

Public Takeovers in Germany

How takeovers are regulated and conducted in practice

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I Introduction

The landmark Vodafone / Mannesmann takeover in 1999/2000 demonstrated the need for a comprehensive statutory regime for public takeovers of German companies. The German Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz – WpÜG*) introduced such a regime and came into force in 2002. It applies to all offers for German issuers whose shares are admitted to trading on an organized market in Germany or within the European Economic Area (EEA), e.g. the Prime Standard and the General Standard markets of the Frankfurt Stock Exchange. The Takeover Act established the general principles for the conduct of takeovers in Germany, the first and most important of which is the requirement that all shareholders must be treated equally, and regulates the offer procedures.

Compliance with the Takeover Act is overseen by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*), which has supervised over 500 public offers with typically between 16 and 26 offers per year. While the transaction volume usually ranges between EUR 10 and 100 million, only one in ten transactions is over a billion euros.

The German market for public takeovers has to cope with continuous legal and factual change. As a result of changes in European legislation, the relevant German statutes have undergone and continue to experience substantial amendments, in particular to increase transparency and to implement a more onerous sanctions regime.

In recent years, foreign investors have increased their takeover activity in Germany. The takeover approach by Canadian Potash Corp. for K+S, which was advised by CMS, was the most notable and the first attempt by a foreign buyer to take over a German DAX listed company for a while, though it was successfully repelled. The intended but unsuccessful “merger of equals” of London Stock Exchange and Deutsche Börse, was ultimately also structured as a takeover by a (new) UK holding company.

The increasing trend of shareholder activism has increased the complexity of public takeover transactions. Activists like Elliott acquire substantial stakes following the announcement of a takeover and try to drive up the offer price (e.g. Faurecia / Hella or Vonovia / Deutsche Wohnen).

Other activists aim at forcing a change in the management of the target company (e.g. Bain and Cinven / Stada) or at delisting its shares followed by a strategic realignment (H&F and EQT / Zooplus).

In this challenging environment, careful consideration of the strategic options is essential. This guide provides an introduction to the legal framework which governs public takeover offers in Germany and gives an insight into how such takeover offers are conducted in practice.

2 Preparation

Intensive preparations will usually precede the decision of a bidder to make an offer. The bidder will appoint financial and other advisors, consider its strategic options, secure the financing, examine the prospects of success and may contact, or even negotiate the terms of the offer with the target company or its major shareholders.

The regulated phase of an offer does not start until the decision of the bidder to make an offer has been

announced. The Takeover Act lays down strict rules for when the announcement must be made (cf. “Announcing the Offer” below). During the preparations it is paramount that the bidder maintains secrecy regarding the possible offer, as a premature announcement or a leak of information is likely to affect the target’s share price, and the minimum price required under the offer.

Voluntary and Mandatory Offers

What types of public offers exist?

The Takeover Act distinguishes between three different types of offer, namely takeover offers, mandatory offers and simple purchase offers.

Takeover offers are voluntary and aim at the initial acquisition of control, being defined as the ownership of 30% or more of the voting rights in the target.

A *mandatory offer* must be made if the 30%-threshold is reached or exceeded by other means than a public offer or in connection with a public offer, either directly or by way of attribution of voting rights. As voluntary takeover offers are less regulated – for example because the offer may be subject to more conditions – and hence more flexible, takeovers are usually structured as voluntary takeover offers.

Voluntary takeover offers and mandatory offers both have to be made for all the target shares not already held by the bidder or related persons. Whereas in the case of a *simple purchase offer* (or partial offer) the bidder only seeks to acquire less than 30% of the voting rights or reinforce a controlling (30% or more) interest it already holds, e.g. following a previous takeover offer, or prepare a delisting which requires a prior purchase offer.

What happens if an offer fails?

If an offer fails because a minimum acceptance condition is not satisfied or because BaFin prohibits the offer, e.g. as a result of the bidder’s failure to comply with its various publication obligations under the Takeover Act, a bidder is prohibited from making another offer for the target for a year. With the consent of the target, BaFin may however grant an exemption from this prohibition (e.g. Vonovia and Deutsche Wohnen).

Approaching the Target

Does the bidder have to contact the target company before announcing an offer?

Unlike the UK, there is no obligation on a bidder to approach and inform the target of its intention prior to the announcement of an offer, though it would be unusual not to and such unannounced offers are rare in Germany (e.g. Fortum / Uniper). In practice, a bidder will usually contact the target's management board in advance of an announcement with a view to negotiating the recommendation of the offer by the target and entering into an investment agreement or business combination agreement (BCA).

The management board of the target is not obliged to enter into talks or negotiate with the bidder, unless it considers it would be in the best interests of the target company. In case of refusal, bidders often take the "bear hug" approach by increasing the pressure on the target to cooperate, allow due diligence, and ultimately recommend the offer, in particular through raising the offer price and intensifying communication efforts. By doing so, the target company's management might essentially be forced to accept an offer because it is legally obligated to act in the best interests of the company, which comprises the interests of its shareholders.

Is the management board of the target company obliged to keep the bidder's approach confidential or must it announce it straight away?

As public offers usually have a substantial effect on the target's share price, the target would generally be obliged to announce the bidder's approach without undue delay, in a so-called ad hoc notification.

The target's management board may however keep the bidder's approach confidential and delay its announcement, if the success of the offer is in the target's best interests and the premature publication of the bidder's intention could jeopardize the transaction. Furthermore, any delay must not mislead the market and confidentiality must be ensured.

As part of its defense strategy against a hostile takeover, a target may also announce a bidder's approach straight away.

Will the target board involve advisors?

Although there is no legal requirement for a target board to seek advice on an offer, in practice management boards will usually engage external legal and financial advisors in relation to an offer. In particular, the target board will usually seek advice on the offer from a financial advisor or investment bank, in the form of a "fairness opinion", in view of the target's statutory obligation to issue a "reasoned opinion" on the offer and in order to minimize the target board's risk of liability. In addition, in recent hostile cases, "inadequacy opinions" have been published (e.g. ACS/Hochtief, Vonovia/ Deutsche Wohnen and Busch/ Pfeiffer Vacuum). In contrast to legal and financial advisors, communication advisors are usually only retained in larger transactions.

