German Takeover Law and Practice ①
Issues in German Takeover Law
(Interview with researchers from the Max Planck Institute for Private Law)

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[Introduction]

This is the transcript of a study session with researchers from the Max Planck Institute for Comparative and International Private Law, focused on various issues related to German takeover law.

Professor Dr. Harald Baum is well-versed in German takeover law and is also known as an expert of Japanese law. Dr. Christoph Kumpan has expertise in EU and German takeover law and counseled the Turkish Capital Markets Supervisory Authority on the implementation of the EU Takeover Directive into Turkish law. Dr. Felix Steffek, who kindly arranged and chaired this session, is an expert in corporate law.

The interview was held in March 2010 at the Max Planck Institute for Comparative and International Private Law, in Hamburg. I conducted an interview based on the English paper and questionnaire describing the issues that I had submitted in advance. /(Watanabe)

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I. Presentation  Hiroyuki Watanabe

“Suggestions” of European Laws Concerning Japanese TOB Rule

Hiroyuki Watanabe, Waseda University

Large gap between statutory rules and practices

Amid calls for reconstruction of Japan’s takeover bid rule, there has been a growing interest in takeover bid (TOB) rules in Europe. I myself have done many researches on TOB rules of European countries including the UK for several years and strongly feel that we often misunderstand the real picture when we see only written rules and it is very important to understand dynamic structures concerning the balance between the rules and the practices including social norms.

“Shareholder decision-making” in TOB in Europe

First, we must be aware of the fact that a consensus of “shareholder decision-making” is generally strong concerning TOB rules in Europe. We also need to understand that the meanings of “shareholder decision-making” and “maximizing shareholder values” are completely different. A TOB is a system based on “shareholder decision-making”. Shareholders voice if they accept an offer or not. In the U.S. advocating “maximizing shareholder values”, however, a poison pill (rights plan) is widely adopted and the power of management is strong. There has been a notable deviation from “shareholder decision-making” in takeovers.

In Europe where “shareholder decision-making” functions well in takeovers, it is believed that adopting defensive measures such as poison pills might cause the pursuit of responsibilities of the directors etc. There is little room for adopting such defensive measures. In takeovers, will “the logic of financial capitalism” rule the world, then?

‘Distinction’ between “shareholder decision-making” and “worker protection”

It is widely known that EU’s takeover rule stipulates the offeror’s obligation to provide information to workers of the target company as well as worker’s right to voice their opinions. However, in European countries including the UK, Germany and France, there exists a consensus that shareholders make the final decision on the consequence of takeover bids. Also, the offer price is significant when the target company makes clear whether it recommends the offer or not. It is believed that an easy adoption of defensive measures such as poison pills against the offer might bring the director(etc)s’ responsibility.
Therefore, not only in the UK where institutional investors have huge influence but also in Germany where workers have strong power, defensive measures have rarely been taken against TOB. Generally in European countries, there exists a distinction between “shareholder decision-making” and “worker protection” in the cases of takeover. These points must be recognized as the difference from Japan’s circumstances or the way of thinking when we discuss takeover and workers’ involvement as well as the adoption of defensive measures.

“Balance” and “cushion” regarding TOB rules

In Germany, a surprising “balance” is maintained regarding the TOB rule. Workers’ influence is strong in Germany which has laws like codetermination law. Adoption of defensive measures based upon approval of a general shareholder meeting or a consent of auditors stipulated in German takeover law seems to be very strong in rhetoric. In practice, however, defensive measures against TOB are rarely taken and the consequence of TOB is left up to the judgment of shareholders ultimately. If the offer price is high, the TOB is basically successful. Due to “potent worker protection”, however, it is difficult to run the company without workers’ cooperation even if a TOB is successful. As a result, there is little hostile TOB and so far, the cases which had started as a hostile TOB ended up as a friendly TOB. Germany keeps a balance by having “potent worker protection” as a “cushion (adjuster)” against “shareholder decision-making” in the case of TOB.

On the other hand, in the UK or France, mandatory offer rule (which requires the offeror to offer all shareholders at the highest price in some previous months) is applied to the addition of shareholdings between 30% (one third) and 50%. This plays a role as a cushion. In short, the ruling strictly restrains “acquisition of halfway control”.

In the U.S., adoption of poison pills also plays a role as a cushion. However, we need to fully pay attention that poison pills are accompanied with the battle of proxy solicitation in the U.S. and there is little possibility of considering poison pills as legal in Europe.

“Moderate mandatory offer rule” as a basic type in Europe

“Mandatory offer rule” adopted through Europe is basically applied when more than a certain amount of shareholdings of the target company (basically, 30% or one third of voting rights) is acquired (it is different from Japan where compulsory tender offer is based on “the ratio which the offeror is about to acquire.”) The basic type of this rule seems to be very strict. However, if you understand “the balance” which arises over the rule, it is not so strict after all and could be “a soft cushion” as a deterrent against easy acquisition of control.

In applying mandatory offer rule, inhibitory effectiveness against transfer of control is often pointed out. Mandatory offer rule could not be an obstacle to M&A if an offer is generally made without applying the rule (voluntary offer).

In TOB practices in the UK or Germany, the offeror generally makes a voluntary offer by holding the buying in the market below threshold of mandatory offer rule (the initial requirement is 30%). In voluntary offer, there is also an “obligation of whole solicitation”. It’s possible to realize “whole solicitation and partial acquisition” by determining the price strategically through voluntary offer (and surplus selling after the buying). If these measures are used, mandatory offer rule or obligation of whole solicitation will
not be an obstacle basically to business restructuring or hostile takeover. The “obligation of whole solicitation” is not considered as strict among M&A practitioners in Europe.

In addition, the ratio of mandatory offer (compulsory tender offer) is generally small in transfer of control. For example, the UK rule “is ‘misunderstood’ as a typical example putting everything on TOB”. However, the reality is totally different. In most cases, British companies transfer control by allocation of new shares to third parties using “whitewash” as an “exemption of the TOB rule” (independent shareholders pass the resolution of general meeting by applying mutatis mutandis only the disclosure regulation in the TOB rule). Principles and exceptions are reversed between the formal rule and the reality. In the UK, most TOB cases are voluntary offers. In Germany, “intentional” TOB is basically a voluntary offer. This does not mean that mandatory offer rule is toothless. Because the rule itself is strict, the offeror would not easily acquire more than 30% of shares in the market. We have to understand the mandatory offer rule functions as a deterrent against easy acquisition of control in that meaning.

