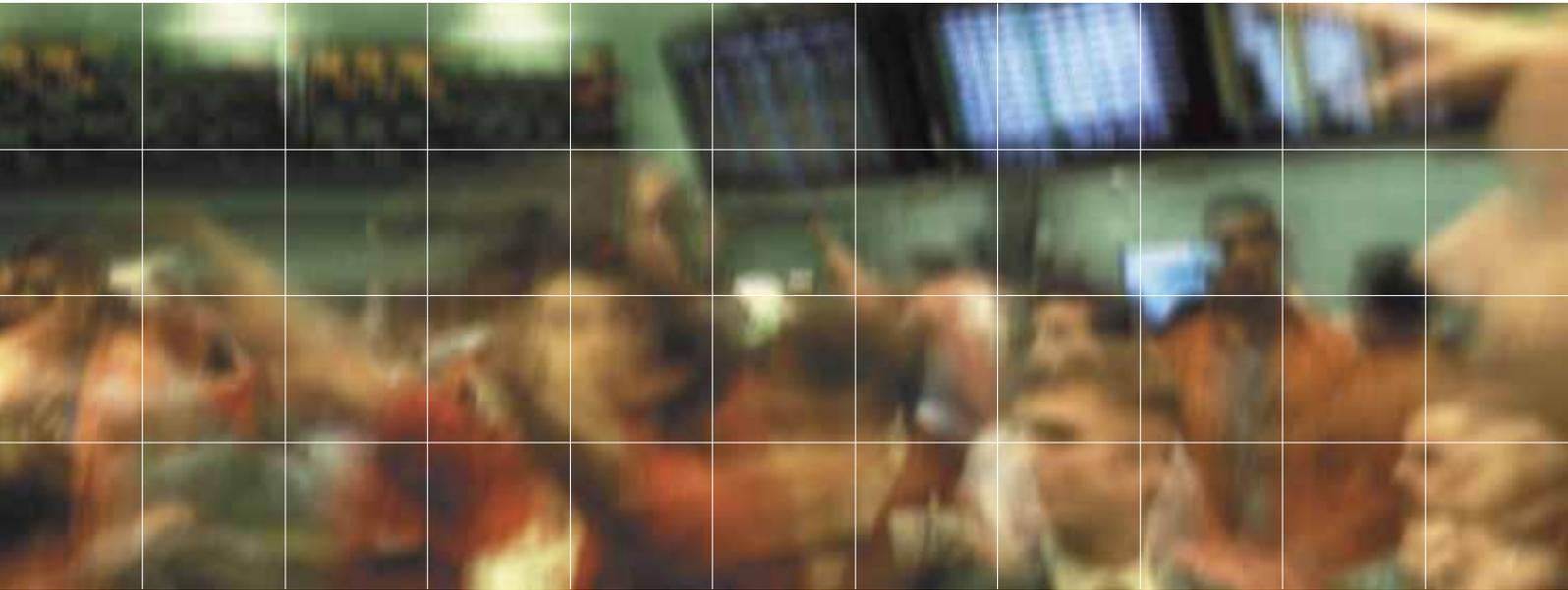




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## Acquisition of German Publicly Traded Companies: LEGAL FRAMEWORK AND PRACTICAL EXPERIENCE

The acquisition of publicly traded companies in Germany is principally governed by the Securities Acquisition and Corporate Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz – WpÜG*; the “Takeover Act”), which was adopted in 2002 and last amended in August 2008, and the regulations promulgated thereunder. The Takeover Act provides the principal construct under which acquirers may offer to purchase the securities of a German publicly traded company. It regulates the conduct of the acquirer prior to, during, and after a tender offer. It also provides for the rights of shareholders in connection with tender offers and the duties of the target company and its management during the acquisition period.

In addition to the Takeover Act, there are a number of German corporate and securities laws that

regulate the rights and obligations of acquirers, shareholders, target companies, and their management in connection with the acquisition of publicly traded companies. The most important of these statutes are the Stock Corporation Act (*Aktiengesetz – AktG*) and the Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*).

Because the issues facing acquirers of German publicly traded companies prior to, during, and after the acquisition often differ from those under other legal regimes, it is important for non-German acquirers to be familiar with such issues and the various solutions that are available under German law. In most circumstances, the issues and the ultimate solutions have a direct or indirect impact on the value of the target company to the acquirer and, consequently, the price it is willing to offer for the securities.



This *White Paper* will therefore outline the legal framework pursuant to which German publicly traded companies are acquired, in the context of voluntary takeover bids as well as mandatory offers. It will also summarize certain defensive measures available to target companies and their management in connection with hostile takeover bids and will identify certain legal issues facing acquirers following the acquisition of publicly traded companies.

<b>CONTENTS</b>	
<b>Statutory Framework</b>	
The Takeover Act .....	4
The Stock Corporation Act .....	6
<b>Voluntary Takeover Bid</b>	
Transaction Structure .....	7
Timeline .....	8
Disclosure Package .....	9
The Target's Response .....	9
Consideration .....	9
Conditions to Offer .....	10
Amendments to Offer .....	10
Competing Offer .....	10
<b>Mandatory Offer</b>	
Control .....	10
Governmental Exemptions .....	11
Penalties .....	11
<b>Defensive Measures</b>	
General .....	11
Pre-Acquisition Defensive Measures .....	12
Defensive Measures During an Acquisition .....	13
<b>Post-Acquisition Measures</b> .....	13
<b>Further Information</b>	
The Firm .....	13
Jones Day Germany .....	14