Offer-related Arrangements between Target and Bidder

Non-Disclosure Agreement (NDA): In the case of recommended offers, the bidder and the target regularly conclude an NDA, particularly prior to agreeing to the bidder conducting any due diligence investigations. Care must however be taken to ensure that the circle of persons receiving confidential information regarding a possible offer is recorded and kept to as small a group of people as possible, in order to avoid the risk of breaching the law on insider dealing.

Standstill Agreement: The management of the target often has an interest in the bidder committing itself to either retaining its shareholding at the current level while the offer is being negotiated or not to increase it after the successful completion of the takeover offer. Such Standstill Agreements are often combined with NDAs.

Business Combination Agreement: In the case of recommended takeover offers the bidder and the target may enter into an investment agreement or business combination agreement (BCA) in which they agree and set out the key parameters of the offer. However, in entering into such a BCA the management of the target may not deprive itself of its ability to manage the target in the company's best interests. The target's management board will therefore usually negotiate a right under the BCA to withdraw its recommendation of the bidder's offer in the event of a superior offer, this is often referred to as a "fiduciary carve-out". Further contents of a BCA might include:

- a timeline for the offer process, as well as the type and amount of the consideration to be offered;
- the commitment by the target to recommend and support the offer and to refrain from certain frustrating measures that could, for example, increase the total consideration to be paid by the bidder;

- strategic considerations and possible structural measures for the post-merger period; and
- commitments by the bidder, e.g. with regard to the retention of facilities and jobs, the continued independence of the target, future corporate governance and the composition of the boards.

BCAs rarely provide contractual sanctions such as penalties, in respect of a breach, as it is unlikely that the target will (successfully) enforce the bidder's obligations after the takeover has been completed. Complex mechanisms to enforce the bidder's commitments, even after a domination agreement is in place (e.g. a public figure acting as an ombudsman) have been developed but have not been put to the test as yet.

Exclusivity Agreement: While in principle permissible, granting exclusivity may not be in the best interests of the target company and may therefore be in breach of the management board's duties.

Break Fee Agreement: Break fees payable by the target in the event that the takeover offer fails due to third-party intervention (e.g. a superior offer) have been agreed in the past but are not common in Germany. The permissibility and enforceability of such provisions remains an open issue under German law. Depending on the individual case, break fees of up to 1% of the deal value may be permissible.

Since the Federal Supreme Court's ruling in the so-called Deutsche Telekom III decision that granting any financial benefits to current or future shareholders can only be justified under very restrictive circumstances, a target company is likely to consider any request for a break fee very carefully.

Due Diligence

A lot of information on listed target companies is publicly available from the company's website, the company register, the Federal Gazette (*Bundesanzeiger*) and other sources containing for example annual reports and financial statements, mandatory publications and announcements, the articles of association, details of the members of the management and supervisory boards, shareholder meeting minutes, corporate governance information and information on the shareholder structure. However, as the option to withdraw after announcing an offer are very limited, a bidder will usually be keen to gain access to non-public information, by contacting the target and negotiating to carry out due diligence.

Is due diligence customary in the case of public takeovers?

Subject to agreeing a Non-Disclosure Agreement with a bidder, the management board of the target may permit the bidder to conduct due diligence, if it believes a takeover is in the interests of the target company and if business secrets are protected.

The board will assess the target's interest in the proposed transaction, in particular by considering the consideration to be offered and the prospects of success of the offer. Therefore, in the case of recommended offers, the target will usually agree to the bidder undertaking due diligence in advance of an announcement of the takeover offer. The scope of due diligence and the way it is carried out vary on a case-to-case basis.

If the offer is hostile however, the bidder is usually limited to publicly available information.

What is market practice in case of exchange offers?

In the case of share for share exchange offers, the target will usually insist on undertaking a "reverse" due diligence on the bidder, because upon acceptance of the offer, the target's shareholders will become shareholders of the bidder. In order to safeguard the adequacy of the consideration shares offered by the bidder and to determine the company's interest in a successful offer, the management board of the target will wish to examine the economic and legal situation of the bidder and verify the assumptions underlying the valuation of the bidder's shares (e.g. Capital Stage / Chorus Clean Energy). The due diligence is likely to be more extensive if a securities prospectus on the combined group needs to be issued in connection with the exchange offer.

What is the usual scope of pre-offer due diligence?

The target company's interest in the possible offer is also decisive in determining the scope of information made available during any due diligence investigations. Target companies are often reluctant to allow bidders to conduct extensive due diligence and may insist that a quick process with limited due diligence is market practice, but there are no specific rules on what due diligence can be undertaken. If the transaction is in the company's best interests, the target may agree that even commercially sensitive and confidential information may be exchanged with the bidder. However, the bidder and the target should be careful to ensure they do not breach anti-trust laws and exchange anti-competitive information. Restrictions may be overcome by the bidder and the target putting in place clean team arrangements.

Can inside information be exchanged or will it impair the offer?

In the event that a bidder obtains positive inside information in the course of its due diligence (beyond the bidder's own offer intention), which supports a higher target share price, it may be prevented from buying target shares or from proceeding with the takeover offer, until the inside information has been published or has ceased to exist prior to the start of the acceptance period.

Since the target company must generally disclose inside information immediately or may only delay such disclosure subject to strict confidentiality requirements, no inside information should be available in any data room.

To further protect the bidder, the so-called "master plan theory" is commonly applied. If the bidder has documented its decision to continue with the offer under specific terms and conditions irrespective of any inside information it may receive, this master plan may be pursued to the

previously planned extent even after obtaining positive inside information. The master plan clearly shows that there is no causal relationship between the receipt of inside information and the continuation with the offer related share purchases.

Will the target have to provide the same information to a competing bidder?

Unlike in the UK, there is no legal obligation that would require a target company, on request, to provide the same information to a competing bidder which it has made available to an initial bidder.

However, the management of the target must generally abstain from exercising influence on the company's shareholder composition. Therefore, the management must not differentiate between competing bidders without cause. Nonetheless, in negotiated takeovers such cause will almost certainly exist, as it is hard to imagine a situation where two competing bidders would afford the same benefits to the target company.

