Ladies and Gentlemen,

With the last edition of our newsletter this year we would like to inform you about current issues in the area of M&A and company law. I would like to particularly point out the developments in the area of “collective action clauses” with respect to government bonds, which were triggered by the current financial crisis, as well as the EU Commission’s regulation proposal for a regulation on insider dealing and market manipulation, which is expected to lead to further harmonization in the Member States. I would also like to draw your attention to an interesting legal design instrument regarding takeover bids, “contingent value rights”. Finally, this edition addresses the question to what extent the general meeting documentation and evaluation can be waived in a transformation law squeeze-out pursuant to the Third Amendment to the German Conversion Act, which recently entered into force.

I hope that this newsletter will again be of interest to you, and I wish you happy holidays and all the best for the year 2012.

Yours, Thomas König
Contingent Value Rights (CVRs) are rights, which – in the context of a public takeover – typically contain the promise of the bidder that under certain circumstances further consideration either in cash or in the form of shares will be made in addition to the already offered consideration, whereby this promise of consideration is often created as a tradable security.

Configuration Possibilities of CVRs
Especially in the United States, in the context of M&A transactions, CVRs were used in order to secure the consideration in the form of shares offered by the acquiror by granting a share price guarantee to the benefit of the shareholders of the target company (price-protection CVRs). In recent times, initially in the pharmaceutical

Collective Action Clauses – Binding application in government bonds as from July 2013

In its resolution of March 25, 2011, the European Council agreed on the mandatory application of collective action clauses (CACs) in all issue conditions of government bonds issued in the euro-zone beginning in July 2013. In the absence of an insolvency law for sovereign entities, CACs are intended to facilitate the participation of creditors in providing debt relief for future restructurings of distressed countries in the euro-zone. CACs allow creditors to effect amendments to the issue conditions, and in particular to the payment conditions, with a majority decision that is binding on all creditors. In this context the maturity date of a government bond may be extended or the interest payment may be reduced. Even the reduction of the nominal capital (a "haircut") would be enforceable by majority decision. The final wording of the predefined CACs is to be finalized by the end of 2011 in collaboration with market investors. The following principal issues are in dispute:

Amount of the Quorum
Possible investors are insisting on a high quorum being set (75% of the total nominal amount of each bond series) for resolving on material decisions such as a "haircut". On the other hand, the Economic and Financial Committee of the EU has recommended a quorum of only two-thirds of the capital represented at the relevant creditors’ meeting, in order to ease the debt relief of the distressed countries.

Voting Rights Preclusion
In addition, a voting rights preclusion shall ensure that creditors that are associated with issuers (i.e., a creditor that is controlled by an issuer) cannot influence the voting to the benefit of the affected country (disenfranchisement clause). Particularly disputed here is a voting rights preclusion of the European Central Bank.

Implementation of Aggregation Clauses
Finally, it shall be ensured that holders of various series of government bonds will not act in competition with one another and thereby complicate an aspired debt relief ("hold-out problem"). Aggregation clauses would enable an overall poll of all holders of different bond series.
and biotechnology sectors, performance-related CVRs and event-related CVRs have become increasingly prominent. Performance-related CVRs are linked to the business development of the target company. Event-related CVRs are linked to certain events at the target company after closing, e.g. to marketing approval of medication or to the settlement of a dispute subject to considerable financial risks. Both of these types of CVRs are directed at bridging uncertainties and/or disagreements concerning the valuation of the company’s development and/or the occurrence of certain future events. The aim is to ensure that the shareholders of the target company can also participate in a positive development of the target company in case of the sale of their shares, in order to create an incentive for the acceptance of the offer.

CVRs as Key for a successful Transaction
Apart from (unsecuritised) voluntary additional payments in particular relating to structural measures, CVRs have up to now not yet been used in public offers under the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG). Even if the drafting of the terms and conditions of CVRs may be sophisticated in individual cases, there are no insurmountable obstacles under German corporate and capital markets law to the use of the different types of CVRs. Especially when it comes to deadlocked takeover negotiations, the extremely flexible possibilities of CVRs can be the key for a successful transaction.

