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SHAREHOLDER ACTIVISM IN GERMANY

By Dirk Besse and Moritz Heuser

Over the past few years, there has been a noticeable increase in hedge funds building up considerable stakes in German-listed companies in the context of public takeovers. Often, the purpose of this is to take advantage of minority shareholder rights granted under German stock corporation law.

Companies seeking to acquire control of German-listed companies need to be aware of the potential risks and costs associated with such activist stake-building in takeover situations.

Post-Takeover Business Integration and Corporate Measures

Following the successful completion of a takeover, the buyer will typically want to integrate the target business and enter into a so-called domination and profit and loss transfer agreement (DPLTA) which enables it to control the target's strategy and business decisions as well as to access its cash flow. To enter into a DPLTA, the buyer needs to hold at least 75% of the share capital. A strategic investor may also wish to "squeeze out" the remaining minority shareholders, provided that it owns at least 90% or 95% of the share capital (depending on the procedure chosen). Both of these scenarios present opportunities to minority shareholders.

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Minority Shareholder Rights

Under the German Stock Corporation Act (*Aktiengesetz*), a DPLTA must include an obligation on the part of the dominating company to acquire the shares of the minority shareholders in return for appropriate consideration, typically paid in cash. Minority shareholders have the right to challenge the appropriateness of the consideration for their shares by means of court proceedings. Similar minority protection rights apply to shareholders whose shares are acquired by virtue of squeeze-out measures.

Activist Strategy and Litigation

Recent years have seen a number of hedge funds equipped with large financial resources taking advantage of these minority shareholder rights: Within a short period of time after the announcement of a public tender offer, the funds acquire a substantial stake in the target companies, usually somewhere above 10% of the target's share capital. Following the completion of the takeover, the funds will wait for a DPLTA to be concluded, request the dominating company to acquire their shares and then commence court proceedings in order to challenge the appropriateness of the consideration offered. A number of hedge funds have been notably successful in such proceedings and obtained a considerable premium for their shares.

General Recommendations

This strategy is essentially based on the statutory shareholder rights under German law. While there may be ways to mitigate the risks and costs of such shareholder rights, the behavior of the shareholders can generally not be prevented. Any foreign investor considering making a public takeover offer for a German target should, therefore, try to anticipate such shareholder activism during the takeover process.

- Taking a close look at the shareholder structure of the target company prior to an investment decision is certainly worthwhile. For example, a target with a high free-float and fragmented shareholder structure will typically make it easy for a fund to acquire a large stake quickly after the announcement of a tender offer.
- Since the consideration offered under a DPLTA (or a squeeze-out) is based on the average weighted stock price for a period of time preceding the announcement of the corporate measure, the timing of the corporate measure and its announcement needs to be considered carefully when structuring the timetable of the public takeover and the subsequent corporate integration steps.
- Finally, if court proceedings have been initiated to challenge the appropriateness of the consideration offered to minority shareholders for their shares, experienced legal counsel is crucial to countering the allegations effectively.

This is an excerpt from an article by Dirk Besse and Moritz Heuser from Morrison & Foerster, published in the Harvard Law School Forum on Corporate Governance and Financial Regulation [http://blogs.law.harvard.edu/corpgov/2014/06/07/shareholder-activism-in-germany/]

REINFORCED UKRAINE-RELATED SANCTIONS ON RUSSIA

By Christoph Wagner and Felix Helmstädter

On September 12, 2014, the European Union (EU) announced expanded sanctions related to Russia and Ukraine.

The EU sanctions (referred to as "restrictive measures") do not only concern EU-based companies as they also apply to companies headquartered outside the EU that have an affiliate incorporated under EU Member State laws or employ EU citizens, or that are carrying out their economic activities in whole or in part within the EU. Any violation of these export restrictions and other restrictive measures may trigger severe administrative fines or even criminal sanctions (including prison). Accordingly, companies doing business in or with Ukraine or Russia should carefully assess whether their dealings and the related financial transactions comply with the restrictions set out by the relevant EU regulations.

Under the reinforced EU sanctions regime numerous persons and companies are subject to restrictive measures such as the freeze of assets and travel bans. In addition, sector-specific restrictions apply which particularly relate to access to the EU capital markets, to the defense industry, and the energy sectors.

The EU Sanctions focus on the following:

- **Blocking of Funds and Assets:** The EU sanctions provide for the freezing and recovery of assets of listed persons and entities: the blocking of assets concerns all funds and economic resources belonging to, owned, held or controlled by the

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listed persons, entities, or bodies associated. In addition, it is prohibited for persons subject to the EU sanctions to make available funds or economic resources to such listed persons, entities or associated bodies.