Stakebuilding – Dealing in Target Shares

What disclosure obligations apply to share dealings?

Under the German Securities Trading Act (*Wertpapier-handelsgesetz – WpHG*), public disclosure obligations are triggered if a person's holding of voting rights in listed shares reaches or exceeds, either directly or by way of attribution of the shareholdings of persons acting in concert, certain thresholds, i.e. 3%, 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%. Starting with the 5%-threshold, the same applies to financial or other instruments, e.g. call and put options, swaps (in particular cash settled equity swaps), futures and forwards with cash settlement, contracts for differences, or irrevocable undertakings. Voting rights in relation to shares and other financial instruments must be aggregated and disclosed once the 5%-threshold is reached. Anti-avoidance rules provide that voting rights of e.g. subsidiaries, trustees and parties acting in concert are attributed to the bidder.

Breach of these disclosure obligations may lead to administrative fines of up to EUR 10 million, an order for the disgorgement of any profit, and the (temporary) loss of shareholder rights, in particular the voting rights attaching to the shares.

In addition, a holding of 10% or more of the voting rights in a German listed company requires the shareholder to publish its intentions for the investment and the sources of the acquisition funds.

May the bidder buy target shares prior to the announcement of the offer?

The potential bidder may buy target shares in the preparation phase, as long as the restrictions on insider dealing i.e. dealing on the basis of inside information, are obeyed. In order to increase the prospects of success of the takeover offer, a bidder will commonly seek to stakebuild in advance of announcing an offer.

As a shareholding in the target of 30% or more of the voting rights triggers a mandatory offer for all remaining target shares, this threshold needs to be monitored carefully.

Stakebuilding and influence on the target thereby achieved may also lead to anti-trust issues. For example, German merger control clearance may be required once a bidder has 10% to 15% of the target's voting rights.

Does stakebuilding by the bidder infringe insider dealing legislation?

While knowledge of the intention of the bidder to make an offer for a target company generally constitutes inside information until the offer is announced, the prohibition on dealing on the basis of this inside information will not prohibit the bidder from announcing and implementing the offer. However, no other person who is aware of the bidder's intention may deal in the target's shares, except on behalf of the bidder.

Can shareholders infringe insider dealing legislation if they agree to sell shares prior to the announcement of the offer?

The over-the-counter acquisition of a block of shares from a shareholder is generally permitted for both parties as a "face-to-face" transaction. The prohibition on insider dealing does not usually apply in these circumstances as no information imbalance affects the purchase and the stock exchange or market price remains unaffected by both the inside information and the purchase. The block acquisition may also be made subject to the condition precedent of a successful completion of the subsequent takeover bid.

Will share dealings impact the terms of the takeover offer?

The price offered in the takeover bid must be at least equal to the highest price paid or agreed for the acquisition of any shares in the target by the bidder, persons acting in concert with it or their subsidiaries, within six months prior to publication of the offer document.

Is it possible to build up a stake without disclosure prior to the takeover offer being announced ("creeping up" to a target)?

As a reaction to the takeover cases of Schaeffler / Continental and Porsche / VW in which the use of derivative financial instruments enabled significant shareholdings to be built up without disclosure, the legislator has significantly extended the disclosure obligations. Given the legislators express intention to capture all practices and tactics, it is now difficult for a bidder to build up a stake without disclosure but there remain limited possibilities to acquire large stakes without prior announcement (cf. Geely / Daimler, Mediaset / ProSieben).

Irrevocable Undertakings

May shareholders of the target company be approached? What rules apply?

If a prospective bidder wishes to contact target shareholders before announcing an offer, its intention to make a takeover offer will usually constitute inside information, due to the potentially significant impact on the target's share price. Disclosure of such inside information to an interested party is only permissible on a need-to-know basis. Following receipt of such information the insider is then prohibited from dealing in the target shares and from disclosing the information to a third party.

However, *market soundings* in which inside information is passed on to a larger number of potential investors in the run-up to a takeover offer in order to assess the interest of the market, the attractiveness of the offer and ultimately the prospects of success of the transaction are a recently created statutory exemption. The market practice of *wallcrossings*, in which the inside information is only disclosed after a confidentiality and non-trade agreement has been concluded, has now been codified and made subject to detailed procedural and documentation obligations.

Are (key) shareholders allowed to irrevocably commit themselves to accept an offer?

As an alternative to stakebuilding in advance of the announcement of an offer, the bidder may wish to approach key target shareholders and obtain "irrevocable undertakings" to accept its offer when made. Such irrevocable undertakings are permitted and tying up as many shares as possible before the offer is announced is likely to enhance the bidder's prospects of success. Shareholders often prefer to enter into an irrevocable undertaking as opposed to selling their shares outright in advance of the announcement of an offer, as they will benefit from any subsequent increase in the offer price.

It should be noted however, that irrevocable undertakings qualify as notifiable financial instruments under the German Securities Trading Act and therefore need to be aggregated with any shares held by the bidder, any persons acting in concert with it or their subsidiaries, and disclosed once the 5% threshold referred to above is reached and at each threshold thereafter. Hence, to maintain secrecy and to avoid any adverse effects of premature disclosures and market rumors, a bidder will usually conclude any irrevocable undertakings that exceed the notification thresholds immediately prior to announcement of the offer.

Announcing the Offer

When and how must the offer be published?

Once a bidder has taken the decision to launch an offer, it must immediately notify BaFin and the stock exchange(s), make a public announcement via an electronic distribution system, and inform the management board of the target.

All board approvals required by the bidder and the results of any due diligence and financial resources should therefore be available before an offer is announced. Irrevocable undertakings or block acquisition agreements are usually concluded simultaneously with the offer announcement.

What information does the announcement of the offer contain?

The bidder must of course identify the target and the shares to which the offer relates. It is customary to voluntarily specify the intended consideration in the announcement, in order to minimize speculation and subsequent movement in the target's share price. While

the decision of the bidder to announce an offer must be unconditional, the announcement may indicate that the offer will be subject to certain terms and conditions (e.g. merger control clearance or a minimum acceptance threshold).

Is the bidder bound by the offer announcement?