An overview of the possible applications of CVRs and their legal requirements can be found in: Sustmann, Contingent Value Rights als alternative Gegenleistung im Rahmen von öffentlichen Angeboten nach dem WpÜG, Corporate Finance Law 2011, 381 et seq.

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No "chain of attribution" to the trustee according to Sec. 22 para. 2 German Securities Trading Act – Judgment of the Federal Supreme Court of July 19, 2011

In a judgment as of July 19, 2011, the German Federal Supreme Court ruled that no voting rights arising out of an acting in concert (for instance by conclusion of a voting agreement) between the trustor and a third party are attributed to the trustee.

Facts (simplified)
Prior to a shareholders’ meeting, three shareholders had entered into a voting agreement with respect to their shares (acting in concert pursuant to Sec. 22 para. 2 German Securities Trading Act (Wertpapierhandelsgesetz – WpHG)) and had issued the notifications required by Sec. 21 et seq. WpHG. One of these shareholders did not hold his shares directly, but through a trustee. The trustee was not involved in the voting agreement and, since the shares held by the trustee did not represent at least 3% of all voting rights, the trustee did not issue a voting right notification pursuant to Sec. 21 et seq. WpHG. The German Federal Supreme Court had to decide whether the shares held by the trustee were without rights pursuant to Sec. 28 WpHG. This would have been the case if the shares attributed to the trustor in the voting agreement were also attributed to the trustee pursuant to Sec. 22 para. 2 WpHG.

Revocation of the prior instance judgment by the German Federal Supreme Court
The Higher Regional Court of Munich had ruled that, on the basis of the so-called principle of "double attribution", also the trustee was obliged to issue a voting right notification.

The German Federal Supreme Court overturned the appeal court’s judgment. An attribution of voting rights as assumed by the Higher Regional Court of Munich cannot be supported by Sec. 21 et seq. WpHG. The cited principle of “double attribution” is incorrect, because an attribution takes place solely at the level of the trustor while the trustee holds the shares directly in terms of Sec. 21 para. 1 sent. 1 WpHG. Moreover, the German Federal Supreme Court denied the existence of a statutory ambiguity that would justify reasoning by analogy. This assumption is correct. An attribution of the shares takes place at the level.
of the trustor and triggers the notification obligation pursuant to Sec. 21 et seq. WpHG (assuming the 3% threshold is met). The German Federal Supreme Court also correctly notes that in this context the prohibition of analogy arising from Sec. 103 para. 2 German Constitution (Grundgesetz – GG) has to be taken into account, since the issuance of a false voting right notification is as an administrable offence punishable by a fine according to Sec. 30 para. 2 No. 2e WpHG. Therefore, no other interpretation of the attribution rules can be made under civil law.

Conclusion
The German Federal Supreme Court’s judgment – or rather the obviously wrong judgment of the Higher Regional Court of Munich – shows the risks to which resolutions of a shareholders’ meeting are exposed with view to Sec. 28 WpHG. The German legislator should therefore consider to restrict the possibility of contestation in this context. From a practical perspective the judgment of the German Federal Court is in any case welcomed.

New Proposal of the EU Commission to tackle Market Abuse

The Market Abuse Directive (Marktmissbrauchsrichtlinie), as well as its Implementing Directive (Durchführungsrichtlinie), have been implemented in a divergent manner among Member States. The EU Commission used this as a reason to adopt a proposal for a Regulation on Insider Dealing and Market Manipulation (Market Abuse) (Com(2011) 651 final (the "Regulation Proposal" or "Regulation")). The EU Commission aims to further standardize the application of the market abuse rules by using secondary Community legislation in form of the Regulation. The Regulation shall be supplemented by a Directive on Criminal Sanctions for Insider Dealing and Market Manipulation (COM(2011) 654). In particular, the Regulation Proposal provides for the following amendments:

Extended Scope of Application
The scope of application of the Market Abuse Directive is currently limited to financial instruments which are admitted to trading on a regulated market. In future, the rules on market abuse shall cover all financial instruments admitted to trading on a multilateral trading facility (MTF) or other new types of organized trading facilities (OTFs) as well as financial instruments traded over the counter and any other conduct or action which can have an effect on such a financial instrument traded on a regulated market, MTF or OTF.