## ■ STATUTORY FRAMEWORK

### The Takeover Act

The Takeover Act and the regulations promulgated thereunder provide the principal guidelines for acquiring German publicly traded companies. The objective of the Takeover Act is to provide for a fair and orderly process pursuant to which acquirers can offer to purchase the securities of publicly traded companies in Germany. Prior to its adoption, the acquisition of publicly traded companies in Germany was regulated only by a voluntary takeover code that was not consistently followed, especially in transactions involving foreign acquirers. Despite its shortcomings, the Takeover Act has significantly improved the legal and market conditions concerning the acquisition of publicly traded companies in Germany by defining the legal obligations of the parties in such a transaction and ensuring the ultimate outcome thereof. The cornerstones of the Takeover Act include the requirement to treat the target company's shareholders equally, access to greater information about the transaction and the acquirer, greater security concerning the financing of the offer, and the obligation to launch a tender offer for all of the outstanding shares of a publicly traded company once the acquirer is deemed to own 30 percent or more of the voting shares of such company.

Between January 1, 2002, when the Takeover Act went into effect, and the end of 2008, more than 275 tender offers were approved by the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) pursuant to the Takeover Act.

*Application.* The Takeover Act applies to all public tender offers by natural or legal persons for the purchase of securities of a target company listed on an organized stock market in the Federal Republic of Germany (*Prime and General Standard*) or the European Economic Area (*i.e.*, the Member States of the European Union, as well as Norway, Iceland, and Liechtenstein) if the target company has opted for Germany as its home member state under the European securities laws. For purposes of the Takeover Act, securities are limited to shares of the capital stock of a stock corporation (*Aktiengesellschaft – AG*) or stock-issuing limited partnership (*Kommanditgesellschaft auf Aktien – KGaA*) domiciled in the Federal Republic of Germany, along with securities convertible or exchangeable into such shares.

*Equal Treatment.* All shareholders of a target company must be treated equally in connection with tender offers under

the Takeover Act and must be provided with sufficient time and information to make an informed decision in respect thereof. The management board (*Vorstand*) and supervisory board (*Aufsichtsrat*) of the target company are required to act in accordance with the target company's interests.

*Governmental Authority.* The German Federal Financial Supervisory Authority (*BaFin*) is the principal governmental authority responsible for promulgating regulation thereunder and for reviewing and approving tender offers and related disclosure documents. The Takeover Act prescribes the establishment by *BaFin* of a Takeover Advisory Commission (*Beirat*) designed to assist *BaFin* in the promulgation of regulations thereunder.

*Public Offers.* The Takeover Act governs all public offers for the purchase of securities (*i.e.*, tender offers). Specifically, the Takeover Act governs offers to purchase securities independent of control, offers to purchase securities in an attempt to gain control of the target company (*i.e.*, takeover bids), and offers required by the Takeover Act of anyone who directly or indirectly obtains control of the target company for the remaining shares of the target company's capital stock (*i.e.*, mandatory offers).

*Beneficial Ownership.* In determining beneficial ownership, securities held by subsidiaries of a security holder, securities held by third parties on behalf of such holder, securities transferred by third parties as a guaranty (unless the third party is entitled to exercise the voting rights independently from the holder and intends to do so), securities held by third parties encumbered with a usufructuary right in favor of such holder, securities that such holder can acquire by declaration of intent, and securities that such holder holds in trust and of which it may make use at its sole discretion unless otherwise advised will be imputed to such holder. Securities held by subsidiaries of such holder or third parties with whom such holder has entered into a voting agreement or otherwise acts in concert in such ways as described in the foregoing sentence are also imputed to such holder.

In determining whether a security holder is the beneficial owner of at least 30 percent of the voting rights of a target company, *BaFin* is obligated, upon written request by such holder, to ignore that portion of voting rights that are attributable to securities held by such holder if such holder obtained the securities by inheritance; as a gift from a spouse, cohabitant, direct descendant, or ancestor up to the third grade; or through divorce or separation from a

partner, change in legal form, or corporate restructuring. In addition, upon written request by such holder, *BaFin* may ignore that portion of voting rights that are attributable to securities held by such holder in its own discretion or otherwise release such holder from the mandatory offer obligation, in certain situations stipulated in (but not limited to) a catalogue pursuant to the regulations promulgated under the Takeover Act.

*Consideration.* In a takeover bid or mandatory offer issued pursuant to the Takeover Act, the offeror may offer consideration in the form of cash, securities listed on an organized market, or a combination thereof. However, the offeror is required to offer the target company's remaining shareholders cash consideration in euros if the offeror has purchased for cash consideration (i) at least 5 percent of the target company's outstanding shares or voting securities within six months preceding the publication of the intent to issue a tender offer, or (ii) at least 1 percent of the target company's outstanding shares or voting securities for cash consideration between the date of publication of the intent to issue a tender offer and the end of the acceptance period of such tender offer.

Under the Takeover Act, the amount of consideration for each class of shares must be "adequate" (*angemessen*). In determining the adequacy of proposed consideration, the weighted average share price of the target company's capital stock during the three-month period immediately preceding the publication of the decision to make a tender offer and the direct and indirect purchase of such shares by the offeror prior to, during, and after the tender offer are material factors prescribed by the Takeover Act.

Following the commencement of the tender offer, if the offeror or one of its affiliates acquires in a transaction outside the stock exchange securities that are the subject of the offer at a price higher in value than the consideration provided in such offer, the amount of consideration to all shareholders who have accepted the offer prior to such purchase will automatically increase accordingly. This rule applies for a period of one year following the expiration of the acceptance period.