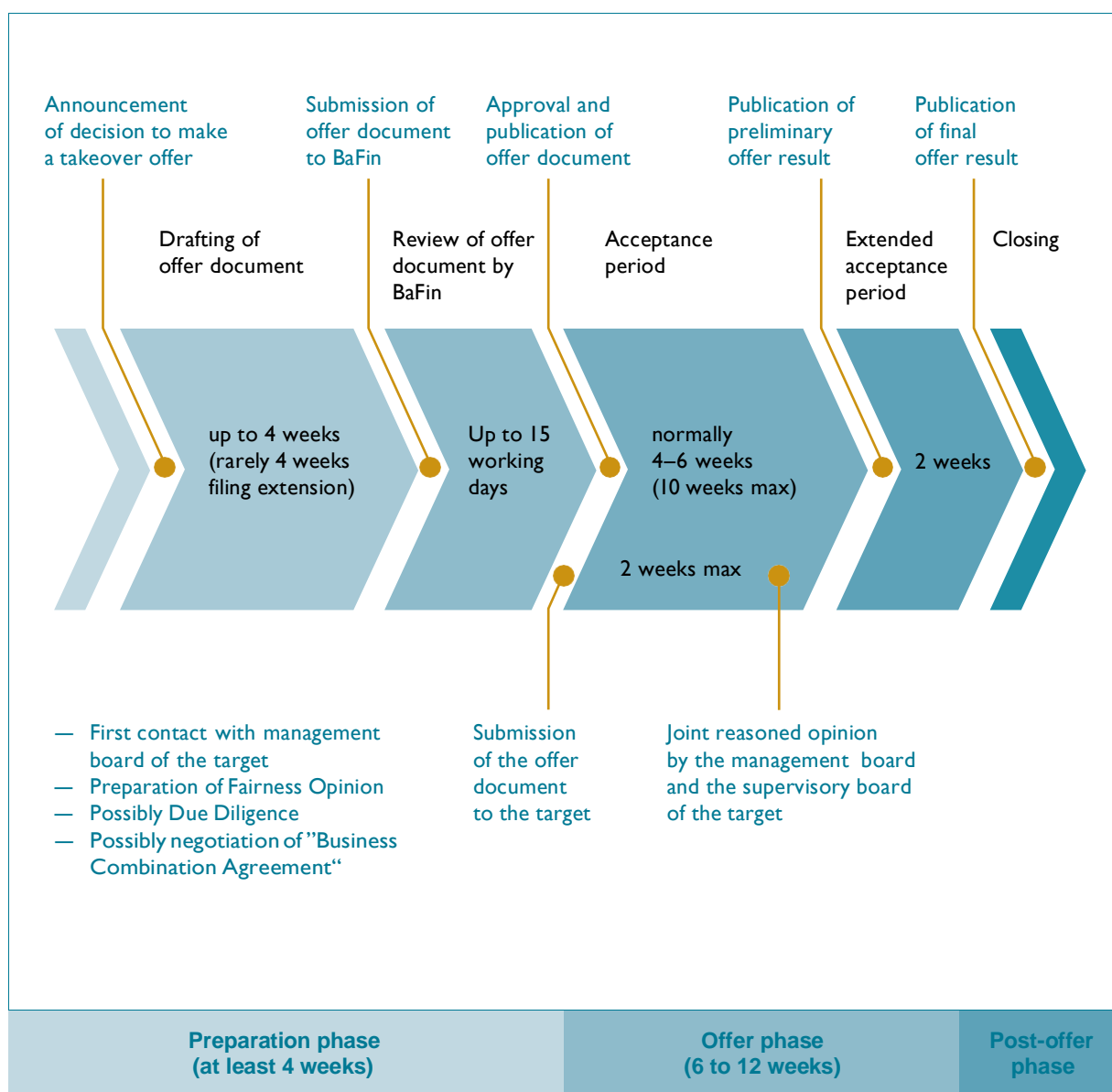
Yes, once the bidder has announced the offer it may neither withdraw from its offer nor refrain from publishing the offer document in the course of the hereafter described statutory offer process.

If the bidder breaches the obligation to publish the offer document, that will not entitle the target shareholders to make claims against the bidder. BaFin may however impose sanctions such as the prohibition of the offer or an announcement of the breach of obligation by BaFin (which may result in reputational damage to the bidder), a one-year prohibition on the bidder announcing a further offer for the target and a fine by BaFin.

3 Overview of the Takeover Process

The announcement of the offer commences the strict statutory timetable for an offer, which is intended to limit the period of market uncertainty about the future

of the target. During the formal takeover process, the bidder and the target have to prepare and publish certain documents.



4 Offer Phase

In preparing the offer document the bidder will have to make a number of decisions regarding the proposed offer. The offer document has to be submitted to BaFin for review and approval normally within four weeks after announcing the offer.

Within ten to fifteen working days of submission of the offer document, BaFin will then approve or prohibit the offer. The approval and publication of the offer document, usually on the same day, commences the acceptance period of four to ten weeks.

In the first two weeks of the acceptance period, the target's management and supervisory boards have to publish their reasoned opinions on the offer, usually in a joint opinion.

After the expiry of the acceptance period and the publication of the initial offer results, an additional acceptance period of two weeks follows in case of voluntary takeover offers.

According to market practice, the overall acceptance period ends after six to eight weeks and the offer can be settled, subject to the fulfilment of all offer conditions.

Offer Document

When must the offer document be prepared?

After the announcement of the offer, the bidder has four weeks in which it must submit the offer document to BaFin for review and approval. BaFin may extend this deadline by up to four weeks under very restricted circumstances (which is often the case when an exchange offer is made due to the more onerous reporting requirements). In practice, bidders tend to prepare substantial parts of the offer document during the preparation phase, often allowing them to deliver the final offer document to BaFin within just a few days after the announcement of the offer.

What is the content of the offer document?

The offer document must contain all information necessary for the shareholders to make an informed decision on accepting the offer.