New Definition of Inside Information
Art. 6 of the Regulation Proposal contains a definition of “inside information” that includes, in addition to the definition under the Market Abuse Directive, a special description relating to emission allowances as well as a catchall clause (cf. Art. 6(1)(e) of the Regulation). The latter merits special attention since it also qualifies information as inside information even if it is not "of a precise nature". By way of example, the secondary Community legislation mentions in recital 14 the state of contract negotiations, terms provisionally agreed in contract negotiations, the possibility of the placement of financial instruments and conditions under which financial instruments will be marketed. In such cases, the prohibition against insider dealing shall apply, but the obligation on the issuer to disclose the information shall not. The aim of this amendment is to partially dissociate the basically consistent application of the definition of inside information and ad-hoc disclosure to ensure that the prohibition against insider dealing applies earlier than the disclosure obligation. From a legal point of view, this differentiation is achieved by making the disclosure obligations inapplicable for inside information within the meaning of the catchall clause. Therefore, the ad-hoc disclosure obligation continues to apply only to information of a precise nature.

New Exemption to the Ad-hoc Disclosure Requirements
In addition to the self-exemption (Selbstbefreiung) already existing for the issuer, the competent authorities shall have the authority to permit the delay of public disclosure
of inside information for a limited period. At times at which a financial institution is receiving emergency lending assistance, it may – according to the recitals of the Regulation Proposal – be in the best interest of financial stability for the disclosure of inside information to be delayed when the information is of systemic importance. It shall therefore be possible for the competent authority to authorize a delay in the disclosure of inside information. This authority is granted in the public interest of maintaining the stability of the financial system and avoiding the losses which could lead, for instance, to the failure of a systemically important issuer.

Directors’ Dealings
The Regulation Proposal would extend the reporting obligations concerning directors’ dealings. In future, the Regulation will clarify that any transaction made by a person exercising discretion on behalf of a manager of an issuer or whereby the manager pledges or lends his shares must also be reported. Moreover, a uniform threshold of EUR 20,000 per calendar year shall apply in all Member States, which triggers the obligation to report such manager’s transactions. In Germany, this would lead to a significant increase of the current threshold of EUR 5,000.

Market Manipulation
In order to enhance market integrity, the Regulation shall, for the first time, include a prohibition against attempting to engage in market manipulation. The intent to commit market manipulation will thus also be prohibited in the future.

Stock Notification Obligation with respect to Cash Compensation Instruments becomes applicable as of February 1, 2012
– Review of Shareholder Agreements may be necessary

Sec. 25a of the German Securities Trading Act, which has been introduced by the German Investor Protection and Functional Improvement Act (Anleger- schutz- und Funktionsverbesserungsgesetz – AnsFuG), implements notification obligations, inter alia, for cash settled instruments (e.g., swaps such as in the case of Schaeffler/Conti). This provision becomes effective on February 1, 2012. A person holding instruments within the meaning of Sec. 25a WpHG that give the holder the right to purchase shares representing 5% or more of a company’s total voting rights will be required to notify the issuer and the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) thereof without delay. In this case, “without delay” means within 30 trading days. Thus, March 13, 2012 is the last possible date for compliance with the notification obligation.