*Procedures and Disclosure Obligations.* The offeror's decision to issue a tender offer must be published, without undue delay, in German in a nationwide authorized journal for the publication of stock exchange announcements or in an authorized electronic information system. The publication requirement exists whether or not the offer needs the

prior approval of its shareholders for such transaction. The minimum information required in the publication includes the securities that are the subject of the tender offer and the intention to purchase such securities. Information regarding the amount and form of consideration offered for the securities of the target company is not required at this time. In addition, the offeror must inform *BaFin*, the target company, and the regional exchanges on which the target's shares are listed of its decision to issue a tender offer.

Within four weeks following the publication of the decision to make a tender offer, the offeror must file with *BaFin* a disclosure package containing all the information necessary to enable the shareholders to whom the tender offer is directed to make an informed decision with respect thereto. Under a limited number of circumstances, *BaFin* may extend that period by an additional four weeks. The offeror is required to publish the disclosure package no later than 10 business days following the filing of the package with *BaFin* (in the absence of any comments from *BaFin* as to its compliance with applicable laws and regulations) or upon revision of the disclosure package to reflect comments from *BaFin* as to its compliance with applicable laws and regulations.

Subsequently, the offeror is required to deliver the disclosure package to the management board of the target company. The management board must then distribute the disclosure package to the target company's works council (*Betriebsrat*), its finance committee (*Wirtschaftsausschuss*) or, if a works council or finance committee does not exist, directly to its employees.

In addition, at equal intervals during the acceptance period and upon its expiration, the offeror is required to publish the number of shares tendered pursuant to the tender offer.

*Duties of the Target's Management.* As soon as possible following the delivery of the offeror's disclosure package, the target company's management board is required to publish an information statement containing the management board's reasoned opinion in respect of the offer. Specifically, the target company's information statement must include (i) the management board's opinion as to the appropriateness and adequacy of the consideration offered, (ii) how the target company, its employees, and their employment conditions will be affected by the tender offer, (iii) the management board's opinion as to the offeror's intention in connection with the tender offer, and (iv) whether the members of the management board intend to

accept the offer, to the extent such members are holders of any securities of the target company that are the subject of the offer.

The Takeover Act reiterates the management board's duty to the target company's shareholders to preserve and protect their interests in connection with the tender offer. Specifically, the Takeover Act forbids the management board from interfering with the success of the tender offer during the period from receipt of the disclosure document from the offeror until the results of the tender offer have been made public.

The foregoing limitations on the conduct of the management board, however, apply neither to any measures approved by the supervisory board of the target company, nor to any measures relating to the ongoing operation of business to the extent such measures are deemed materially necessary to the conduct of such business and are independent of the tender offer. In addition, the management board is permitted to seek and pursue competing tender offers (e.g., white knights).

Furthermore, in advance of any tender offer, the general meeting may authorize the management board to take certain defensive measures and interfere with the success of the tender offer to the extent such authorization is sufficiently substantiated. The authorizing resolution requires a 75 percent majority of the company's capital stock to be represented at the general meeting and expires after 18 months. While these authorizations are rarely used by publicly listed companies in Germany, the shareholders can stipulate in the company's articles of association that such authorizations may not be adopted.

Prior to the expiration of the acceptance period and subject to a two-week term, the management board may call a meeting of the target company's shareholders to decide whether to approve the tender offer.

*Competing Offer.* In the event a competing offer is issued for the same securities, the acceptance period for the original offer is automatically extended until the expiration of the acceptance period of the competing offer. Shareholders who have accepted the original offer prior to the publication of the competing offer may withdraw their acceptance up to the expiration of the acceptance period. Persons whose securities have been imputed to the offeror for purposes of determining beneficial ownership of such securities may not issue competing offers for the same securities.

## **The Stock Corporation Act**

The Stock Corporation Act governs the capital structure and corporate governance of a stock corporation, the most common form of publicly traded company in Germany.

*Capital Structure.* The share capital (*Grundkapital*) of a stock corporation is denominated in par value shares (*Nennbetragsaktien*) or individual stock without par value (*Stückaktien*). Shares may be certificated in the form of bearer shares or registered shares. In addition, shares can be issued in multiple classes. The most common class of equity securities in a stock corporation consists of ordinary shares (*Stammaktien*). In addition to ordinary shares, a stock corporation may issue a host of preferred shares (*Vorzugsaktien*) that typically grant the holders thereof priority over the holders of ordinary shares to the stock corporation's dividends and other distributions. The most common form of preferred shares consists of those without voting rights (*stimmrechtslose Vorzugsaktien*).

*Subscription Rights.* Unlike U.S. corporate law, German corporate law grants the holders of shares in a stock corporation certain subscription rights, the restriction of which is limited in scope and circumstances and strictly regulated. Consequently, shareholders in a German stock corporation have the right, unless validly restricted, to subscribe for new shares on a pro rata basis, in order to avoid nominal dilution (i.e., dilution of the percentage of shares and voting rights held in the company).

*Treasury Shares.* The Stock Corporation Act prohibits a stock corporation from, directly or indirectly, subscribing for its own shares. However, the stock corporation may repurchase its own shares under certain limited circumstances, particularly on the basis of a shareholder resolution to implement a buyback program or for use in connection with incentive schemes for the company's employees. The stock corporation's treasury shares must at all times be less than 10 percent of its existing share capital.

*Corporate Governance.* German stock corporations are governed by three corporate bodies whose individual scope of authority is defined by German corporate law: the general meeting (*Hauptversammlung*), the supervisory board (*Aufsichtsrat*), and the management board (*Vorstand*). The relationship between the various governing bodies and the limitations imposed on the scope of authority of each are designed to allow shareholders only indirect control over the management of the stock corporation.