“Strict mandatory offer rule” in some jurisdictions

On the other hand, it is necessary to consider unique social norms and accompanied structures of shareholding in each country from other perspectives. In the UK, it is not preferable to remain as a minority shareholder in a company which has block holders. It is preferable to acquire 100% as closely as possible if the ratio of shareholding is more than 30%. Therefore, there is little case of acquiring 30% to 50% voting rights (large volume holding without acquiring control) “as a result of the offer”. The mandatory offer rule is also applied to slight adding by more than 30% but less than 50%.

Like the UK, several legal jurisdictions in Europe such as France, Ireland, and Greece also apply the mandatory offer rule to “30% (one-third) to 50% adding”. Adopting the “strict mandatory offer rule” as such will be an effective deterrent against transfer of control in the legal jurisdictions where the ratio of block holders is high. In Europe as a whole, however, urgent capital infusion or business restructuring within a group for corporate reconstruction is exempted from the application of the mandatory offer rule. It is also important to understand “the existence of legal exemption” as such.

Comparative study on takeover regulatory organization

It is also risky to simply schematize systems of various countries for designing an ideal takeover regulatory organization. For example, the UK has “self-regulation totally relying on moral or disciplines of market participants” and Germany has “detailed and strict regulations based on the statutory law by administration (BaFin)”. Making such a comparison is very misleading. In the early regulation by the UK Takeover Panel, what played an important role was the City norm called cold shouldering: “we do not work for those who break the rules of the City” because the rules were brief and lacked enforcement. After the FSA was established, the FSA rule succeeded the cold shouldering rule. Recently, the Code rule is upgraded to be equivalent to German rules in terms of detailed structure when note or practice statement is included. After adopting the EU Takeovers Directive into domestic laws, there is little difference between the UK and German regulatory organizations in daily practices for TOB regulations, coupled with the fact that the TOB rule was included in the statutory law (UK Companies Act 2006). Rather, what is considered as an important difference between the UK and Germany includes ① whether they can voluntarily establish and maintain concrete rules, ② whether private M&A practitioners constitute a majority,
and ③ whether they can refer to the “principle base” when it is difficult to apply the rule (currently, yes to the all questions for the UK, no for Germany).

**An outlook for Japan**

For predictability of the related parties, we need to have a detailed rule concerning TOB which causes transfer of control. However, it is “difficult to write down everything in the detailed rule” including exceptions and considering the characteristics of M&A, it is necessary to have speedy and flexible regulations by specialists.

In referring to TOB rules in European major countries, it is important to understand the structure of “a distinction between shareholder decision-making and worker protection”. Regarding concrete rules, it is also important to fully understand the difference and meanings between two mandatory offer rules stated in this article and to pay attention to rational exemption or reversals between principles and exceptions in the reality (for example, “Whitewash” in the UK).

“Shareholder decision-making” has a vital role as a precondition for the smooth functioning of TOB rules. What “cushion” should be put is important in order not to let only the logic of financial capitalism carry through. In Japan, for good or bad, defensive measures play a role as a cushion. In addition, “de facto influence” of stakeholders such as workers in TOBs is very strong and “shareholder decision-making” does not function well. It is a quite difficult challenge to assess these realities and find out what direction we should lead to and how to do so. We should carefully work on restructuring TOB rules, looking at the structure of social norms and the impact of introduction of rules.

**II. List of Questions (Hiroyuki Watanabe)**

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<th>① “Moderate mandatory offer rule” as a basic type in Europe</th>
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In applying mandatory offer rule, inhibitory effectiveness against transfer of control is often pointed out. However, I suppose that mandatory offer rule could not be an obstacle to M&A if an offer is generally made without applying the rule (voluntary offer).

In TOB practices in the UK, the offeror generally makes a voluntary offer by holding the buying in the market below threshold of mandatory offer rule (the initial requirement is 30%). In voluntary offer, there is also an “obligation of whole solicitation”. So, mandatory offer rule or obligation of whole solicitation will not be an obstacle basically to business restructuring or hostile takeover. And the “obligation of whole solicitation” is not considered as strict among M&A practitioners in Europe.

In addition, the ratio of mandatory offer (compulsory tender offer) is generally small in transfer of control. In the UK, most TOB cases are voluntary offers. This does not mean that mandatory offer rule is toothless. Because the rule itself is strict, the offeror would not easily acquire more than 30% of shares in the market. We have to understand the mandatory offer rule functions as a deterrent against easy ac-
quisition of control in that meaning.

Please comment on my understanding first.

However, according to the statistics by the BaFin, the number of mandatory offer in Germany is the same level as that of voluntary offer.

What does the fact above (the numbers in the statistic) mean?

I suppose one of the main reason of it is the existence of the rule in Germany that the same regulation about the offer price is applied both to the mandatory offer and voluntary offer.

② “Strict mandatory offer rule” in some jurisdictions and “Creeping Rule” as a Cushion

In several legal jurisdictions in Europe such as the UK, France, Ireland, and Greece apply the mandatory offer rule also to “30% (one-third) to 50% adding”. Adopting the additional “strict mandatory offer rule” as such will be an effective deterrent against transfer of control in the legal jurisdictions where the ratio of block holders is high.

The creeping acquisition rules adopted in France are relatively easy on the offeror, whereas those in Ireland are very strict. In the UK, where there are few block holders, takeover attempts have continued to be very active even after the creeping acquisition rules were abolished.

The degree of strictness of the mandatory offer rule largely depends on whether or not the rule is applied to the offeror’s attempt to increase shares of the target company beyond the threshold but below the 50% level. If we set such an additional mandatory offer rule, we will be able to control the level of strictness of the rule by setting conditions for creeping takeover rules.

Please comment on my understanding.