Over time an almost uniform standard for the detailed contents of the offer document has developed which includes:

- basic information on the bidder and the target company, in each case including information on any persons acting jointly with the bidder;
- the terms and conditions of the offer (nature and amount of the consideration, including the valuation methods used to determine the consideration, acceptance period, details of how to accept the offer and on how the consideration will be satisfied by the bidder);
- conditions for completion of the offer;
- measures taken to ensure the offer's financing and the expected effects of a successful offer on the financial position and results of operations of the bidder and the bidder's group;

- the bidder's intentions with regard to the future business activities, the employees and their representatives as well as the composition of the boards of the target, including cash benefits or other monetary benefits paid or promised by the bidder to board members in connection with the offer;
- number of voting rights held by and attributed to the bidder and any persons acting in concert with it, and details of any share purchases made during the six-month period preceding the offer announcement; and
- in the case of an exchange offer, comprehensive information on the bidder and the consideration shares that corresponds to a securities prospectus in accordance with the European Prospectus Regulation.

Depending on the complexity of the case, the offer document may be from approx. 30 to 100 pages. The preparation of exchange offer documents is even more time-consuming as it is also subject to the prospectus regulation.

The bidder is liable for the completeness and accuracy of the information contained in the offer document which has to be signed by the legal representatives of the bidder.

When is the offer document published? What role does BaFin play?

The offer document will only be reviewed by BaFin for completeness and compliance with laws, not accuracy of its content in general. The offer document must be published – which commences the acceptance period – without undue delay after BaFin approves the offer document or after the expiry of ten to fifteen working days after submission of the offer document to the BaFin, without it having prohibited the offer. In practice, the latter scenario occurs very rarely.

Offer Consideration – Cash and Exchange Offers

Can shares be offered as consideration instead of cash?

In addition to the usual cash consideration in euros (cash offer), bidders may also offer liquid shares admitted to trading on an organized market within the European Economic Area (exchange offer). The shares offered in exchange for the target shares do not necessarily have to be shares of the bidder, although this is most common.

If the offered shares do not meet these legal requirements, for example because the bidder's shares are not liquid or only listed outside the European Economic Area, they may only be offered as an alternative to cash, at the option of the target shareholder. Combined cash and exchange offers are also permitted.

If the bidder acquires 5% or more of the target's share capital for cash within a period beginning six months prior to the announcement of the offer and ending with the end of the offer period, the offer consideration must be in cash.

How often are exchange offers made?

Exchange offers have been the exception in Germany. In recent years however, some bidders particularly real estate companies, have offered shares as compensation, both in straight share-for-share exchange offers.

Must a securities prospectus be prepared for an exchange offer?

Yes. If shares are to be offered which have not yet been admitted to trading on a regulated stock exchange within the European Economic Area, a secondary listing within the European Economic Area is required. In the case of such a secondary listing a securities prospectus must be prepared.

In all other cases, the offer document itself has to contain sections which are equivalent to a prospectus.

How can US shareholders participate in an exchange offer without the shares of the bidder being registered in the US?

If an exchange offer is extended to target shareholders in the US, the bidder's shares generally have to be registered in the US as well. Bidders often aim at circumventing this registration requirement by means of a "vendor placement" (e.g. LSE/Deutsche Börse). However, the US regulator, the Securities Exchange Commission (SEC) has announced that it will no longer issue "vendor placement no action letters" confirming that no registration is required. Therefore, bidders cannot be certain that the vendor placement is sufficient to avoid registration in the US.

Under a recent takeover offer (Capital Stage / Chorus), the bidder – advised by CMS – used an alternative statutory exemption for the first time in Germany which allows US shareholders to participate in the exchange offer without US registration if certain requirements are met.

Is there a minimum price requirement?

The consideration must be equal to the higher of the volume-weighted average stock exchange price of the target shares, calculated for the three months prior to the publication of the offer announcement, and the highest price paid or agreed by the bidder during the six months prior to the publication of the offer document.

What happens if the shares of the target or the bidder are illiquid?

If the shares of the target or the bidder are illiquid (cash and exchange offers), the average share price is insignificant and an enterprise valuation needs to be conducted. Shares are considered "illiquid" if stock market prices have been determined on less than one third of the relevant trading days, and if several (at least two) consecutive stock market prices deviate from one another by more than 5%.

Can the bidder be obliged to increase its offer in case of parallel and post-offer acquisitions?

If the bidder acquires target shares during the acceptance period – on the stock exchange or over-the-counter – at a price which is higher than the offer price, the offer to all shareholders is automatically increased to the higher acquisition price.

In addition, if the bidder acquires target shares over-the-counter at a higher price within one year after publication of the result of the offer, it must pay the difference to all other shareholders who have accepted the offer. Post-offer acquisitions on the stock exchange and as part of structural measures with a mandatory exit compensation, e.g. domination and profit and loss transfer agreement or squeeze-out, have no such price effect.

Agreements under which the transfer of shares may be required, e.g. options, are treated as an equivalent to share acquisitions. Since there is no de minimis threshold, the purchase of a single target share triggers the aforementioned consequences.

Must the bidder engage a financial advisor?

Though there is no legal requirement for the bidder to appoint a financial advisor it is very common for it to do so, in order to support the bidder in the determination of an adequate offer price. If shares offered in an exchange offer are to be listed on a German stock exchange, the bidder must have a sponsor.

Acceptance Period

When does the acceptance period start and how long is it?

The acceptance period starts with the publication of the offer document, i.e. immediately after BaFin's approval. In practice, bidders may choose an acceptance period of four to six weeks, whereas four weeks is the mandatory minimum and ten weeks the maximum.

In the case of voluntary takeover offers, there is an additional acceptance period of two weeks if the bidder has achieved control (30%) and particularly has reached a minimum acceptance threshold within the regular acceptance period. Given the pending change of control, this extension is intended to give the shareholders the opportunity to still accept the offer.

Can the acceptance period be extended?

Changes to the offer within the last two weeks of the acceptance period automatically extend such acceptance period by two weeks. In addition, if the management of

the target calls a general meeting during the acceptance period, the acceptance period is automatically extended to ten weeks. Another extension of the acceptance period can be triggered by a competing offer. In the case of a competing offer being announced the acceptance period of the initial offer will then be automatically extended until the end of the acceptance period of the competing offer.

Are there any regular publication requirements during the acceptance period?

Yes. The bidder must disclose the number of tendered target shares on a weekly basis, and during the last week of the acceptance period on a daily basis (the so-called "water level notifications"). The fulfilment of any offer conditions must also be announced. The same applies to the offer results, i.e. the number of tendered shares, after the initial acceptance period and the additional acceptance period.