The members of the management board, the body solely responsible for the day-to-day management of the stock corporation, are afforded a great deal of independence. They are appointed not by the shareholders of the company but rather by the supervisory board, whose members are in turn appointed at the shareholders' general meeting.

The supervisory board in a German stock corporation acts much the same as independent directors of a U.S. corporation. Members of the management board may not serve simultaneously on the supervisory board. The management board is required to report to the supervisory board. The supervisory board is responsible for oversight of the management board, which may be required to obtain the supervisory board's approval before taking certain actions.

German labor and corporate laws grant the employees of larger stock corporations certain codetermination rights, including membership on the supervisory board. The members of the supervisory board representing the shareholders are appointed by a simple majority of the shareholders at the general meeting for a term of up to five years. The shareholders of a stock corporation may act only through resolutions adopted at a general meeting.

## ■ VOLUNTARY TAKEOVER BID

Because an offeror that acquires control in a target company on the basis of a voluntary takeover bid is exempted from the obligation to launch a mandatory offer, the proceedings for both forms of tender offer are to a great extent the same. However, since an offeror is afforded a greater degree of flexibility in a takeover bid (particularly with regard to conditions to the offer), offerors typically prefer to acquire control in a takeover bid as opposed to acquiring a controlling interest in a private transaction followed by a mandatory offer.

### Transaction Structure

*Pre-Offer Arrangements.* In friendly transactions, the acquirer and the target company may enter into an agreement, often in the form of a memorandum of understanding, in which the parties lay out their understanding of the contemplated transaction structure, a schedule of events, and the fundamental terms and conditions of the contemplated offer, including the consideration to be offered. Such an agreement between the acquirer and the target company may be in the interest of both the acquirer and the target company and its shareholders. The agreement

would enable the acquirer to obtain access to confidential information about the target company that would be otherwise inaccessible, by providing the terms and conditions pursuant to which due diligence is conducted. The acquirer would also obtain the cooperation of the target's management in connection with certain pre-closing matters (including antitrust/merger control filings). In addition, the agreement may provide for a breakup fee in the event the transaction is not consummated, such as in the event of a competing offer. However, the extent to which breakup fees are enforceable in Germany is unclear. While breakup fees calculated to reimburse the bidder for its costs associated with the transaction should be permitted, the significantly higher fees permitted in some jurisdictions may be null and void, as they counteract the target management's duties in takeover situations and may force the shareholders to accept an offer they do not support.

The agreement would enable the target company to negotiate the best possible price and conditions to the offer for its shareholders and would provide greater certainty as to the future of the target company and its other constituencies.

The agreement would also enable both parties to obtain a standstill arrangement *vis-à-vis* the other. The acquirer would agree not to purchase any shares of the target outside the agreed tender offer, hence reducing the likelihood of a hostile takeover during or after the due diligence phase. The target company would agree, subject to the limitations imposed by its duty of care and loyalty, to recommend the proposed offer to its shareholders and not to solicit any competing offers during the term of the agreement. The same duty-of-care and loyalty principles play a role in determining the appropriateness of any breakup fees provided in the agreement.

Concurrently, the acquirer may enter into arrangements with major shareholders of the target company in which the shareholders agree to tender their shares pursuant to the agreed offer and/or to vote in favor of the proposed acquisition at the target's general meeting (should such a meeting be deemed necessary) or to sell their shares in the target company upfront to the acquirer.

In Germany, acquirers have to be careful about when, if at all, to enter into a pre-offer agreement with the target's major shareholders that would bind their actions *vis-à-vis* the offer or voting at a shareholders' assembly. Under the Takeover Act, such agreements might result in the

attribution of the voting rights of the shareholders to the acquirer, thus leading to a premature mandatory takeover obligation, which is not always desirable.

*Acquirer's Objectives.* The levels of ownership and control that an acquirer wishes to achieve are among the most important factors to be considered in structuring a takeover transaction. While control is deemed achieved under the Takeover Act once the 30 percent threshold has been reached, acquirers will typically not consider the level of control to be sufficient at 30 or even 50 percent ownership.

Aside from the level of ownership that tax and accounting rules require for various consolidation and synergistic purposes, the rights that German corporate laws afford minority shareholders require acquirers to pursue significantly greater ownership in the target to achieve their objectives. Because a minority of more than 25 percent can—if the target company's articles of association do not provide otherwise—block a number of significant corporate measures (e.g., removal of members of the supervisory board), most acquirers are incentivized to pursue at least 75 percent ownership. In addition, it is worth noting that minority shareholders can be involuntarily removed (i.e., squeezed out) only if ownership of at least 95 percent has been achieved.

#### **Timeline**

While the publication of the decision to make an offer is the single event that leads to and dictates the timing of all other principal events in connection with a voluntary takeover, there are a number of important steps that precede such publication when pursuing the acquisition of a German publicly traded company.

In a typical transaction, the acquirer will conduct a preliminary review of the target company based on the limited information regarding the target that is publicly available. This includes corporate information filed with the applicable commercial register, shareholder information filed with *BaFin*, financial information published in the Federal Gazette, and annual, semi-annual, and continuous disclosure, as well as disclosure relating to specific public offerings made available pursuant to applicable securities laws and exchange rules.

After the preliminary review, the acquirer will wish to begin a dialogue with the target's management in order to obtain access to more confidential information and to conduct a due diligence investigation. However, the limitations imposed by German corporate and securities laws and the

ambiguities surrounding the same have in many circumstances impeded the conduct of a comprehensive due diligence investigation, hence thwarting the successful consummation of the proposed transaction.