③ Condition allowed to be made for a mandatory offer

The European TOB rules basically require the offeror to solicit all shareholders irrespective of whether the offer is mandatory or voluntary. It is also common for the offer to lapse when the offeror fails to acquire the minimum percentage of shares initially set during the offer period (generally 50 or 66.7%). Under these conditions, theoretically, the issue of coerciveness would not arise.

This is the only condition allowed to be made for a mandatory offer in the UK, whereas Germany and France do not allow making a condition of the minimum percentage of shares to be acquired in the case of a mandatory offer (such a condition is allowed in the case of a voluntary offer). This means that Germany and France, in the case of a mandatory offer, give priority to purchasing shares from all shareholders who accept the offer over preventing...
coercive offers.
Is my understanding right?

4 ‘Distinction’ between “shareholder decision-making” and “worker protection”

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Is my understanding right?

5 “Shareholder decision-making” and worker’s influence in TOB
~ Statement by the board of auditors of the target company

In Germany, a surprising “balance” is maintained regarding the TOB rule. Workers’ influence is strong in Germany which has laws like codetermination law. Adoption of defensive measures based upon approval of a general shareholder meeting or a consent of auditors stipulated in German takeover law seems to be very strong in rhetoric. In practice, however, defensive measures against TOB are rarely taken and the consequence of TOB is left up to the judgment of shareholders ultimately. If the offer price is high, the TOB is basically successful. But, due to “potent worker protection”, it is difficult to run the company without workers’ cooperation even if a TOB is successful. As a result, there is little hostile TOB and so far, the cases which had started as a hostile TOB ended up as a friendly TOB. Germany keeps a balance by having “potent worker protection” as a “cushion (adjuster)” against “shareholder decision-making” in the case of TOB. In France, there exits a similar situation.

Why the validity of the offer price is the main topic in the statements made by the board of auditors of the target company in Germany where the worker’s influence is very strong?

6 Defensive Measures and Concept of “interest of enterprise”

In the UK, where institutional investors have huge influence, most shareholders are negative about adopting defensive measures such as rights plans. Similarly, in Germany and France, the adoption of such defensive measures is generally considered to be against the interest of enterprise (UnternehmensInteresse in Germany, intérêt social in France) and is regarded as the grounds for raising the issue of responsibility of directors, etc.
However, in relation to the concept of *interest of enterprise*, there is no specific criterion as to what would or would not actually be *in the interest of enterprise* at the scene of a takeover. This concept involves the same problem as that involved in the concept of *corporate value*, which is discussed in Japan.

Please comment about my understanding.

### 7. Disclosure of substantial beneficiaries

In the offer document, *disclosure of substantial beneficiaries* does not mean unlimited disclosure of investors. For instance, in UK practices, whether to disclose the names of investors depends on the types of funds, that is, those funds subject to the fund manager’s discretion are required only to disclose the fund names, whereas those free from the fund manager’s discretion should disclose the names of investors. I heard that the same practices were in operation in Germany.

Is my understanding right? If so, what’s the ground for such a practice?

### 8. Hidden ownership acquired through the use of equity derivatives

Along with the recent advances in financial innovation, equity derivatives transactions, in which voting rights are decoupled from economic interest, have often been conducted. Ownership acquired in such transactions through the use of equity derivatives, described as *hidden ownership*, could be used to sidestep regulations such as the large-holdings report system and the TOB rules.

Recently, the UK, Switzerland, and France have taken actions to tackle this problem by imposing general regulations on *acquisition of hidden ownership* through the use of equity derivatives, rather than stipulating a specific definition of this manner of shareholding. Such regulatory policy adopted by these European countries is a very good example for Japan, of an effort to prevent the *spiral of revision and evasion of rules*. At the same time, it is important to provide appropriate exceptions so that regulations on equity derivatives transactions will not excessively discourage financial transactions as a whole.

For instance, we can find a good example in the UK rules under which the disclosure requirement basically does not apply to equity derivatives transactions, etc. conducted by a client-serving intermediary aiming to provide liquidity to the market.

Why is it difficult to regulate equity derivatives in the context of takeovers in Germany?

### 9. Necessity of a takeover regulatory organization that is capable of enforcing prompt and consultation-based regulations

In Germany, where the government agency (BaFin) is in charge of TOB regulations under statutory law, the regulatory staff finds a problem with their limited discretion in legal
construction. Those engaged in regulatory activities have the common idea that they cannot take adequate measures unless necessary legislation is put in place, in order to apply the disclosure regulations to hidden ownership acquired through the use of equity derivatives, or to have the offeror who offers an inappropriate price compensate the shareholders of the target company.

If consultation-based TOB regulations are made possible, there will be almost no unintentional violation of the TOB rules, and even when a dispute occurs regarding the illegality of an offeror’s action, the offeror will be able to choose a scheme or action that will not be deemed to be against the rules, by consulting with the supervisory body in advance.

Do you think it is possible to change BaFin into such a consultation-based regulator? And do you think such a change of BaFin is good or bad?

III. [Comments and Discussion]

1. General Comment (Felix Steffek)

STEFFEK: Welcome very much to the Max Planck Institute for Private Law in Hamburg, Professor Watanabe. Also, I would like to extend many thanks to my colleagues for giving us their precious time, especially because you, Professor Baum and Dr. Kumpan, are both experts in the field of takeover law.

I very much agree with many issues Professor Watanabe has dealt with in his Waseda University newsletter article. A point I particularly agree with, Professor Watanabe, is your approach to understand the law in the books as well as the law in practice. I am very interested to hear the views of my colleagues, but I dare to assume that they will agree with this point. It has been argued for a long time that the technical approach to commercial law needs to be combined with a functional and practical approach. This method has a long and well deserved tradition and we very strongly believe in this way to deal with law.

In order to develop good regulations, we have to know the practice. We have to understand what impact the existing regulations have had on practice so far and how practice has reacted to regulations, if we want to increase the quality of regulation.

Briefly, regarding the point where you, Professor Watanabe, develop the distinction between shareholder decision-making and worker protection: In my view it is exactly as you have written in your newsletter article that in the end it is the shareholders who have the say. But you correctly point out that in the public opinion there are cases where the workers’ position was very important.