It is likely that Sec. 25a WpHG will also cover shareholder agreements which, for instance, contain pre-emptive rights (Vorkaufsrechte) and tender rights (Andienungs- rechte) that allow the rights-holder to acquire shares of an issuer. While Sec. 25a WpHG allows for the issuance of a statutory order exempting certain financial or other instruments from the notification obligation, recent public statements made by BaFin suggest that the statutory order will not contain an exemption for shareholder agreements. Against this background, the time until Sec. 25a WpHG enters into force should be used to review shareholder agreements for whether they grant rights to parties that may trigger notification obligations under Sec. 25a para. 1 WpHG.
"Real Economy" Companies Subject to Banking and Financial Supervisory Law

In recent years, companies and groups primarily engaged outside the financial industry have initiated operations that are subject to financial regulation under the German Banking Act (Kreditwesengesetz – KWG). For example, many car manufacturers, energy companies and trade groups have established subsidiaries that are engaged in activities regulated under the KWG, e.g., to promote sales by providing financing and leasing solutions and/or for hedging commodity price and other risks. In recent years, the scope and intensity of the regulation and supervision of such financial activities have increased substantially. Notably, the scope of the KWG extends far beyond the classic definition of banking business (i.e., deposit-taking and lending). As a result, companies of the "real economy" increasingly have become affected by and are subject to financial regulation and supervision. The most important legal issues resulting from this development are license requirements under the KWG, the financial regulatory control of owners holding a qualifying interest in regulated companies (Inhaberkontrolle) and corporate governance implications resulting from the fact that regulated companies form part of the group.

Licence Requirement – Intra-Group Exemption and its Limits

In many cases, "real economy" companies rely on the so-called intra-group exemption (Konzernprivileg) for regulated activities rendered to other group companies to avoid a license requirement under the KWG. This is true, e.g., for the extension and receiving of credit in a group-wide cash-pooling system, the extension of parent guarantees for the benefit of subsidiaries or the extension of shareholder loans. However, the scope of the intra-group exemption is surprisingly narrow. Thus, the extension of shareholder loans and guarantees to joint-venture partners or minority participations are in general not covered by the intra-group exemption.

Relevance of Holders of Significant Holdings

Furthermore, non-regulated companies have come into the focus of financial supervision as holders of significant holdings in regulated companies. An acquisition of a stake of 10% or more in an industrial holding company may trigger financial regulatory clearance requirements and result in the power of the German Financial Supervisory Authority and/or comparable foreign financial regulators to prohibit the acquisition, if it has a regulated subsidiary. This needs to be taken into account when planning and structuring such transactions.

Features with respect to Corporate Governance

Regarding the corporate governance of regulated subsidiaries, non-regulated companies may be subject to additional legal requirements. For example, members of the supervisory board of regulated companies must meet fit-and-proper requirements and must demonstrate sufficient expertise and experience in the relevant financial sector.

Outlook

The overall importance of the KWG for companies primarily engaged outside of the traditional financial sector will continue to increase. Legal and compliance departments of non-regulated companies should make themselves familiar with the applicable rules.

In February 2012, the legal magazine "Betriebsberater" will publish a detailed article by Andreas Wieland on this topic.
The Third Amendment to the German Conversion Act, which came into effect on July 15, 2011, facilitates intra-group upstream mergers of stock corporations in two ways.

First, the amendment provides for the possibility of a squeeze-out in connection with a group merger requiring only a 90% shareholding in the merging company by the surviving company, in contrast to the established 95% threshold applicable for squeeze-outs under the Stock Corporation Act and the Takeover Act. Furthermore, a merger following such a squeeze-out does not require approval by the shareholders of any of the participating entities.

Process Steps
The first step of this combined squeeze-out/merger process is the execution of the merger agreement. Within a period of three months following such execution, the shareholder’s meeting of the merging company resolves on the squeeze-out of the minority shareholders. The squeeze-out resolution is then filed with the commercial register at the seat of the merging company. The resolution will be registered subject to the effectiveness of the merger and will come into effect “simultaneously” with the merger.