Once the transaction structure and its terms and conditions are determined, the decision to issue a tender offer must be published (with a prior submission of the text thereof to *BaFin* and the securities exchanges on which the relevant securities are listed). The publication must indicate the bidder's intention to issue a tender offer in the form of a takeover bid. It must identify the target company and the securities that are the subject of the tender offer, as well as the internet address on which the tender offer documents will be posted.

Once the intention to issue a takeover bid has been published, the acquirer has a four-week period during which it must prepare and submit to *BaFin* a disclosure package containing all of the relevant terms and conditions of the offer. Under limited circumstances, *BaFin* may extend that four-week period by another four weeks. Within 10 business days after submission of the disclosure package with *BaFin* or after satisfactory revision thereof based on comments from *BaFin*, the acquirer is required to publish the disclosure package on an official stock exchange gazette or make it available for free distribution by a distribution agent and post the same on a dedicated internet web site.

The acceptance period begins with the publication of the disclosure package and may be as short as four weeks or as long as 10. The Takeover Act provides for a number of circumstances (e.g., amendments to the offer by the acquirer, a competing offer, or a general meeting in response to the acquirer's tender offer) that will automatically extend the acceptance period. Furthermore, if all of the conditions to the takeover bid have been fulfilled prior to the expiration of the acceptance period, the target's shareholders will nevertheless have an extended acceptance period of two weeks following the expiration of the ordinary acceptance period to tender their shares in accordance therewith.

During the acceptance period, the target's shareholders have the right to express their acceptance of the tender offer and tender their shares through their respective depository banks. Once the acceptance period has expired, the sale and transfer of the shares so tendered will be consummated by the shareholders' depository banks and the acquirer's exchange agent.

The offeror must publish the results of the tender offer on a weekly basis during the acceptance period, on a daily basis during the last week of the acceptance period, and immediately following the expiration of the acceptance period. The offeror is also obligated to publicly disclose the purchase of the securities that are the subject of the tender offer for a period of one year following the publication of the offer documents.

The timeline of a takeover bid with consideration that includes a noncash component will also have to take into account the issuance and listing of the shares to be offered as consideration, including the necessary corporate approvals and admission for listing.

### **Disclosure Package**

The Takeover Act and the regulations promulgated thereunder prescribe the preparation and dissemination of offer documents, the content of which is sufficiently detailed and complete to enable the shareholders to whom the tender offer is directed to make an informed decision with respect thereto. While the Takeover Act and the regulations promulgated thereunder identify in great detail the necessary information that must be contained in the disclosure package, no specific form is prescribed by law. In recent years, *BaFin* and the offerors have developed certain market standards as to the format of the disclosure package.

The typical disclosure package involving a voluntary takeover bid consists of the following general sections: (i) the summary, (ii) the offeror, (iii) the target company, (iv) the securities subject to the offer, (v) the consideration, (vi) conditions to the offer, (vii) the acceptance period, (viii) procedures, (ix) withdrawal rights, (x) restrictions on the offer, (xi) governing law, (xii) responsibility for the disclosure package, and (xiii) the signature of the offeror.

The disclosure concerning the offeror includes a description of its business, its reasons for the acquisition, its affiliates and related persons involved in the transactions, the amount of shares directly and indirectly held by the offeror, and the effect of the acquisition on the offeror and its business. The disclosure concerning the target company includes a description of its business, the intentions of the offeror, and the effect of the acquisition on the target company and its management.

In addition, the offeror is required to explain in the disclosure package how it intends to finance the proposed acquisition and must provide as an exhibit thereto

confirmation by an independent financial service provider as to the adequacy and availability of funds to satisfy the consideration under the offer.

By signing the disclosure package, the offeror (and anyone else assuming responsibility for the disclosure package or any portion thereof) is liable for any material misrepresentations or omissions therein. Only those shareholders to whom the offer is directed, who have accepted the offer, and who have suffered a loss resulting from any alleged material misrepresentations or omissions have the right to sue.

To the extent the transaction involves consideration in the form of newly issued shares of capital stock of the acquiring company, certain rules and regulations concerning disclosure under the Securities Prospectus Act (*Wertpapierprospektgesetz*) also apply.

### **The Target's Response**

The offeror is required to deliver the disclosure package, contemporaneously with its publication, to the management board of the target company. Shortly after receiving the disclosure package, the target's management board and supervisory board must issue a reasoned opinion regarding the takeover bid.

Like the offeror's disclosure package, the target's information statement containing its management's reasoned opinion must be published in an official stock exchange gazette and posted on an internet web site.

The management board is required to distribute the offeror's disclosure package to the target company's works council or, if a works council does not exist, directly to its employees. Any statement regarding the transaction issued to the target's management by the works council will have to be included in the target's information statement.

### **Consideration**

One of the key elements of the Takeover Act is the set of provisions prescribing the minimum consideration that an offeror must offer in connection with a takeover bid or a mandatory offer. As a general rule, the Takeover Act prescribes a consideration that is appropriate in type and value.

As far as the type of consideration is concerned, the consideration is deemed appropriate if offered in the form of cash (denominated in euros), shares listed on a European

organized exchange, or a combination of both. However, in a tender offer involving a consideration with a noncash component, if the offeror has, directly or indirectly, acquired shares for a consideration in cash in excess of 5 percent of the target's total share capital during the three-month period immediately preceding the publication of the decision to issue a tender offer or in excess of 1 percent during the acceptance period, then the offeror must offer an alternative consideration in cash.