Then, it seems to me that you have a strong interest in how the mandatory-offer rules work in practice. In the newsletter and your questions you describe it as both a cushion and a hurdle to gaining control. Speaking about a cushion, practitioners often tell us that they plan very exactly what percentage of control rights the offeror will acquire in a target corporation. A topic that has been prominent in Germany in recent years is the rules determining what percentage the offeror actually holds. Generally, voting rights controlled by subsidiaries are added.

In practice, the situation sometimes, however, becomes a little bit unclear: For banks, for example, as regards the voting rights they maybe have in their trading portfolios. And for offerors sometimes it is not so easy to determine on the spot how many control rights the company has.
So, in theory it may be easy to say, but in practice sometimes, if you think about a corporate group, and groups of subsidiaries, especially banking groups, it is actually not so easy. That is an issue that is under review by government these days.

Now I would like to repeat some more general remarks I made in our previous conversation. There I was referring to the fact that you are thinking about good regulation for Japan. You are asking why the U.K. took the development it took and what the situation is in Germany. This leads us to the topic of formal versus informal rules or hard-law rules versus social norms.

Historically, in the U.K. there used to be more social regulation, that means more informal rules. But this system only had a chance to work in the 19th-century and early 20th-century capitalism in the U.K., where relatively few families with strong family ties and intensive social relationships were commercially active. Everyone knew each other. So, if you breached a social norm, you got a social sanction.

But nowadays, with the U.K. market being much larger and more anonymous, with the huge international capital influx, this social system does not work any more. Hence, in the wake of this development the U.K. has seen some scandals. The case of the Bank of Credit and Commerce International (BCCI) is a prime example. There we had a banking corporation that actually misused the system of mutual trust to the detriment of those who trusted but did not check.

As a consequence of internationalization the U.K. has developed a more detailed, hard-law regulation. In Germany, the approach to develop positive and detailed rules has rather been the starting point. So, I would like to argue that there is some convergence as regards the approach to regulation. Of course, now the European legislator is a major driver in the development of more detailed rules.

Finally, specifically regarding the field of take over law that has brought us together today, you might have read about the Schaeffler-Continental case. There, market players used economic behavior to indirectly control what others do. And the question from a regulatory standpoint is: “How do you react to this?”

U.S. researchers have developed the distinction between rule-based and principle-based regulation. Principle-based regulation is, I simplify extremely, where the law defines: “If a person gains control over a company, such person must make a mandatory offer.” Rule-based regulation is more detailed, the law says exactly what should happen in which case. For example: “If a person acquires 30% of the voting stock of a company, such person must make a mandatory offer”.

In those fields where the market players look for loopholes and try to circumvent the rules, the question is “How do you react as a regulator?” The advantage of principle-based regulation is that the courts and officers (e.g. from the Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin) can use the principles and apply them to new market behaviour that was not envisioned when the principle was enacted. However, principle based rules can be unclear for market players ex ante, before they enter into a transaction, to understand what the consequences of their actions will be. While rule-based regulation or more detailed regulation provides a higher legal certainty, it comes with the disadvantage of facilitating the searching and finding of loopholes.

My personal opinion is that generally we should try in the interest of legal certainty to stick to clear legal rules. But now, as a reaction to the Schaeffler-Continental case, we see that this approach sometimes might not work. So, in a limited proportion of cases I think it might make sense to turn to principle-based regulation as far as it is necessary.
But, I have spoken much to long, and I would be very interested in hearing from Professor Baum what his opinion on those issues is.

2. The case of Schaeffler/Continental and the issue of “acting in concert”

BAUM: In the Schaeffler-Continental case the problem was that, in my view at least, some kind of acting in concert did most probably happen, but it could not be proven. That was the core problem and this problem cannot be solved by a principle-based regulation either.

The acting-in-concert provision, with its unclear rule, which votes will be counted together when people act together in one or another way while making an investment in a listed company creates a constant problem as you don’t know what you are exactly legally allowed to do and what not.

The burden placed on the daily economic business by this annex to the mandatory-offer rule is sometimes excessive. There is almost no discussion of major investments in listed companies without mentioning the takeover law and how to stay clear of its application, because you don’t want to be forced to make a takeover bid.

So the indirect costs of the mandatory-offer rule are substantive. A lot of economic activity is not taking place because of that rule.

If you only look at the figures, and you can say that there are many takeovers that work and that the market for corporate control is active, but that market would be much more active without this rule.

KUMPAN: There will be a new proposal for regulating the acting-in-concert clause in Germany. It’s a very recent development.

BAUM: I haven’t seen it the draft yet.

KUMPAN: If I am not mistaken the BaFin has already submitted its proposal to the Ministry of Finance.

BAUM: The BaFin is famous for being precise about numbers. But they have sometimes difficulties in spotting the real problem.

KUMPAN: They will probably release the proposal regarding the acting-in-concert clause within the next weeks to the public.

BAUM: I think they want to include derivatives.

WATANABE: Do you mean equity derivatives by that?

BAUM: Yes. I think that is the direction taken, following the U.S. and Switzerland.

STEFFEK: As regards derivatives you have to differentiate between physically settled and cash-settled derivatives. In the Schaeffler-Continental case we were dealing with cash-settled derivatives. The regulator is now thinking how to bring cash-settled derivatives into the picture of take-over regulation.

For now, there is an idea to focus on something like an economic interest which is comparable to a legal interest, as in a physical settlement. I am not sure how far the regulator will go here. Such an approach would certainly broaden the spectrum even more.

BAUM: Yes, but the real problem is not the derivatives but the people who are setting up the scheme. It’s acting in concert. It will not help to start with the derivatives. You have to focus on the behavior.

STEFFEK: Absolutely, I very much agree.

BAUM: So the regulatory approach, in my view, is somewhat misguided. However, in practice it may bethe only way to address the issue. I’m not sure. But, as I said, the real problem is that the parties involved are acting in concert. There is an understanding that if the takeover is successful, and the bidder

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gets the percentage of shares he wants, the persons acting in concert with him will tender their shares to him.

This informal non-binding and non-enforceable understanding is the key issue the regulator should address, not the derivatives as such.

STEFFEK: The problem is: “How do you prove that?”

BAUM: You can’t.