Financing

Does the funding of the offer have to be secured?

Yes. As a result of legal and practical requirements, the bidder must have secured the funds necessary to satisfy the consideration payable under the offer in full, before the offer is announced. Since the secured funds have to be sufficient to satisfy “complete” fulfilment of the offer, i.e. if all outside shareholders were to tender their target shares, the (theoretical) maximum amount to be paid by the bidder must be taken as a basis. The financing measures taken by the bidder must be described in the offer document.

In the case of an exchange offer, the bidder must ensure that the shares offered as consideration are available to it at the latest at the time of the settlement of the offer. Any necessary resolutions to increase the share capital of the bidder are therefore usually adopted before publication of the offer document.

In the case of cash consideration, an independent securities service provider licensed to do business in Germany (usually a bank) must issue a written financing

confirmation which must be submitted to BaFin and attached to the offer document. The bank issuing such a confirmation is liable to the target shareholders for the complete fulfilment of the offer, if the bidder fails to meet its financial obligations.

Is it possible for the target to provide financial assistance? Can the bidder refinance the offer by withdrawing liquidity or assets from the target after the takeover?

In light of German stock corporation regulations regarding maintenance of equity capital and restrictions on financial assistance, recourse to the funds of the target is very limited, before and after the takeover. It is inadmissible for the target to provide advances, loans, or security for loans with which the bidder has financed the takeover.

In the long run, this can be remedied by implementing a domination and profit and loss transfer agreement between the bidder and the target or by transforming the target into a German Limited Liability Company. In these circumstances a more relaxed regime would apply.

Offer Conditions

Can offers be subject to conditions?

After the offer document has been published, the offer is irrevocable. Voluntary takeover offers and mandatory offers must extend to all shares not already held by the bidder and any persons acting in concert with the bidder. It is therefore in the bidder's interests that the consummation of simple purchase offers and takeover offers may be made subject to the occurrence of conditions, provided that such conditions are not solely at the discretion of the bidder.

In the case of mandatory offers however, the only admissible conditions are regulatory approvals (e.g. merger control clearance). Delisting offers may not be made subject to any conditions.

What conditions are often seen in German takeovers?

In addition to necessary regulatory approvals, a minimum acceptance condition such as more than 50% or 75% of the voting rights, or a precisely defined Material Adverse Change (MAC) event not having occurred, and no defensive measures having been taken by the target, are common offer conditions.

Are there inadmissible conditions?

As an offer is binding, conditions over which the bidder can exert influence, or the occurrence of which cannot be objectively ascertained are not permissible. It would be inadmissible to impose conditions such as a financing reservation (financing-out) or that the bidder's due diligence investigations are satisfactory.

When must conditions be satisfied?

According to BaFin's regulatory practice, offer conditions must be satisfied or waived prior to the end of the acceptance period. Unlike other jurisdictions, the bidder may not wait until the acceptance period has lapsed, waive the condition and still consummate the offer, despite having missed, for example, a minimum

acceptance threshold. As acceptance levels have been low in some recent offers, this BaFin practice causes bidders to carefully consider the initial scope of any conditions.

As an exception to the rule, regulatory approval conditions can be met after the acceptance period has ended, as the scrutiny periods under relevant competition laws would otherwise not be compatible with strict timetable under the Takeover Act.

Another change in BaFin practice has recently facilitated the implementation of exchange offers by German bidders. The bidder's share capital increase creating the shares offered in exchange may become effective upon registration in the commercial register after the acceptance period has lapsed.

How can the bidder reach a desired minimum acceptance level given that large stakes are often held by index-oriented tracker funds?

Index-oriented tracker funds cannot tender their indexed target shares until the original target shares have been replaced in the index by the "tendered shares" of the target. Under index rules, this index update usually takes place when the bidder has received acceptances in respect of shares carrying more than 50% of the voting rights in the target.

The bidder can therefore set the minimum acceptance threshold at more than 50%. After this condition has been met and the index has been updated, the index funds may tender their shares during the additional acceptance period (e.g. Bain and Cinven / Stada).

Alternatively, the index funds can enter into irrevocable undertakings which oblige them to tender their shares after the index has been updated. This option has the advantage that the shares covered by the irrevocable undertaking are included into the minimum acceptance threshold (e.g. Praxair / Linde).

Changing the Offer

Can the bidder amend the offer's terms and conditions?

The bidder may amend the offer during the acceptance period by increasing the offer consideration or offering an alternative form of consideration and by waiving offer conditions, in particular reducing a minimum acceptance threshold.

What are the consequences of changing an offer?

If the bidder amends the offer, target shareholders who have already accepted the offer have a right of withdrawal, and the acceptance period is extended by two additional weeks, if the change is made within the last two weeks of the acceptance period.

Measures and Obligations of the Target Board

What are the obligations of the target board during a public offer?

Throughout a public offer, the management board and supervisory board of the target have to act in the best interest of the target company.

Each board is required to issue a reasoned opinion on the offer, without undue delay, after receipt of the offer document. A joint opinion within a timeframe of two weeks is the market standard. In particular, the opinion(s) must comment on the offered consideration, the likely consequences of a successful offer for the target company, the employees and their representatives, and any intention of target board members to accept the offer if they hold target shares.

If the target has a works council, it may also submit a reasoned opinion to be attached to the opinion of the management board.

Must the employees be informed about the offer?

The management boards of the target, as well as the bidder, have to inform their respective works council, or directly the employees if no works council exists, both after the announcement of the offer and the publication of the offer document. The works council or the employees, as the case may be, are free to submit a reasoned opinion on the offer to its management board. There are no obligations to take advice or to consult with employees or their representatives.

What measures can the target take to defend itself against a hostile offer?

The recent increase in the number of hostile takeover offers has fueled discussions on potential defensive measures. After the offer announcement has been published, the management board of the target must not take any actions which could frustrate the success of the offer. However, this does not apply to:

- actions which a prudent and conscientious manager of a company which is not subject to a takeover offer would have taken;
- the search for a competing bidder (“white knight”);
- actions which the supervisory board of the target company has approved (which, however, must strictly observe the company’s best interests); and
- actions authorized by a shareholder resolution explicitly passed to prevent the success of takeover offers.