As far as the value of the consideration is concerned, the offeror must offer a consideration not less in value than the consideration paid by the offeror, directly or indirectly, for shares acquired during the six-month period immediately preceding the publication of the decision to issue a tender offer (including option arrangements), shares purchased outside the tender offer during the acceptance period, and shares purchased in a private transaction (an off-market transaction) during the one-year period following the expiration of the acceptance period. Furthermore, the consideration offered in a takeover bid or mandatory offer must equal or exceed the weighted average market price of the respective shares during the three-month period immediately preceding the publication of the decision to issue a tender offer.

#### **Conditions to Offer**

While mandatory offers must not be subject to any conditions other than those required by law (e.g., antitrust approvals), takeover bids can be conditional on certain actions and events, provided that the satisfaction of the condition is not under the control of the offeror. Accordingly, such conditions, e.g., those referring to material adverse changes, need to be structured so that the assessment of their satisfaction is the responsibility not of the offeror but of an independent person.

Furthermore, except in transactions involving consideration in the form of shares whose issuance is to be approved by the offeror's shareholders, the Takeover Act prohibits any form of financing condition, even though such condition is in many circumstances outside the control of the offeror. In fact, it must be clearly disclosed in the disclosure package and confirmed by an independent financial service provider that the offeror has, prior to the launch of the tender offer, taken all actions necessary to have sufficient funds or financing available to consummate the transaction.

#### **Amendments to Offer**

Once the offeror publishes its disclosure package, it may amend its offer only in a very limited number of

circumstances, all of which are to the benefit of the shareholders to whom the offer is directed. The offer may be amended no later than one business day prior to the expiration of the acceptance period to (i) increase the consideration offered, (ii) offer an additional form of consideration, (iii) waive a condition to the offer, or (iv) reduce the minimum amount of shares required to be tendered in order to consummate the transaction. The amendment must be published in the same manner as the disclosure package relating to the offer.

The Takeover Act prohibits an amendment to the tender offer by which the offeror extends the acceptance period. If the tender offer is amended during the last two weeks of the acceptance period, however, the acceptance period is automatically extended by two weeks, although the offeror is prohibited from further amending the tender offer during the extension.

#### **Competing Offer**

In the event of a competing tender offer, the Takeover Act prescribes the right of the shareholders who accepted the original tender offer to withdraw their acceptance and consider the competing offer.

In addition, in the event a competing tender offer is issued, the acceptance period of the original tender offer is extended to match that of the competing offer. Each offeror may extend the acceptance period by amending its offer, provided that the offerors are barred from amending their offers during any extended acceptance period resulting from an amendment during the last two weeks of the acceptance period, hence limiting the extent to which a bidding contest extends the acceptance period.

### **■ MANDATORY OFFER**

#### **Control**

The Takeover Act provides for a mandatory offer obligation to be imposed on anyone who, directly or indirectly, reaches the control threshold. In fact, since the adoption of the Takeover Act, many transactions involving the acquisition of significant holdings in a German publicly traded company without the intent to acquire actual control of the company have been thwarted, notwithstanding their business merits, because the Takeover Act defines "control" as holding 30 percent or more of a German publicly traded company's voting rights. In addition, the 30 percent threshold has had a significant impact on the structure and timing of transactions that have been consummated, especially

those with the original intent to acquire the target over a long period of time.

The negative consequences of the mandatory takeover obligation are further exacerbated by the attribution rules provided thereunder. Under the Takeover Act, it is not only the voting rights of a host of the holder's affiliates that are attributed to the holder, but also the rights of those persons acting in concert with it, as well as any subsidiaries thereof. Consequently, the holder may find itself in "control" and subject to the mandatory offer obligation without such intent and, in certain circumstances, without being aware of such status.

The attribution rules under the Takeover Act have created a number of unresolved problems, including the potential imposition of a mandatory offer obligation on multiple parties that are related but do not necessarily have identical or even compatible interests.

Transactions involving (i) the acquisition of a block of shares in a German publicly traded company, whether in a private transaction or through the exchange, (ii) the subscription of new shares in connection with a capital increase in a German publicly traded company, or (iii) the exchange of securities in connection with a business combination could potentially lead to the acquisition of "control" as it is defined by the Takeover Act and consequently impose a mandatory takeover obligation on one or more of the parties to such transactions.

#### **Governmental Exemptions**

The Takeover Act provides for a number of exceptions to the mandatory takeover rule. Most important, an offeror in a takeover bid is not required to follow such bid with a mandatory offer once it acquires control through such takeover bid.

In addition, the Takeover Act grants *BaFin* the authority to exempt parties from the general obligation to issue a mandatory offer either by excluding the attribution of certain shares acquired by a party to such party for purposes of determining control or by granting an exemption despite achieving control because of the nature of the transaction pursuant to which control was achieved. For example, an investor acquiring control in a target company can be released from the mandatory offer obligation if (i) another investor controls an even greater stake in the target company, (ii) the investor's interest in the target company is not

expected to account for a majority of voting rights in the general meeting based on the attendance at the target company's past three annual general meetings, and (iii) the investment is made in connection with a comprehensive restructuring of the (distressed) target company.

#### **Penalties**

The Takeover Act imposes a series of relatively severe penalties in the event the mandatory offer obligation is not fulfilled. Specifically, fines of up to €1 million can be imposed for noncompliance with the provisions of the Takeover Act. In addition, once a mandatory offer has to be issued, the offeror must pay interest on the consideration required by the Takeover Act equal to 5 percent per annum above the base interest rate determined by the German Civil Code (*Bürgerliches Gesetzbuch*) for the entire period during which the offeror failed to make the offer. Most notably, however, the rights (including voting rights) under shares held directly and indirectly by such person cannot be exercised during this period.