STEFFEK: That is the problem, where the regulator tries to figure out whether to go the rule based way or the principle based way. If the regulator could have figured it out before, there would have been a legal solution. But apparently the regulator did not.

BAUM: It’s always like that. If you interfere in markets too much, the problem is that people tend to avoid these regulations, because the outcome is non-functional. If there is a more restrained functional regulation, markets can live with it.

STEFFEK: If you regulate the acting in concert, the question is whether you understand acting in concert to require the two or more persons acting together to have a mental element of knowing that they are acting together, or if one person manipulates the other economically, whether you already understand this as acting in concert. Professor Baum, if I understand you correctly, this is your preferred approach.

3. Mandatory offers and voluntary offers

STEFFEK: Looking at Professor Watanabe’s list of questions, if I understand the first part correctly, the main issue is that you have analysed statistics of the BaFin and they say that the level of mandatory offers in Germany is at the same level as voluntary offers.

WATANABE: Yes, according to the statistics of the BaFin.

BAUM: Well, of course, because it doesn’t make any difference whether you make a voluntary offer or if the authorities order you to make an offer. Once you acquire enough shares to have a controlling interest in a company, you know you that you have to make a full bid.

In any case, as soon as you start acquiring shares you have to have a plan for how to deal with financing the acquisition rest of the shares offered to you. Whether that starts officially as a voluntary offer or whether you start just buying shares and wait for the BaFin to say, “Hello, you have to make a mandatory offer,” does not make a difference in this regard. Also if you buy another company that is invested in a third company where you are invested yourself as well, and if these two packages together count for more than 30% of the target’s voting shares, then you have to make an offer and that, again, is not a voluntary but a mandatory offer. By acquiring the company in the first place, you know that the offer will have follow. So I think it doesn’t make any difference whether that starts as a mandatory or a voluntary offer.

WATANABE: From the point of . . .

BAUM: Once you have gained control, you have to make a bid, and the consideration has to meet certain minimum standards. Whether you start with a so called “voluntary takeover bid” or whether because of some other activities you are obliged to make a mandatory bid, both scenarios are similar. You know in advance that you will have to make a bid, so you are planning accordingly as you probably will have to invest a lot of money and may need to arrange the finance for that.

WATANABE: But some bidders may intend to get partial control, for example 30-50%. As you know, it is
usual in Japan.

4. The case of Porsche/Volkswagen and Porsche’s strategy

STEFFEK: We might have seen this in the Porsche-Volkswagen case, because Porsche tried to acquire just a certain number of shares. The plan was to structure the acquisition in order to settle for a price of the mandatory bid that would allow Porsche to just get a few percent of Volkswagen but not all of the shares.

I think Professor Watanabe also mentioned this case in the Waseda newsletter. It might be interesting to research in more detail how Porsche has manipulated the mandatory bid, not just the voluntary bid. Porsche tried to determine the point when the shareholding crossed the threshold so that Porsche could offer a reduced mandatory-bid price which would have people not interested in selling.

BAUM: Actually, the bid price was lower than the stock price of the outstanding shares at the time the bid was launched. – and that was exactly what Porsche intended. In my view, one can see a clear strategy starting years ago. The takeover strategy was quite clever. The law on the books was observed and, at the same time, Porsche did not pay much money in the course of the bid as not many people offered their shares because the price was not attractive. After Porsche made the bid the way it was free to built up its stake in Volkswagen.

However, in the end the strategy went to nowhere, because Porsche miscalculated the regulatory outcome at the EU-level. The EU left a surprising loophole for the German government to maintain parts of its so-called “Volkswagengesetz” – a classical anti-takeover statute. Also, Porsche made a mistake, misinforming the market by a press release that was not correct. This was the only, but possibly fatal mistake. With respect to all other issues at least the letter of the law, though probably not the spirit was observed in a rule-based approach.

With a principle-based approach, this strategy might have run into problems earlier. But in the end, it backfired, anyway.

5. “Eliminating coerciveness” and the “protection of minority shareholders” in the process of takeover bids

STEFFEK: Very well, we have already covered Professor Watanabe’s next question, which dealt with the 30-50% adding. So we can go on.

Your other main question is whether we allow for capped offers. The law is, indeed, as you describe it in your document. Behind this issue is also the idea of equal treatment of shareholders. Do all shareholders get an offer or only some? The principle of equal treatment is quite a strong principle in German law.

It also makes sense economically, from my point of view, because the idea of equal treatment of shareholders goes back to minority-shareholder protection. There the paradigm is that if you treat minority shareholders very badly, you depreciate minority shareholders’ investment. At the end of the day such bad treatment causes society to lose investment by minority shareholders. Since, if you are a minority shareholder and know that you will likely be expropriated, you might not invest. But the economic idea of public companies is to be a pool of finance to do good things for society. Hence, society does not want to lose the investment of minority shareholders.
KUMPAN: In my opinion you can see that in numerous clauses in the German Securities Acquisition and Takeover Act. For example, the rule regarding compensation after a squeeze-out follows the approach of equal treatment of shareholders: Everybody should receive the same amount of money as compensation.

So I agree with you.

BAUM: Yes. And you can see this concept clearly in the directive. There are provisions that expressly stipulate and refer to equal treatment.

WATANABE: I suppose German and French regulations about this are very consistent from the point of view of protecting minority shareholders. But there still remains coerciveness.

So, from the point of eliminating coerciveness, the U.K. system is perhaps more reasonable.

KUMPAN: I'm not sure. Many differences can also be explained by a different business culture. In Germany the principle of equal treatment of “strong” and “weak” investors is very important. So in that regard, the situation differs for example from the one in the U.S. In the U.S. that coercive aspect that you mentioned might be more prominent.

WATANABE: I think both of the two approaches are reasonable in each context.

KUMPAN: Sure. Each legal culture needs to find its own approach. Hence, I would not call any of them unreasonable.

WATANABE: I suppose the German and French systems place priority on protecting minority shareholders, and the U.K. system places priority on eliminating coerciveness.

STEFFEK: Legal culture might play a role here. In Germany the starting point is the constitutional concept of protecting each person's rights. So equality of shareholders plays a strong role in Germany. The general English approach to be witnessed in the common law is that the law provides more freedom, but you have to protect yourself. Following this approach, if you accept a minority shareholding in a company, you do know what is written in the company's constitution. This means that you know what you are dealing with, since you know the rules.