Within this legal framework, a defense strategy can comprise the following components. Due to the restrictions under stock corporation law, the defensive impact is limited however:

- issue of new shares from authorized capital to make the takeover more expensive for the bidder or to win an anchor-shareholder;
- acquisition of treasury stock to increase the voting power of friendly shareholders and to reduce the free float that could fall into the bidder’s hands;
- sale of treasury stock to an anchor-shareholder;
- disposal of material assets representing “crown jewels” of the target.

If the target arrives at the assessment that the offer is not in the company’s best interests, refusing to talk with the bidder or to grant information or due diligence, lobbying against shares of the bidder offered in an exchange offer, as well as attempts to talk up the price of its shares are all strategic components that do not fall within the prohibition on frustrating action.

Competing Offers and M&A activists

Competing offers are rare in practice but legally not restricted. Apart from a potential extension of the acceptance period, target shareholders that have already tendered their shares have a statutory right of withdrawal in the event of the announcement of a competing offer.

What are the risks of M&A arbitrage activities by hedge funds (M&A activists) and how can they be addressed?

M&A activists acquire large shareholdings in the target (partly by use of security loans) after a takeover has been announced, speculating on an increase in the offer price or a higher mandatory exit compensation under structural measures taken by the bidder after the takeover has been completed (e.g. domination and profit and loss transfer agreements or squeeze-outs). The activists then make use of the fact that the bidder needs the M&A activist’s block of shares in order to

achieve a certain minimum shareholding threshold in the target company, e.g. to refinance the takeover or to implement their intended business strategy. This approach increases pressure on the bidder to offer a higher price or compensation.

The risk of such M&A arbitrage activities in the context of German takeover offers has significantly increased in recent years (e.g. Elliott’s activities in Bain and Cinven / Stada, Vonovia / Deutsche Wohnen, Faurecia / Hella). Possible countermeasures depend on the concrete strategies of the activists which vary widely. In general, it is helpful if the bidder has secured large target shareholdings before the announcement of the takeover offer. At times, it may be preferable to offer the M&A activist special benefits which other shareholders do not receive (which, however, needs to be carefully structured due to the doctrine that all shareholders should be treated equally).

5 Post-Offer Measures

After a successful takeover, the bidder has several options to further integrate the target company with its own and to strengthen its control over the target company. Which so-called “post-offer measures” are

available to the bidder depends on the shareholding-level achieved as a result of the takeover offer, and on the extent to which the bidder strives to integrate the target.

Squeeze-out Procedure

How can the bidder gain control over 100% of the target shares?

The objective of most bidders is of course to gain control over 100% of the target shares. However, after a successful takeover it is almost certain that a number of shareholders will not have tendered their shares. By means of a squeeze-out, all shares held by the remaining minority shareholders are transferred to the bidder as a matter of law. In return, the minority shareholders have a claim against the bidder for payment of an adequate cash compensation.

What options for a squeeze-out exist?

German law provides for three different procedures to acquire the shares of the remaining minority shareholders, which are squeeze-outs (a) under stock corporation law, (b) under conversion law, and (c) under takeover law.

How does the squeeze-out under stock corporation law work?

If the bidder holds at least 95% of the shares of the target company, it can request the management of the target to convene a general meeting which shall pass a resolution to transfer the shares of the minority shareholders to the bidder.

Adequate cash consideration is required to be offered to the minority shareholders which is usually determined based on an enterprise valuation and examined by an independent court-appointed expert and may generally not be less than the stock exchange price. A written report on the squeeze-out and the adequacy of the cash consideration has to be presented to the general meeting. The squeeze-out resolution becomes effective upon entry in the commercial register, when all shares of the minority shareholders are transferred to the bidder.

Just as in the case of a domination and / or profit and loss transfer agreement, shareholders can subject the adequacy of the offered cash consideration to a court review, in lengthy appraisal proceedings.

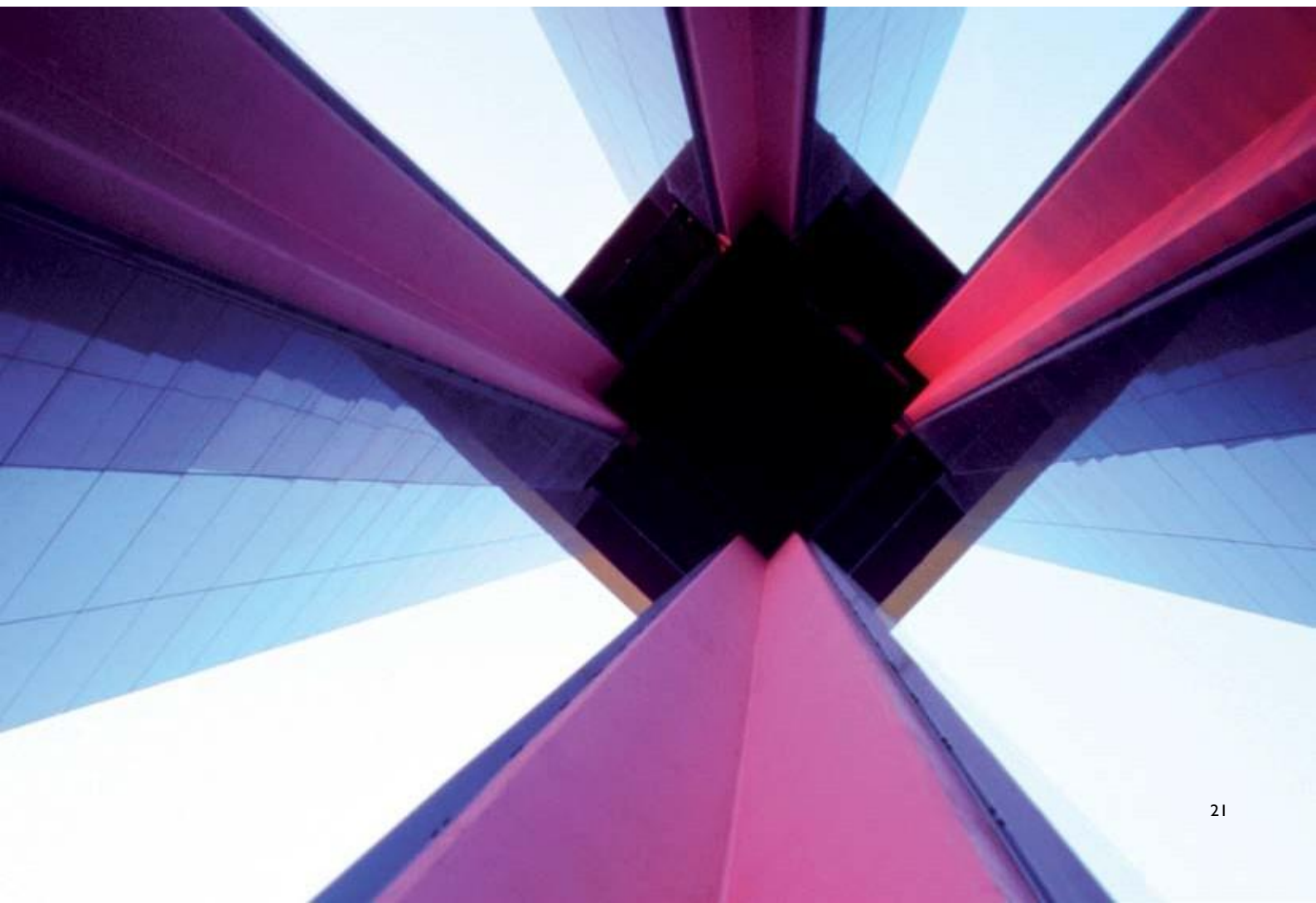
Is the squeeze-out under conversion law much different?