### **■ DEFENSIVE MEASURES**

#### **General**

While there are relatively few effective defensive measures available to German stock corporations in comparison to their U.S. counterparts, many conditions in Germany act as natural barriers to hostile takeovers that do not necessarily exist elsewhere. Compared to their U.S. counterparts, there is less material information publicly available regarding German publicly traded companies, making a due diligence investigation (which is available only in a friendly transaction) even more vital to a successful acquisition.

As a general rule, the principals governing the conduct of the various corporate bodies set forth in the Stock Corporation Act have not been altered by the Takeover Act. The powers available to the management board, however, have been slightly curtailed. Specifically, the Takeover Act prohibits the management board of a target company from taking actions that could frustrate a takeover bid during the tender offer period, unless such actions (i) would have been taken by a prudent and diligent management board in the absence of a takeover bid, (ii) involve the search for a competing offer, or (iii) have been approved by the target's supervisory board. The foregoing exceptions, notably the last one, effectively gut the general prohibition against defensive measures during the tender offer period.

The defensive measures available to a potential target company under the Stock Corporation Act and the Takeover Act can be divided into the following categories principally because of the interplay between the two statutes.

#### **Pre-Acquisition Defensive Measures**

While the Stock Corporation Act provides for a number of measures that a company may take prior to any proposed takeover bid to fend off undesired offers, most of these measures have the additional undesired effect of limiting the company's business and financial activities. Consequently, as a practical matter, they tend to be of limited use. Because of the drastic effect they may have on the success of a takeover bid and the future of the company in the event one is consummated, it is important for potential acquirers to ensure that none of these measures are in place or, if one or more are in place, to understand their effect on the proposed transaction prior to launching a tender offer.

*Preferred Shares.* Because the Takeover Act requires takeover bids and mandatory offers to be issued in respect of all of the issued and outstanding share capital of a target company, the issuance of preferred shares with no voting rights may act as a financial deterrent. However, German corporate law prohibits the issuance of preferred shares with multiple voting rights. Such preferred shares act as an even more effective deterrent in jurisdictions where such measures are available.

*Severance Arrangements.* While German corporate law requires the compensation schemes of the management board to be appropriate in light of the company's financial condition and the members' responsibilities, golden parachutes that meet such criteria and silver-parachute plans that offer large severance packages to a broader group of employees triggered by a change in control can act as a significant deterrence against hostile bids.

*Change-in-Control Provisions.* Change-in-control provisions in material agreements to which the target company is a party that alter or terminate the arrangement could have a significant impact on the business condition of the target following a successful takeover bid. While such provisions require an independently justifiable basis for the management to comply with its fiduciary duties, if the agreements and the effect of the provision on the underlying arrangement are of material significance, they can play a deterring role in hostile takeover bids.

*Super-Majority Requirements.* Because most of the majority requirements for actions in a general meeting can be increased in the company's articles of association, such increased requirements can play a deterring role in companies that become the target of a hostile bid. For example, the majority requirements for amending the articles of association or appointing and removing members of the company's supervisory board may be increased, making it more difficult for a hostile offeror that has acquired only a simple majority of the company's shares to pursue some of the post-acquisition measures it would like or needs to pursue. As with other defensive measures of this nature, increasing the majority requirements will also have a restricting effect on the conduct of the company's business and financial activities in the absence of a takeover bid.

*Supervisory Board Appointment Rights.* Under the Stock Corporation Act, the articles of association of a company may grant the holders of specific shares in such company the exclusive right to appoint up to one-third of the members of the supervisory board representing the shareholders (*Entsendungsrecht*). Once such a right has been granted, its removal requires an amendment to the company's articles of association that is approved not only by the requisite majority but also by the holder whose right is to be removed.

*Blocking Minority.* One of the most effective defenses against a hostile takeover is a shareholder with a blocking minority interest. Since many of the more important measures in a general meeting require approval by 75 percent of the votes represented, the holder(s) of slightly more than 25 percent of the shares outstanding (or even less in a company with dispersed shareholding) can effectively discourage a hostile bid. Of course, a bid hostile to the company's management is not necessarily always one hostile to the holder of a blocking minority.

German publicly traded companies are required to publish information concerning the aforementioned takeover-related measures. This includes company information on (i) the structure of its capital, (ii) any restrictions on the transfer of securities, (iii) significant direct and indirect shareholdings, (iv) the holders of any securities with special control rights and a description of those rights, (v) any restrictions on voting rights, (vi) the rules governing the appointment and replacement of board members and the amendment of the articles of association, (vii) the powers of board members, particularly the power to issue or buy back shares, (viii) any significant agreements to which the

company is a party and which take effect, alter, or terminate upon a change in control of the company following a takeover bid, and (ix) any agreements between the company and its board members or employees providing for compensation if they resign or are made redundant without valid reason or if their employment ceases because of a takeover bid.

This list of takeover-related measures by the company can be valuable information to any potential offeror since every possible difficulty and obstacle in the acquisition process is disclosed and can be taken into account when preparing for a takeover attempt.

### **Defensive Measures During an Acquisition**

The Stock Corporation Act grants the shareholders of a stock corporation the right to delegate certain powers to the company's management by authorizing certain activities that management may take at a future date subject to the exercise of its business judgment. Furthermore, the Takeover Act permits the authorization by the shareholders in the general meeting of defensive measures against a takeover bid. The combination of these two constructs has given rise to a series of defensive measures that can successfully deter a hostile takeover bid.