So, the different legal rules are an expression of a different legal culture. Interestingly, both approaches work. You can also see it in general company law.

6. “Shareholders’ decision making” and “worker protection”

STEFFEK: Professor Watanabe's next question refers to the distinction between shareholder decision-making and worker protection. Professor Baum, may I please ask for your valuable opinion?

BAUM: There is a distinction between the two. That is true. But because of worker protection, the management of the target company is especially authorized to take defensive measures, whereas, if I understand you correctly, you think it's the other way round.

In Germany, the interest of the company does not, especially in the understanding of the trade unions, prohibit management from taking defensive measures. Rather the contrary is true. We can observe a significant influence of trade unions here. During the legal proceedings the trade unions were able to convince the legislator to adopt a provision in the Takeover Act, the WpÜG that management is empowered – with the consent of the supervisory board – to take defensive measures, even if these are actually against the interests of the shareholders in the sense of shareholder value. With large companies the supervisory board is 50% staffed with representatives of the employees and the trade-unions.
As defined by the trade unions, the interest of the company basically means the preservation of jobs for the employees (and for the representatives of the unions). That understanding of the enterprise is, of course, diametrically opposed to the shareholder value concept.

So I think it’s the other way round, actually.

Of course a sufficient protection of workers is necessary in general and also in a specific takeover situation. But this protection has to be provided by the labor laws, but it is not an issue of takeover law. German labor laws are very strict. No one can be dismissed arbitrarily. To deal with social tensions, various takeover laws stipulate information rights for the employees. But these are not empowered to say no to a takeover. However, indirectly this outcome is achieved by empowering the management to act in its own interests, which mostly is more or less identical with that of the employees: Keeping its job.

Management may, with the approval of the trade unions and the workforce, oppose a hostile bid that would make the company more fit for international competition. In such a situation they will only keep their jobs in a short-term perspective.

STEFFEK: Considering that in the case of the shared shareholder/worker representation on the advisory board the shareholder side has the deciding vote. What role does that play in practice? Or is it hard to quantify?

BAUM: We have no cases so far like that. But the legal proceedings were hijacked by the trade unions in this regard. The provision you find now in the statute was not initially intended by the Ministry of Finance when drafting the law. It was inserted at the last minute of the legal proceedings by pressure groups like Volkswagen and trade unions. They joined forces, because they did not want market forces to control the management.

So that’s a very ambiguous story. An informative article by the American company law expert Greg Gordon on this titled “The German Anti-takeover Law” supplies a comparative perspective on these matters.

There is actually a first decision of a German district court, stating that a bidder, if it’s a listed company, should ask its shareholders before making a disastrous takeover bid. The decision regards the takeover of Dresdner Bank by Commerzbank. I just saw it mentioned in the papers the other day. I don’t have the case materials yet.

STEFFEK: The management was not accepted by the shareholders.

BAUM: As a rule, the past performance of the board is approved by the shareholders at the annual shareholders’ meeting. In the Commerz Bank case, however, minority shareholders sued and said, “no, we do not approve. This was such a disastrous decision and such a fundamental decision that the shareholders should have been asked beforehand.” The district court obviously shares that view. That is an interesting decision. I expect a lot of comments on that.

7. Statement by the target’s supervisory board and the offer price

WATANABE: I’d like to move on to the next question. “Why is the validity of the offer price the main topic in the settlement made by the board of auditors of the target company in Germany?” Because workers’ influence is very strong.

It’s very interesting and surprising for the Japanese.

STEFFEK: To understand the question correctly, may I ask whether you are surprised by the fact that,
while workers’ influence is very strong, the auditors review the price so intensively, which often is not the primary concern of the workers?

**WATANABE:** I understand that a typical statement made by the board of auditors is, “The offer price is rather low. Please go up in price. The offer price isn’t good.” That is the main statement.

**STEFFEK:** … and you are surprised by it, because the price is maybe not that important for the workers? They are more interested in plans for the future, investment strategy or divestment strategy. Is that why you are surprised?

**WATANABE:** I heard that in the statement from the supervisory board the main interest was the offer price itself, not the employment policy or business plan.

**BAUM:** Well, I have not heard that. Is the background for your question that you have read statements by the management of a target companies on the respective takeover bids?

Legally there are few requirements. The board and the supervisory board have to comment on the offer. But as far as I know, there are no legal requirements on what they have to say.

So that cannot be the basis for your question. But what then is the basis for your question, if not the law?

**WATANABE:** It’s not a legal requirement but practical one, I suppose.

**BAUM:** Practical. That’s what I meant. You are referring to reading to statements made by boards.

**STEFFEK:** At the end of the day a takeover is a question of whether people want to sell their shares. The main information for the shareholders is the price, which they take into account for their decision.

**BAUM:** Yes, but that’s independent of worker protection.

**STEFFEK:** Yes, exactly.

**WATANABE:** The information is from our research by the delegation of last summer. Many people summarized so.

**STEFFEK:** As far as I have had the chance to read the comments this issue is usually prominent.

**KUMPAN:** Well, if workers are against the offer, stating that the offer price is too low could be an indirect way of advancing the workers’ interests.

**BAUM:** But you have a lot of price regulation. The average stock-exchange price for a certain period of time has to be taken into account; also prices paid earlier by the bidder within a certain period before the offer was made matter. Both have to be taken into consideration as the minimum price. The Porsche-Volkswagen case may have been an exception. In general, the fair value of an offer can be taken for granted under the present regulation. Of course, the management is free to say, we see further potential for future growth, and that’s why the price should be higher.”

But such as statement of a German board on the price is not as important as it would be in the U.S. where the issue of the price is the main reason for management to refuse a hostile bid. In the U.S. there is no price regulation as they do not have a mandatory bid rule. The regulatory structure is fundamentally different.

8. “Unternehmensinteresse” and “corporate value”

**STEFFEK:** The next question you raise is a very interesting but also very difficult question, because you ask something that many people have thought about for hundreds of years, and we still do not know the answer for sure. The question I refer to is: “What is the interest of the enterprise?” You qualify it by
specifying: “What is the interest of the enterprise in the scene of the takeover?”