Open Issues
The new statutory provisions do not explicitly address the question whether or not the various procedural simplifications already in place for upstream mergers of wholly owned subsidiaries into their parents which are prior to the merger (i.e., no determination of an exchange ratio and related business valuations, no merger report of the management boards and no merger audit and audit report) shall also apply to the merger following a squeeze-out as described above. The question arises since, technically speaking, the 100% shareholding of the surviving parent in the merging subsidiary does not exist prior to the merger, but is only established “simultaneously” with the merger. However, as the determination of an exchange ratio, a merger report and a merger audit appear to be unnecessary in this scenario as well, the prevailing view in German legal literature is that such reporting and examination duties do not exist with respect to a merger combined with the squeeze-out. A different view would also contradict the legislative intent to significantly facilitate intra-group mergers.

Practical Importance
However, the question for practitioners remains how to advise clients on this issue until it has been finally decided by a judicial precedent. The merger and merger audit reports have to be filed with the motion for registration of the merger in the commercial register (Sec. 17 para. 1 UmwG) and, theoretically, the commercial register could refuse the registration of the merger. It is therefore advisable to clarify the issue with the commercial register in advance. Furthermore, a quorum of 5% of the shareholders of the surviving parent have the right to require that a shareholders’ resolution on the merger be adopted, which could then be challenged by a shareholder on the grounds of a violation of the (alleged) statutory reporting and audit duties. In such a case, however, it is hard to see how a court in the accelerated court procedure for registration (Freigabeverfahren) could come to the conclusion that the potential detriment to the challenging shareholder – which practically does not exist – should speak against the immediate effectiveness of the merger. Nonetheless the answer depends, as is often the case, on the specific circumstances, and a certain risk remains until a final clarification of the issue by a court precedent.

An overview of the new regulations of the German Conversion Act can be found in the publication of: Breschendorf/Wallner, Neues im Umwandlungsrecht durch das Dritte Gesetz zur Änderung des UmwG (News in German Conversion law by the Act on the Third Amendment to the German Conversion Act), Gesellschafts- und Wirtschaftsrecht (GWR), 2011, page 511 et seq.
German Federal Labor Court: Sec. 613 a
German Civil Code applicable also in cases of site relocations to foreign countries

Facts (simplified)
The plaintiff worked as an engineer for a German company. The employer had terminated the plaintiff's employment relationship on the basis of the closure of parts of its operations. The equipment essential for production at the plaintiff's plant section (facilities, machines, tooling equipment and warehouse) were transferred to the production site of a group company in Switzerland located approximately sixty kilometers away from the German operations. Already existing projects and relationships with customers and suppliers were also transferred to the Swiss subsidiary. Approximately half of the staff affected by the closure of operations received an employment offer from the Swiss subsidiary. The plaintiff rejected such offer claiming invalidity of the termination due to transfer of business pursuant to Sec. 613a para. 4 German Civil Code (Bürgerliches Gesetzbuch – BGB).

Summary of the court's ruling
The German Federal Labor Court ruled that the termination was invalid due to a violation of the prohibition of termination of employment pursuant to Sec. 613a para. 4 BGB. The defendant had not actually closed any operations which could have justified the termination of the employment, but had transferred parts of the business to a group company in Switzerland. The plaintiff's employment contract was governed by German law. Therefore, Sec. 613a BGB was decisive for the question of whether a transfer of business had actually taken place. The court did not have to make a decision with respect to the terms and conditions under which the employment was to be continued by the Swiss acquiror.

For determining whether a transfer of business under German law takes place, German law is decisive even if a site is relocated to a foreign country.