*Authorized Capital.* The shareholders' assembly may authorize an increase in the company's share capital of up to 50 percent for cash contributions or contributions in kind. The authorization may have a five-year term and enable the management board to restrict the existing shareholders' subscription rights as to some or all of the newly issued shares. However, the capital increase will require the approval of the company's supervisory board. Furthermore, restricting the subscription rights of existing shareholders is subject to certain limitations.

The issuance of authorized capital in connection with a business combination would enable the company to issue new shares representing up to one-third of the company's share capital following the capital increase for a contribution in kind, which could conflict with the business interests of the hostile acquirer and thus thwart the hostile bid.

*Treasury Shares.* The shareholders of a stock corporation can authorize management to repurchase up to 10 percent of its existing shares and to resell the same at a future date. The authorization can last as long as 18 months and may require the approval of the supervisory board. The effectiveness of treasury shares as a defensive measure is quite

limited on its own (e.g., it can be used to increase the market price of the target's shares) but may be significant if used in combination with newly issued authorized capital.

### **■ POST-ACQUISITION MEASURES**

Following the acquisition of a company, German law offers efficient possibilities for the acquirer to consolidate its control over the target company, to financially and strategically incorporate the target into its corporate group, and/or to dispose of assets and consolidate its business in order to take advantage of synergies and increase the value of its equity in the target.

To overcome the independence of the target company's management board, a 75 percent shareholder can enter into a domination agreement (*Beherrschungsvertrag*) with the target company allowing such shareholder to issue certain instructions to the target company's management; into a profit and loss transfer agreement (*Ergebnisabführungsvertrag*), resulting in the immediate consolidation of the target company's net annual results with the shareholder; or into a combination of such agreements.

Full ownership in the acquired company can be achieved through a squeeze-out of the minority shareholders. Upon the application of a shareholder who owns shares of at least 95 percent of the share capital in the target company, the remaining shares will be transferred to such shareholder in exchange for adequate consideration. Where a squeeze-out is initiated within a period of three months following the consummation of a takeover bid or a mandatory offer, which was accepted for at least 90 percent of the shares that were subject to the offer, the consideration paid under the offer is deemed adequate for purposes of the squeeze-out of the minority shareholders. In any other event, the amount of consideration is to be determined on a valuation based on discounted cash flow-related analysis.

### **■ FURTHER INFORMATION**

#### **The Firm**

Since the Firm's founding in 1893, Jones Day has grown in response to our clients' needs from a small, local practice to one of the world's largest international law firms. With more than 2,400 lawyers resident in 32 offices around the world, including 450 practitioners in Europe and 200 in Asia, the Firm counts more than half of the *Fortune* Global 500

among our clients. Jones Day's success stems from our key strengths: high-value client service, depth of experience and resources, and a "One Firm" organization and culture allowing us to bring the best of the Firm to every engagement, regardless of the location of the client or the details of its needs.

The Firm has received numerous accolades over the years. In 2009, 2008, 2006, 2004, and 2002, Jones Day was ranked "No. 1 for Client Service" by The BTI Consulting Group, which stated, "Jones Day claims the number one seat for a second year in a row, crowning them the absolute best law firm for continuous superior client service performance in the eyes of clients." The BTI report goes on to say, "Jones Day's unparalleled client service excellence has earned the Firm a top five spot for eight solid years, a performance rivaled by none." Likewise, Legal Week Intelligence's client survey states that "in three out of the last four years Jones Day has outperformed the UK magic circle firms in terms of quality of legal and commercial advice." *Asian Legal Business* China Law Awards named us "International Law Firm of the Year" in 2006 and 2005, and we received the second-highest number of mentions in *Corporate Counsel's* 2006 survey, "Who Represents America's Biggest Companies."

#### **Jones Day Germany**

The Firm's attorneys advise national and international corporate clients on a wide range of German and cross-border acquisitions and joint ventures, along with corporate finance and securities matters and private equity and venture capital. They offer legal services regarding commercial, labor, tax, intellectual property, and unfair competition law. The Munich IP team, with its integrated group of patent attorneys, protects and enforces clients' intellectual property rights by prosecuting and litigating patents, trademarks, and copyrights.

The Firm's industry experience includes financial services, pharmaceuticals/biotechnology, telecommunications, aviation, automobiles, and the chemical industry. Technology experience includes EU and national regulations concerning new technologies and all corporate and regulatory aspects of information technology, such as e-commerce, software, licensing, and outsourcing. The corporate real estate practice advises on major infrastructure and privatization projects.

Jones Day's German Business Restructuring & Reorganization Practice represents national and international corporations, banks, and financial institutions as debtors, creditors, shareholders, and investors in complex restructuring, out-of-court workouts, and other domestic insolvency matters, including representation of boards of directors in evaluating corporate restructuring alternatives and fulfilling their fiduciary duties.

The German Tax Practice advises national and multinational clients regarding tax and corporate structures within complex cross-border acquisitions. The Firm's lawyers are involved in a variety of general litigation and arbitration matters. As part of Jones Day's European Antitrust Practice, the German attorneys represent clients in EU and national merger control proceedings and a variety of competition and antitrust matters. On the administrative level, the attorneys render legal services in all German and EU-related regulatory matters, as well as environmental and public procurement issues.



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## JONES DAY GLOBAL LOCATIONS

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BEIJING

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DUBAI

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IRVINE

LONDON

LOS ANGELES

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