary purchase bids, takeover bids and mandatory bids. The legal provisions relating to those three kinds of bids do not coexist parallel and separate from each other but build on each other, while the regulations pertaining to voluntary purchase bids form the statutory regular case.

Finally, the right of a shareholder already holding 95 % of the share capital of the target to decide a transfer of the remaining shares to him in return for payment of an equitable cash compensation to be fixed by the shareholder ("squeeze-out"), is set forth not in the WpÜG but in the German Stock Corporation Act. The adequacy of the cash compensation may be reviewed by a court.

a) Start of the procedure

The procedure starts with the publication of the offeror's decision to place a bid to the shareholders of the target company. While in the case of voluntary bids (purchase bid, takeover bid) the offeror itself determines the time of publication, in the case of mandatory bids the law connects the obligation to place a bid to the time of the company's public announcement that it now holds 30 % or more of the voting rights in another company. No mandatory bid has to be placed if control over the target company is obtained through a takeover bid. This saves the offeror, who has already placed a takeover bid, the placing of another public bid which would extend to the same shares and be subject to the same provisions in view of the consideration.

b) Offer document and consideration

The offeror must draft and publish a German language offer document, which constitutes an irrevocable, binding tender offer to the shareholders of the target company. The offer document forms the core of the statutory regulations aiming to establish transparency with the purpose of protecting the shareholders. It has to provide, in particular but not limited to, information about the offeror, the subject-matter of the bid, the consideration, the financing of the bid, and about the offeror's intentions regarding the future business activities of the target company. Amendments of the offer document are subject to limitations: For example, the offeror may only increase the consideration or alternatively offer a different consideration, but he is not permitted to decrease the bid. Any amendments of the offer have to be published in the same manner as the offer itself.

While in the case of voluntary bids the offeror may generally determine the consideration in its discretion, takeover and mandatory bids are subject to restrictions in terms of type and amount of the consideration. In these cases the consideration offered either has to be a monetary consideration in Euro, or shares approved for trade in an organized market within the European Economic Area. Furthermore, the amount of the consideration has to be equitable. This is stipulated in more detail in the related German Regulation

(WpÜG-AngebotsVO), according to which the consideration offered must not fall short of the amount corresponding to the average market price of the target company's shares in the three months prior to publication of the offer document, or which the offeror paid for shares of the target company in the three months prior to publication of the offer document.

The offer document submitted is reviewed by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin) for conformity with the WpÜG.

3. Required conduct of the target company's board

a) Statement of the management board and supervisory board

Management board and supervisory board have to submit a substantiated opinion on the bid without delay. Especially in international takeover practice, the statement of the board can play an important role in unfriendly takeover bids since international takeover battles are regularly fought as a competition of concepts where it is left up to the shareholders to decide whether to accept or decline the bid on basis of the arguments submitted by the offeror and the target company's management in the substantiated opinion.

b) Neutrality obligation and admissible defensive measures

Under the German WpÜG the target company's management board may, after the publication of the decision to place a bid and until the expiry of the period for acceptance, not implement any measures that might cause the bid to fail. This applies to all acts that are objectively suitable to prevent the success of the takeover bid while there does not necessarily have to be the intention to prevent the success. Whether the measure, in case it is implemented, in fact causes the bid to fail is irrelevant; the only decisive criterion is whether it is suitable for that purpose. Generally, possible defensive measures are, in particular, the so-called crown jewel defense, the acquisition and/or sale of companies or parts thereof, a capital increase, and the acquisition of own shares.

