German Takeover Law and Practice ②
Regulatory Philosophy behind German Takeover Law
(Interview with Professor Peter O Mülbert)

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[Introduction]

This is the transcript of an interview with Professor Peter O. Mülbert (Mainz University) on the “Regulatory Philosophy behind German Takeover Law.” Prof. Mülbert is a distinguished specialist in German takeover law (Wertpapiererwerbs und übernahmegesetz) and is a member of the advisory council (Beirat) of the German Federal Financial Supervisory Authority (BaFin). The interview was held in March 2010 at Mainz University (Institut für deutsches und internationales Recht des Spar-, Giro- und Kreditwesens). /Watanabe

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1. Mandatory offers and voluntary offers

WATANABE: Professor Mülbert, thank you very much for taking time to meet with me today. I have been involved in much research on German takeover law and its actual practices both in an official capacity and as an individual; however, there are still many points that I do not understand very well. As is the case for UK takeover rules, the more I learn about the actual practice of German takeover law, the more surprised I become upon recognizing the dynamics of parties’ actions that are unforeseeable from the explicit rules, and the more questions I have.

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Since you are the authority on German takeover law and on the advisory committee (Beirat) in the BaFin, I would like to ask you questions on these topics.

MÜLBERT: It is my pleasure. I hope our discussion can provide a more thorough understanding of German takeover law.

WATANABE: I appreciate your contribution. First, I'd like to ask you a question about the significance of the mandatory offer rule.

MÜLBERT: The mandatory offer rule does not deter public offers since most bidders want to acquire all outstanding shares; they would have launched a bid for all shares anyway.

Sometimes potential bidders would have refrained from acquiring all the shares, but these situations are not the norm. In most cases bidders want to acquire all the shares.

The technique of acquiring control is different depending on a particular target company's situation. Some bidders will launch a full bid for all the shares, while other bidders will first buy a stake, even a controlling stake, and then launch a bid for the rest of the shares. However, these different approaches mostly reflect the varying existing shareholder structures of different companies. If there is a block shareholder, or if there are several blocks, the bidder will first acquire those blocks, even if, by acquiring these blocks, he crosses the threshold of control, and he will then launch a public bid for the rest of the shares. This is because a bidder wants to make sure from the outset that he will get the 30% controlling stake. Otherwise you could end up holding maybe 70% of the widely held shares, but would still face a controlling block shareholder. A bidder would definitely want to avoid that situation.

However, in rare cases, where no block of 3-5% or more exists, the bidder will launch a full bid, without any prior acquisition of blocks.

Whether the bidder first buys shares and then launches a bid or launches a full bid from the outset depends on the existing shareholder structure. In other words, he will choose the strategy that is most likely to succeed.

WATANABE: To my understanding, in Germany the same type of price regulation will apply to both mandatory and voluntary offers.

MÜLBERT: Indeed, yes. Since the Takeover Act stipulates identical price rules for both types of bids, a bidder's choice between the different acquisition strategies is less subject to price concerns than to which strategy will most likely be successful.

WATANABE: According to the statistics of the BaFin, there are many mandatory offers, about as many as the number of voluntary offers. In the UK, the percentage of mandatory offers is very small; indeed, most offers are voluntary. What accounts for the difference?

MÜLBERT: That fact is explained by the existing shareholder structure in Germany. There are fewer companies that are widely held or publicly held in the way UK companies are.

Many German companies still have a block owner who controls 25% or even more of the shares. In such cases, even if the bidder wants to acquire all of the shares, he will first acquire the controlling block and then will launch a public bid. In terms of the Takeover Act, such a bid is a mandatory bid since the acquisition of the block results in the bidder obtaining control. Put differently, it is mandatory in the sense that it follows acquisition of control.

But from the perspective of the bidder's intent, it is a voluntary bid, because he deliberately acquired the controlling stake with the intent of launching a mandatory bid after having acquired control.
and since he wants to acquire all the shares anyway.

The Wella-takeover by Proctor & Gamble illustrates this point well. Proctor & Gamble acquired a controlling block from the family that held more than 30% of the shares of Wella and following the acquisition of control launched a bid. In terms of the Takeover Act it was a mandatory bid, even though from Proctor & Gamble’s perspective, it was part of the strategy for acquiring the whole company.

In the UK, where you don’t have a single controlling shareholder, you have to buy all the shares by launching a public bid. There are few companies where you can first buy a 30% stake privately and then launch a bid, whereas in Germany many more such block shareholders exist. This why in the UK you have such a small number of mandatory bids, whereas in Germany you have many more mandatory bids.

WATANABE: But in Germany, what if the block shareholder has only 20%?

MÜLBERT: There may well be other block shareholders, who own 5% or more. Alongside acquiring the 20% stake, you would start by buying these smaller blocks and make sure that you get control because that creates an additional incentive for the widely disbursed shareholders to tender their shares.

Having block shareholders thus makes it easier to acquire all the shares of a company. However, this has nothing to do with the mandatory bid rule. If you want to buy all shares anyway, the mandatory bid rule in itself only affects the technique for executing the acquisition.