Dr. Rainer Thum

Recommendations for practice
As far as applicable law in cross-border cases is concerned, the periods before and after a business transfer are decisive. If the employment is governed by German law at the time of the transfer of business, Sec. 613a BGB also applies in the case of a transfer of business to a foreign country. The question of applicable law after the transfer of business has to be evaluated separately. If the employment contract does not contain a choice of law clause, foreign law usually applies to the employment after the transfer of business according to the principles of international private law. Consequently, the protection against dismissal pursuant to Sec. 613a para. 4 BGB in cases of cross-border transfers of business is as a rule maintained. The terms and conditions of the employment after the transfer of business are determined by the laws of the country to which the business is transferred.

Germany seeks a Modern Group Taxation Regime – Renunciation of the Profit Transfer Agreement?

On November 14, 2011, the Federal Ministry of Finance published a working group paper for recommendations for the introduction of a new group taxation regime. The essential objectives of a new group taxation regime, as compared to the present fiscal unity concept (Organschaft), are the disentanglement of corporate and tax law as well as the simplification of the present rules.

Present Situation
The present fiscal unity concept is perceived as too complex. In particular, the conclusion and execution of a profit transfer agreement in practice implicates significant application problems. These are generally based on the differences between the commercial balance sheet and tax balance sheet and the resulting complexities.
Second Exchange of Ideas on Corporate Law

On November 22 and 28, 2011, the Munich and Düsseldorf offices of Shearman & Sterling hosted the Second Exchange of Ideas on Corporate Law. The Exchange of Ideas was moderated in Munich by Prof. Dr. Hans Christoph Grigoleit from Ludwig-Maximilian-University of Munich and in Düsseldorf by Prof. Dr. Christian Kersting from Heinrich-Heine-University of Düsseldorf.

Dr. Andreas Merkner gave an overview to the participants on the proposed Amendment to the German Stock Corporation Act 2011 (Aktienrechtsnovelle 2011). The draft bill of the Federal Government is scheduled to be released before year end. The reform will amend the rules on transparency of unlisted stock corporations and increase flexibility in corporate finance. Dr. Markus Rieder presented current developments in the compliance practice. He critically analyzed products available for auditing and certifying the corporate compliance organization. It was especially stressed that such compliance certifications must be assessed in light of the increasingly stringent requirements set forth by the courts that must be met in order to allow the company to rely on such outside expert opinion. Without meeting such requirements, such certifications may not be a valid defense in favor of management.

Discussed Proposals

The Hessian Ministry of Finance has proposed a group contribution regime (Gruppenbeitragsmodell) similar to the Scandinavian models. This regime associates the attribution of taxable income with the group contributions, based on a group contract between the group members. As in the present fiscal unity concept, a loss offset shall only be applicable if the losses are actually borne.

The Bavarian Ministry of Finance has proposed an alternative approach an earnings attribution model (Einkommenszurechnungsmodell). According to this model, the attribution to earnings shall be carried out only for tax purposes without the obligation to transfer or balance the earnings according to commercial law.

Relevant Shareholding Structure

Both reform proposals would increase the equity interest threshold for consolidation of a group company. Whereas the Bavarian model proposes an increase to at least 75%, the Hessian proposal requires an equity interest in a group company of at least 95% of the capital and the voting rights.

Outlook

The currently envisaged reform of the group taxation regime may overcome some of the existing issues. The working group prefers the Hessian group contribution regime, since the alternative regimes would lead to lower tax revenue. However, it is doubtful if this model can eliminate the issues in relation to profit transfer agreements.

A detailed discussion of the reform proposals can be found in the essay of Frey/Sälzer, BB 2011 (coming soon).

In his presentation on contingent value rights, Dr. Marco Sustmann illustrated a versatile instrument in structuring M&A transactions. However, each structure involving CVRs must be analyzed specifically in order to determine its consequences under corporate law and the law of obligations. In their discussion, the participants developed further views on various structures. Dr. Hans Diekmann reviewed in his practice report the Societas Europaea in Germany and its development during the past seven years. Starting with an overview of relevant legal rules, he subsequently presented typical cases of incorporating as an SE and analyzed matters that may become subject to reforms. Participants and speakers concluded the Interchange with a reception.
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