There are, however, several exceptions from this restriction: For example (i) measures which a manager of a company not affected by any takeover bid acting with the diligence of a prudent businessman would have taken as well, (ii) seeking a competing bid and (iii) acts approved by the target company's supervisory board, are admissible. Furthermore, the WpÜG allows for "Vorratsermächtigungen" – reserve authority – authorizing the board to implement measures for the defense against takeover bids that actually fall within the responsibility of the general shareholders' meeting. Such reserve authority must be conferred before the publication of a bid, and may be valid only for a maximum term of 18 months. Moreover, the general shareholders' meeting may of course also pass resolutions for the implementation of a defense after the publication of the bid.

c) Legal consequences of unlawful defensive measures

A defensive measure not covered by the exemptions and/or qualifying as a reserve authority under the law or under an ad-hoc resolution of the general shareholders' meeting constitutes a violation of the duty of care imposed on the management board and supervisory board as bodies of the target company. When applying inadmissible defensive measures, the management board and supervisory board therefore render themselves liable to pay damages towards the company pursuant to the general liability rules under the German Stock Corporation Act.

However, they are not directly liable to pay damages to the shareholders. According to the prevailing opinion the institutional liability under the German Stock Corporation Act applies only towards the company. Until now the Supreme Court has not yet decided whether and to what extent individual shareholders of the target company may prohibit unlawful measures of the management board and/or supervisory board by way of an injunction.

III. Takeover Directive of the European Union

1. Essential content and effects on the WpÜG

Following many years of struggle the European Takeover Directive finally came into force in May 2004. The Directive obliges the German legislator to transpose the provisions into national law by 20 May 2006 and necessitates amendments of the WpÜG in order to implement those provisions of the Directive that were added only after the WpÜG was adopted in 2001. These are, in particular, the complex rules pertaining to the establishment of a "level playing ground field" set forth in Articles 9 to 12 of the Directive. Moreover several of the already familiar regulations of the WpÜG need to be, partly substantially, revised. Aside from the scope of application of the WpÜG and the competence of the Federal Financial Supervisory Authority (BaFin), also the provisions relating to mandatory offers require considerable modification, while the minimum price regulations for takeover bids even have to be deleted completely.

With respect to the revision of the initial draft Directive, legal policy discussions and also the interest of the public furthermore concentrate on the issue to what extent defensive measures of the target company's boards, statutory defensive measures of the target and/or legal bars to public takeover bids should remain admissible.

2. Neutrality obligation and admissibility of defensive measures

a) Strict neutrality obligation pursuant to Article 9

Based on the Anglo-Saxon example, Article 9 stipulates a general, strict neutrality obligation of the target company's board in the sense of a prohibition of frustration of the bid. According to Article 9 the board has to obtain prior authorization from the general shareholders' meeting for all measures taken as from the start of the period allowed for acceptance of the offer before taking any measures with the aim of frustrating the bid (exception: seeking competing bids, action in the company's normal course

of business). The existing German WpÜG regulations in that context would therefore have to be partially amended, providing for a stricter neutrality obligation.

b) Breakthrough rule pursuant to Article 11

Pursuant to Article 11 of the Directive, specific bars to takeovers have no effect. For example restrictions on the transfer of securities laid down in the target company's articles of association, restrictions of transferability of shares after the adoption of the Takeover Directive, or restrictions of voting rights in general shareholders' meetings deciding on defensive measures, do not apply during the time allowed for acceptance of the bid. There exist further restrictions with respect to resolutions passed in the first general shareholders' meeting of the target company upon expiry of the period for acceptance.

3. Optional arrangements pursuant to Article 12

The provisions of Articles 9 to 11 are complemented in Article 12 by granting the Member States the option, in a three-step option model, to deviate from some provisions, which can be anticipated to become the regulatory basic case of national law in most Member States, also in Germany – contrary to the concept of the Directive. According to Article 12 the Member States are granted the right to release their companies from the strict neutrality obligation under Article 9 and/or the breakthrough rule under Article 11, so-called "opting-out clause". If this right is exercised shareholders nonetheless have to be given the possibility to decide in their respective general shareholders' meeting to voluntarily subject to the strict European standard.