No. The procedures basically resemble the squeeze-out under the stock corporation law. To the benefit of the bidder, the level of the shareholding required to trigger the provision is however only 90% of the target shares. The squeeze-out must be combined with an upstream merger of the target company into the bidder which has to be a German stock corporation, a German partnership limited by shares or a European Stock Corporation (SE). To lay the foundations for a potential squeeze-out under the conversion law, bidders often chose a German stock corporation as a special purpose vehicle for making the takeover offer.

Are squeeze-outs under takeover law a relevant option?

While the legal differences are tempting for bidders, the requirements of a squeeze-out under takeover law have rendered this measure practically insignificant. The bidder has to own at least 95% of the voting share capital of the target as a result of the takeover offer, but this is hardly ever achieved in practice.

In those rare cases where it is, the squeeze-out does not require a resolution of the general meeting and the shareholders may not initiate appraisal proceedings. Subject to some additional requirements, the takeover offer price is deemed an adequate squeeze-out consideration, so that no costly valuation is required.



Target Board Composition

How can the bidder restructure or replace the management board and supervisory board after a takeover

The appointment and dismissal of supervisory board members falls within the competence of the general meeting. The bidder may therefore use its voting power to dismiss the current supervisory board members and to install members chosen by it (to the extent the supervisory board members are elected by the shareholders and not the employees). The bidder is usually anxious to be represented on the supervisory board at least to an extent that adequately reflects its participation in the target.

The appointment of the management board is the responsibility of the supervisory board. Accordingly, the bidder can only exert an indirect influence on the composition of the management board through representation on the supervisory board. The management board members can only be dismissed for due cause (and the successful takeover is not considered such cause) but in practice they usually resign if the majority shareholder and the supervisory board urge them to do so. In the absence of a domination agreement, the bidder cannot issue instructions to the target's management board either.

In practice, the future board composition is usually part of any Business Combination Agreement (BCA) entered into between the bidder and the target before announcement of the offer.

Domination Agreement

Can the bidder cause the target company to conclude a domination agreement after the takeover

Once the bidder has control over at least 75% of the share capital in general meeting, it may initiate a shareholder resolution on the conclusion of a domination and/or profit and loss transfer agreement (*Beherrschungs- und/oder Gewinnabführungsvertrag*).

What are the benefits of a domination agreement?

Implementing a domination agreement allows for a significantly closer cooperation in strategic and operational terms between the bidder and the target and facilitates the unhindered exchange of information between the companies. The bidder is entitled to issue instructions to the management board regarding the management of the target. Such instructions may even be detrimental to the target's corporate interests if they serve the interests of the bidder or its group of companies.

In the event of the (additional) conclusion of a profit and loss transfer agreement, the target company must transfer its entire annual profit to the bidder.

Are there downsides to the conclusion of a domination and/or profit and loss transfer agreement?

In any event, the bidder must compensate for any annual net loss of the target in return for the rights granted to it.

The agreement must contain an offer to all outside shareholders to acquire their shares in return for an appropriate exit compensation. Shareholders who do not sell their shares must be offered an appropriate annually recurring compensation (often referred to as "guaranteed dividend").

Shareholders may initiate so-called appraisal proceedings during which a court reviews the adequacy of the offered compensation. While the legislator intends to curb these notoriously long proceedings, bidders have to bear their substantial costs and nuisance for the time being.

Delisting

Is it possible to enforce a delisting of the target company?

After a squeeze-out has become effective, the listing of the target will be revoked by the admission board due to the permanent discontinuation of stock exchange trading. One may call this an “automatic delisting”. In all other cases and as long as there is no domination agreement in place, the bidder may not instruct the target’s management to apply for and execute a delisting. In practice, the management usually reacts to the bidder’s request for a delisting with a benevolent assessment, provided that the bidder holds a high majority stake after completion of the takeover offer. Such assessment may result in a delisting agreement between the bidder and the company specifying the preconditions and necessary steps of the intended delisting.

The target's management may particularly enter into such agreement, if the stock exchange listing of the target will usually have lost its function, so that the running costs quickly outweigh the advantages of the listing. However, according to the German Stock Exchange Act (*Börsengesetz – BörsG*), a delisting requires a prior public acquisition offer to the remaining shareholders for an adequate cash compensation. The Takeover Act applies *mutatis mutandis* to such “delisting offer” which must be unconditional and offer a cash consideration. Unless the original takeover offer also complies with these requirements, the bidder will have to conduct two offers, the first takeover offer and a subsequent “delisting offer”.

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