**WATANABE:** It’s a practical meaning.

**STEFFEK:** We also have to see this question against the background of the interest of the enterprise generally. That is a prominent and interesting debate in Germany, which we have not yet solved. It comes up every 20 or 30 years.

**BAUM:** Let’s agree that we talk about German law thus I do not comment on a comparative basis on this issue. In Germany we have the two statutes, the Aktiengesetz and the Übernahmegesetz, which are different on that issue. We don’t have the “Unternehmensinteresse”, that was originally introduced in the Nazi era, anymore in the Aktiengesetz. But surprisingly, because of Social Democratic pressure, we suddenly see it again popping up in the Takeover Act. It was political decision with trade union backing as the “Unternehmensinteresse” may serve as a tool to protect the jobs of the employees and, not by chance, those of the incumbent management. That’s all.

**STEFFEK:** With regard to the “Unternehmensinteresse” in the Aktiengesetz, there is a very inspiring article by Professor Peter Ulmer in the Archiv für die civilistische Praxis (AcP) 202, 143-178 (2002). The conclusion of this research is, basically, that the Aktiengesetz provides an open framework, just as Professor Baum said. The Aktiengesetz allows for what is the general approach, in English called the “enlightened shareholder-value approach”: shareholder interests are most important, but other interests have to be considered.

**BAUM:** The concept of the “Unternehmensinteresse” in a broad understanding is detriment against good corporate governance, because it may be instrumented as an excuse for poor management, because the board always may pretend to have acted in the interests of some stakeholders involved.

The less the management is focused on shareholder value, the greater is the danger of bad corporate governance.

**STEFFEK:** Yes. It is interesting to see that this enlightened shareholder value approach, which is probably the main approach in Germany in practice, but which is not expressly written into the text of the Aktiengesetz and the Übernahmegesetz, is now statutorily formulated in the Companies Act 2006 in the U.K. There the directors’ duties are described in sections 170 and following. But you have looked into that already, I’m sure.

Comparatively, it is interesting to see that in the UK it is written down in the Companies Act 2006 what happens here in practice.

**WATANABE:** I suppose the concept of “interests of the enterprise” generally is very important. But in the context of a takeover, it has little practical meaning.

**BAUM:** I am not so sure whether it really has no practical meaning, because the “interests of the enterprise” may allow defensive measure taken for the sake of protecting jobs.

**WATANABE:** But please imagine the concept of “corporate value” in Japan, as you know.

**BAUM:** I’m a bit skeptical about that idea if it does mean anything other than the long term interest of the shareholders.

**WATANABE:** I think that it is very important theory, but it functions only retrospectively. We can decide whether the offer was good or bad just after the offer was made.

**BAUM:** But who will decide on what? On what criteria? What is a bad offer?

**WATANABE:** There could be no complete criteria.
BAUM: That’s right. So it’s organized interests that will get the advantage. That’s why I’m so skeptical.
WATANABE: Yes.


STEFFEK: Thank you very much. Our next topic on the agenda is “disclosure of substantial beneficiaries”. Dr. Kumpan actually knows everything about it, because he has done a lot of research in this field. Here, Professor Watanabe suggests that in the offer document disclosure of substantial beneficiaries does not mean unlimited disclosure of investors.
WATANABE: It’s a very practical question.
STEFFEK: For example, in the U.K. the practice whether you disclose the names of investors depends on the type of fund. Those funds subject to the fund manager’s discretion are required only to disclose fund names, whereas those free from the fund manager’s discretion should disclose the names of investors.

And you heard about the same practices in Germany? This is, of course, more of a practitioner’s question.
BAUM: The idea behind it seems to be clear: It should be disclosed who is making the decision or who has the power to initiate the decision. That is a logical approach, of course.
WATANABE: Probably there is an explicit rule, I think.
STEFFEK: We have this in the Securities Trading Act. We do have disclosure of beneficiaries.
BAUM: Yes, of course.
STEFFEK: It probably makes sense to also take into account neighboring laws. Like the Securities Trading Act. There are very interesting transparency rules, if you are talking about disclosure transparency.
BAUM: That’s parallel, yes.
STEFFEK: … and I think it even goes further, because we have a new transparency rule, according to which if you acquire 10% you have to disclose your aims and what you intend to do with respect to the company.

So this is something that is an additional hurdle to takeovers, even though it’s not in the Takeover Act. By having additional rules in neighboring statutes, you also make it more and more difficult to achieve a takeover or to avoid these takeover rules. So, I think, even if the regulator reduces the threshold to just disclose that you have only 2-3% is also trying to raise the bar and to make it more difficult.
BAUM: Yes, it’s an antitakeover device.

It was clearly stated in the lawmaking proceedings. It’s aimed against foreign funds, especially sovereign wealth funds, because the Government did not want to have the Chinese or Arabs or Singaporeans or whoever, “over”-investing in German companies. That was before the financial crisis. As soon as the financial crisis started, the were begging these funds to invest in the insolvent German banks.
KUMPAN: This 10% rule is almost a copy of article 13(d) of the US Securities Exchange Act.
BAUM: Yes, but it’s not what the U.S. is doing. There are some crucial differences.
STEFFEK: While we are touching on the subject, it might be interesting for you talk to representatives of foreign funds in Germany. There is a foreign funds association. The question for Japan would be “How do we deal with foreign investors?” They have their specific problems. When you go to the BaFin, and they get the experts in to listen to them, the foreign funds always have very specific questions, and the BaFin
actually listens.

10. Equity derivatives and “hidden ownership”

STEFFEK: For the next question, it is no exaggeration to say you could hardly get anyone better to talk to than Dr. Kumpan. Why? Since he has written an article that has been published in one of the best journals and cited by the Supreme Court.

WATANABE: I heard that Professor Schneider also has written an article.

STEFFEK: The issue refers to hidden ownership acquired through the use of equity derivatives. Your question is “Where are the difficulties in regulating equity derivatives in the context of takeovers, and what are strategies used in Germany?”