No amendments are necessitated by the Takeover Directive with respect to the issue of material claims and the possibilities of legal protection of the target company's shareholders. The Directive does not affect the power of the Member States to designate the legal situation in view of disputes between the parties to the bid, nor their power to determine whether and under which circumstances the parties to a bid are entitled to enforce their rights in administrative or judicial proceedings.

4. Disclosure and transparency requirements pursuant to Article 10

For the purpose of an increased degree of transparency Article 10 provides for the obligation of the companies to disclose any specific corporate structures or defense mechanisms in the management report. Accordingly, the management has e.g. to describe and to list any provisions relating to transfer restrictions, restrictions as to the ownership of shares or restrictions as to voting rights. Furthermore, the management report has to describe all relevant provisions relating to the appointment and replacement of members of the corporate executive bodies and relating to any amendments of the articles of association. In addition, the management report has to disclose any shareholders' agreements that may have an effect on the transfer of shares of the company as well as any agreements between the company and third parties that become effective in the course of a take over bid, unless the disclosure of such agreements may cause any damage for the company.

5. Involvement of employee representatives / protection of employees

Pursuant to Article 9 (5) the target company's board has to forward its statement with respect to the bid to the employee representatives of the company. If the employee representatives decide to make their own statement such statement has to be contributed to the statement of the board and has to be publicized correspondingly. Whereas the first draft of the Directive still provided for the obligation of the target company's board only to inform its employees, now both, the employees of the offeror and of the target company have to be furnished with all relevant information once the offeror has made its bid pursuant to Article 6 (1) of the Directive.

6. Other important regulations

The Takeover Directive furthermore provides for restrictions in terms of type and amount of the consideration only with respect to mandatory bids, while voluntary purchase bids and takeover bids are not subject to any price regulations. As for mandatory bids the highest price the offeror paid for the same securities during a period of six to twelve months prior to the publication of the bid is deemed an equitable price. If between the time of publication of the bid and the time the offer closes for acceptance the offeror acquires securities at a price higher than the offer price, he has to submit a higher bid of no less than the highest price paid for the same securities. However, the Member States may provide for regulations authorizing their supervisory authorities to change the price under the circumstances according to clearly determined criteria. Furthermore, aside from securities and cash, the Takeover Directive allows for considerations composed of combinations thereof.

With respect to "squeeze-outs", the Takeover Directive stipulates that an offeror holding at least 90 % of the target company's capital carrying voting rights and also more than 90 % of the voting rights in the target company, may demand the remaining holders of securities to sell their securities to the offeror at an equitable price. As a counterpart to the "squeeze-out" the Takeover Directive provides for a so-called "sell-out", according to which the minority shareholders have the right to offer their shares for purchase to the offeror at a fair price for a term of three months following a voluntary bid or a mandatory bid.

IV. Conclusion

The adoption of the Takeover Directive overall can be considered a successful step towards a genuine, European-wide harmonization of the legal framework for company takeovers. For the first time after almost thirty years of negotiations there is a uniform procedural law for takeovers throughout the Internal Market. Nonetheless the recently adopted version of the Directive is far removed from the originally envisaged goal of liberalization, since every Member State and every company will, also in the future, be able to take advantage of precisely those defensive means it deems appropriate. In that respect, therefore, also Germany achieved its goals in the negotiations about the Directive with its demand to loosen the strict neutrality obligation. Otherwise no compromise could have been reached on a European level, which in the end made the adoption of the Takeover Directive possible. At the same time the Directive offers issuers the opportunity, which should not be underestimated, to face competition by waiving their rights of defense. If that route is not taken, purchasers of shares may consider this a disadvantage for an optimum company management and therefore be prepared to pay only a lower price for the relevant shares. This marks the beginning of

an international harmonization of the national acquisition markets, which might offer Europe the chance of increased competitiveness – especially vis-à-vis the US. It is awaited with anticipation how the German legislator will incorporate the provisions of the European Takeover Directive into the German takeover code.

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