- **Exports of Dual Use Items, Military Goods and certain Technology:** There is a prohibition on the export to Russia of military goods and of dual-use items if those items are or may be intended for military use. As of September 12, 2014, it is also prohibited to sell any dual-use item or to provide financial or technical assistance to certain listed companies, including JSC Sirius, OAO JSC Chemcomposite, and JSC Kalashnikov. With regard to specific technologies, especially oil exploration, additional restrictions apply.

- **Capital Markets:** For certain Russian state-owned banks and companies of the defense and energy industries, the access to the EU's capital markets has been further reduced. EU nationals and companies are disallowed to provide certain loans and financial instruments to those companies which include, for example, Gazprombank, Gazprom Neft, Rosneft, and Transneft.

- **Ukraine Specific Prohibitions:** With regard to the annexation of Crimea and Sevastopol, the EU has set up an additional regime of restrictive measures which have to be taken into consideration when dealing with persons or companies in eastern Ukraine. For example, the EU sanctions prohibit trade with key equipment and technology related to the creation or development of infrastructure for the exploitation of oil, gas, and mineral reserves in Crimea and Sevastopol.

Given the ongoing changes to the Ukraine-related sanctions programs, persons and entities covered by the scope of the applicable sanctions regimes should have appropriate procedures in place to comply with existing sanctions and monitor developments to ensure ongoing compliance.

CURRENT DEVELOPMENTS

Foreign Direct Investment into EU Increasing

The EU statistical agency Eurostat released its preliminary results on foreign direct investment (FDI) in 2013:

- FDI into the European Union reached EUR 327 bn.

- The main investor into the European Union was the U.S. (EUR 313 bn), followed by Brazil (EUR 21 bn), Switzerland (EUR 18 bn), Japan (EUR 10 bn), Hong Kong and Russia (each EUR 8 bn).

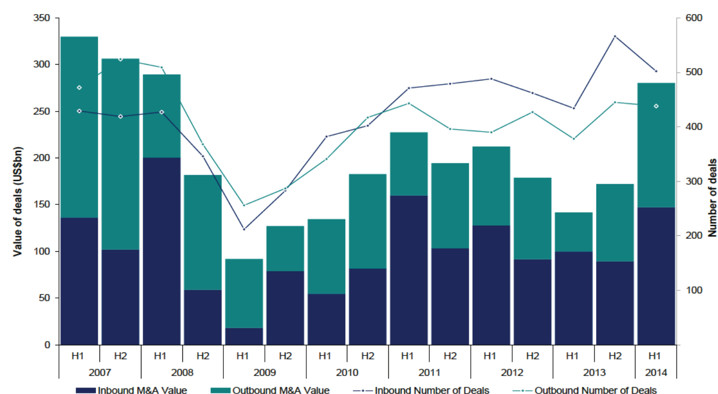
- Of the FDI invested in the EU, EUR 240 bn went to Luxembourg, followed by the UK (EUR 24 bn), the Netherlands (EUR 14 bn), Ireland (EUR 12 bn), Spain (EUR 11 bn) and Germany (EUR 7 bn).

For more information, read the press release.

Rising Confidence – European M&A Trends for the First Half of 2014

Mergermarket has announced its M&A trend report for the first half of 2014 with the following findings:

- Inbound deals increased by 47.4% in terms of value (USD 147.3 bn compared to H1 2013's US$ 100 bn).



- European deals were valued at USD 453.6 bn, which is an increase by 35.5% compared to the first half of 2013, and the highest level since the second half of 2008.

- The most targeted countries were the UK and Ireland (25.9%), closely followed by France (25.1%), which overtook the traditionally more attractive Germanic countries.

- The average size of European deals increased by 30.7% to USD 430.8 m, compared with USD 329.5 m in the first half of 2013.