You have heard that there also is some reform on the way. Christoph Kumpan, may I ask you for your opinion? How should the acquisition of hidden ownership through equity derivatives be regulated ideally? If you had a blank sheet of paper, what would you write?

KUMPAN: It’s a very good question. However, let me briefly address the issue of regulating equity derivatives in the context of takeovers. An important aspect is what we have discussed at the beginning, with regard to the Schaeffler-Continental case. Many market participants are very creative and develop devices to circumvent the law or what they perceive to be legal obstacles to their business. That observation speaks in favor of a more principle-based approach, which allows for an ex post examination by the courts. The downside of this approach, however, is that it entails some legal uncertainty.

Now to the question that Dr. Steffek raised: The problem of hidden ownership and empty voting is not yet a common one in Germany. However, recently we had a case in which a shareholder of a company borrowed securities (via securities lending agreements) to collect sufficient shares of that company to be able to vote through a squeeze-out (Linder Holding KGaA).

Since securities lending agreements in Germany usually lead to a transfer of legal ownership (but not to a transfer of the associated economic risk) the problem here was whether voting in such a case would violate German law. The answer is difficult. Since the legal ownership was transferred, but not the associated economic risk (due to the obligation to return the borrowed shares after the agreed upon lending period) the respective shareholders engaged effectively in an empty-voting scheme. A number of German scholars perceived this to be a circumvention of the German rule according to which only shareholders (or whomever they have given a mandate to vote for them) are allowed to vote. Others who vote will be considered to have abused their position.

The question before the court was whether becoming the formal owner of shares was sufficient to be able to vote or whether the respective investor/shareholder also has to become the “material” owner, meaning that he has to assume the economic risk associated with the shares as well. – The court actually decided that becoming the formal owner suffices. –

However, I think this issue is not only a matter of the Securities Trading Act or the Companies Act but also one of market practice. If you stick to the formal approach under German law, as the court did, it will be difficult to appropriately deal with that issue. The market and the company perspectives intertwine here.

Now, if you use equity derivatives to “cut out” the economic risk, the situation becomes even more difficult: Because you do not acquire the shares temporarily, just for a certain period of time (as with
WATANABE: I think equity derivatives itself are a very useful device. So, I think that basically it should not be attributing to calculating voting rights. But it should be subject to the reporting of large shareholding.

KUMPAN: Right. So in our paper on empty voting in Germany we went section by section through the Companies Act to see whether there was any rule that would help us to determine whether empty voting could be regarded as an abuse or not. However, the rules were not very helpful. So, we turned to the duty of loyalty which in Germany does not only apply to directors; even shareholders have a duty of loyalty - to the company and to other shareholders (see the cases Linotype and Girmes).

WATANABE: I suppose in the German Securities Trading Act Section 25, there is a comprehensive notion of “financial instruments”.

There are similar notions also in Switzerland, the U.K., and France. By using that notion of financial instruments, Switzerland, the U.K., and France are regulating equity derivatives.

And it is subject to reporting of large shareholding. But in Germany it is not subject to such a reporting system.

What makes such a difference?

KUMPAN: I’m not sure if I understood you correctly, but I think we are talking about different topics right now.

I think you thought about whether you could control these activities by transparency rules of major shareholdings. Is that correct?

WATANABE: Yes, major shareholdings, reporting system for large shareholding.

KUMPAN: Well, transparency could be one approach. But that would mean you will leave it – more or less – to the market to solve the problem. Because you would only stipulate that the information will be given to the market and then you will leave it to the market participants to draw their own conclusions and deal on their own risk.

Do you think about an additional prohibition or an additional device to limit that behavior?

WATANABE: I think such a provision is needed.

KUMPAN: In the sense that you would prohibit activities such as empty voting or hidden ownership?

WATANABE: Yes, hidden ownership.

KUMPAN: Okay.

WATANABE: It is not regulated in the process of takeovers also in Japan. So, acting in concert is very easy.

KUMPAN: I agree. That is why in our paper we tried to get away from the securities market perspective and turn to the company’s perspective. That means we attempted to find out whether we could make a case from a Company Law perspective on that issue, because we had to deal with that issue within the existing legal system. If you would like to propose a new provision, that would be a different approach.

STEFFEK: Very good, this was a very productive interview and it is not finished yet. It is only transferred. May I suggest that we meet in two minutes downstairs at the main entrance, we could get our coats
and go to the restaurant.

BAUM: And then we will discuss the question about the BaFin.

STEFFEK: The discussion is not finished, but I would like to have on the record that I am very grateful to Professor Baum and Dr. Kumpan for taking their precious time for this session.

BAUM: The pleasure was on my side.

STEFFEK: I'm always so impressed. There is no one better than Professor Baum, who knows the Japanese system and the takeover rules, and Dr. Kumpan, who the Supreme Court listens to.

And I am also very grateful that you took your time, Professor Watanabe, to come here for this interview. It is not something that we can take for granted and we are very grateful that you made your long journey here. So thank you very much for this opportunity. I am looking forward to having lunch with you all, where we can discuss the last question, about the role of BaFin. Thank you very much.

WATANABE: Thank you very much indeed for all your concern and suggestive comments.

Endnotes:

1 This column was originally published in Newsletter, Waseda Institute for Corporation Law and Society, No.5 (Fall 2009) titled as “Suggestions” and “Pitfalls” of Foreign Laws Concerning Takeover Bid Rule.

2 The discussion on the issues related to the BaFin was held during the lunchtime after the study session. It is unfortunate that the transcript of the discussion on the BaFin is not available because it was difficult to record due to the location. Regarding this issue, please also refer to the transcript of a detailed interview and discussions with Prof. Peter Mülbert (Mainz University), an expert on the German takeover law who is also a member of Beirat (advisory council) of the BaFin in this special edition

3 Concerning the analysis of European country’s takeover rules and its implication for Japanese takeover rules, please also refer to “Hiroyuki Watanabe, Designing New Japanese Takeover Regulation Regime –Suggestion from the European Takeover Rules-, Zeitschrift für Japanisches Recht, Nr.30 (Max-Planck-Institute für Privatrecht, 2010) 89”. This article can be seen on this website. (http://www.globalcoe-waseda-law-commerce.org/activity/publish01.html).