- Most active sectors were: pharma, medical & biotech, with a 19.1% market share and 191 deals worth USD 86.6 bn (compared to 158 deals worth USD 18.2 bn in the first half of 2013); followed by the telecommunications sector

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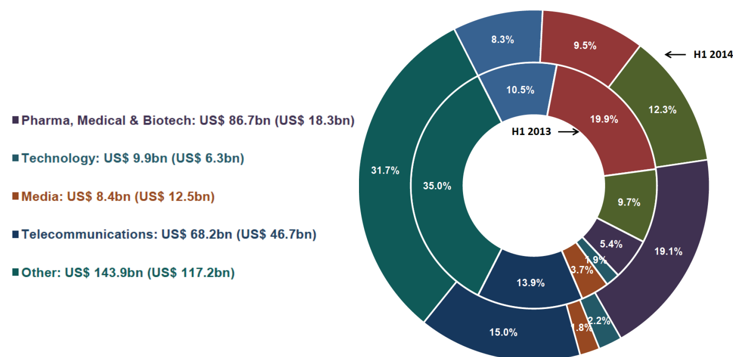
(15.0%, USD 68.2 bn); industrials & chemicals (12.3%, USD 55.8 bn); and energy, mining & utilities (9.5%, US$ 43.4 bn).



Source: Mergermarket global trend report H1 2014. Read the Mergermarket League Table H1 2014.

- Europe's largest deal was Medtronic's (U.S.) USD 49.5 bn acquisition of Covidien (Ireland) in the Pharma, Medical & Biotech sector, followed by Holcim's (Switzerland) USD 40 bn acquisition of Lafarge (France) in the Construction sector, and Altice's (Luxembourg) USD 23.3 bn acquisition of SFR (France) in the Telecommunications sector.

LEGISLATION

European Commission Consults the Public on Improvements of Merger Control at the EU Level

The European Commission is taking public comments on proposals to improve merger control at the EU level; these proposals are outlined in the White Paper "Towards More Effective EU Merger Control". The proposals aim at better dealing with non-controlling minority shareholdings which may affect competition, and at making referral procedures simpler and faster.

The key proposals are:

- A light and tailor-made review by the European Commission of cross-border acquisitions of non-controlling minority shareholdings that could harm competition, e.g., where minority stakes are bought by competitors.
- More business-friendly and effective case referrals between Member States and the Commission, e.g., companies notifying a merger can refer their case to the Commission through a simpler procedure and more streamlined rules for Member State requests to have a case reviewed by the Commission, in order to avoid parallel investigations and better implement the one-stop-shop principle.
- Simpler procedures, e.g., by excluding certain non-problematic transactions from the scope of the Commission's merger review, such as the creation of joint ventures that will operate outside the European Economic Area (EEA) and have no impact on European markets.
- Fostering coherence between Member States with a view to enhancing cooperation and avoiding divergent decisions in parallel merger reviews conducted by the competition authorities of several Member States.

For more information, read the White Paper.

NOTEWORTHY DEALS

GE Wins Alstom Energy Bid Battle

Following one of the most prominent bidding battles in 2014 so far, General Electric (GE) is buying France-based Alstom's gas turbine operations and creating joint ventures in the steam turbine, renewable energy and electrical transmission businesses for a purchase price of USD 17 bn. As part of the deal, the French state will buy 20% of Alstom, meeting a condition set by the government to back the deal. GE prevailed over a counterproposal submitted by Siemens AG and Mitsubishi Heavy Industries Ltd. (later joined by Hitachi Ltd.).

21st Century Fox Sells European Pay-TV Channels Sky Deutschland and Sky Italia to BSkyB

The UK's British Sky Broadcasting Group plc has sealed a deal to buy 21st Century Fox's stakes in the leading German and Italian pay-TV channels Sky Deutschland and Sky Italia for GBP 5.3 bn (USD 9 bn), creating a

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company with 20 million subscribers. BSkyB agreed to pay GBP 2.07 bn plus a 21% stake in National Geographic Channel International for 21st Century Fox's wholly owned Sky Italia S.r.l. as well as to pay GBP 2.9 bn for a 57.4% stake in separately listed Sky Deutschland AG and make a EUR 6.75-per-share (USD 9.08) offer for the remaining 42.6% of that company. Morrison & Foerster advised 21st Century Fox on the proposed sale of Sky Deutschland in the areas of media law, due diligence and tax. (MoFo team: Christoph Wagner (lead media/corporate), Jens-Uwe Hinder (lead tax), Sebastian Kost, Jens Hackl, Felix Helmstädter, Fabian Hentschel, Anna Wolschner and Friederike Busch.)

BlackBerry Buys German Mobile Security Company Secusmart

Canadian smartphone maker BlackBerry Ltd. made an agreement to buy the German Secusmart GmbH, a voice and data encryption provider and anti-eavesdropping technology for government organizations and telecommunication's service providers in Germany and elsewhere.

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Because of the generality of this newsletter, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. The views expressed herein shall not be attributed to Morrison & Foerster, its attorneys or its clients. This newsletter addresses recent mergers and acquisitions.

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