WATANABE: I understood. But I heard that recently in Germany in some takeover cases, such as Porsche-Volkswagen and Schaeffler-Continental, they did not intend to get all the shares. Are these cases unusual cases?

MÜLBERT: Unusual, with respect to Schaeffler-Continental, since the bidder, Schaeffler, was a much smaller company than the target, Continental. And indeed, at one point during the transaction, Schaeffler wanted to avoid having to acquire all the shares. However, this was due to the unfolding of the financial crisis after the Lehman Brothers collapse and the massive decline of stock prices that followed.

I imagine that at the outset, Schaeffler wanted to acquire all the shares. But because of the turbulences on the financial markets and the ensuing decline of stock prices, they had difficulties in financing the acquisition of all the shares. That is why Schaeffler, after having launched the bid, tried to avoid having to acquire all the shares. Otherwise Schaeffler would have had to pay a higher amount than the credit volume available to them at that time.

Normally, as bidder, you would want to acquire all the shares or at least 75% of the common stock, since a 75% stake will allow you to conclude a domination agreement (Beherrschungsvertrag in German; Section 291 of the Aktiengesetz) with the acquired company. In turn, this gives you access to the liquidity of the acquired company, since you are then able to use the target’s assets to pay back the loans taken out for financing the acquisition of the company.

If you acquire at least 75% and make the target company enter into a domination agreement with you, it will be much easier for you to control the company. In addition, and this is of particular importance in the present context, you can siphon off assets from the target company and use these to pay back loans that you have taken out for financing the whole acquisition.

Therefore, in most cases bidders would want to acquire at least 75%. Otherwise they would not be able to force the target company to enter into a domination agreement, because such a contract will only enter into force if the target company’s general meeting approves the contract by a 75% majority. So you would need 75% in order to make sure that the target company will conclude such a contract with you.
WATANABE: Has such a control been usual in Germany?
MÜLBERT: Yes.
WATANABE: Is it very usual?
MÜLBERT: There are some cases. Again, the acquisition of Wella by Proctor & Gamble provides one such example. Since the remaining minority shareholders of Wella caused all sorts of difficulties for Proctor & Gamble, the majority shareholder finally realized that in order to avoid these problems and to exert full control over Wella, it would have to enter into a domination agreement with Wella – regardless of the fact that it would then have to offer to purchase the shares of the remaining outside shareholders at a fair price, i.e., at a price that German courts have often determined to be higher than the then current stock market price.

This strategy serves as a blueprint for other transactions. Since minority shareholders, by making full use of their rights, are able to cause substantial difficulties for the target’s management, the controlling shareholder will want to be able to force a domination agreement on the target company. Such a contract allows the other party to the contract to direct the target management’s actions by issuing binding directives as to what management should do.

WATANABE: In Japan, as you know, the acquirer often intends to simply get halfway control. Is there such a trend in Germany?
MÜLBERT: No.
WATANABE: I suppose it may be because management in Germany is very strong.
MÜLBERT: Indeed, the position of a German company’s management board vis-à-vis its shareholders, even a controlling one, is quite strong. If management does not want to go along with the controlling shareholder, they can refuse – albeit at the high risk of being relieved from their office by a supervisory board that is controlled by a block owner.

Apart from that, as I explained previously, the minority shareholders of German companies can and often will cause major difficulties for the controlling shareholder. As a consequence, controlling shareholders will often want to squeeze out the remaining shareholders. And, indeed, we have seen lots of squeeze-out procedures in the last couple of years, probably more than 50-60 cases in which the squeeze-out procedure was used.

WATANABE: Is it under the Aktiengesetz (company law) or WpÜG (takeover law)?
MÜLBERT: Aktiengesetz. German law provides for two different squeeze-out procedures. The first one, Articles 39a and 39b of the Takeover Act, results from the transposition of the EU Takeover Directive. The second one, Article 327A et seq. of the Stock Corporation Act, was introduced in 2002 alongside the Takeover Act.

Usually, German controlling shareholders would use the procedure provided for by the Stock Corporation Act to squeeze out minorities. The squeeze-out provision of the takeover law only applies if the squeeze-out procedure is initiated within three months of the acquisition of control by a bidder. Hence, in other situations, you have to resort to the squeeze-out provision of the Stock Corporation Act. However, both squeeze-out mechanisms require that you control 95% of the shares. As a consequence, regardless of the mechanism a bidder intends to use, he will want to acquire at least 95% or, better still, 100% of all the shares.
2. “Additional mandatory offer rule” and the “creeping rule” in some other EU countries

WATANABE: I’d like to move on to the next question. We talked about the basic type of mandatory offer in Europe. And I suppose in some jurisdictions there are some additional strict mandatory offer rules, like in the UK, Ireland, France, and Greece. In these jurisdictions the mandatory offer rule is also applied also the aquisition between 30% and 50%. It’s very strict. Especially the percentage held by the block shareholder is rather high, in continental Europe, not the UK.

But in such jurisdictions there is a so-called creeping rule. It allows a bidder to acquire shares to some extent (e.g. in France it is allowed up to 2% in 12 months). So the degree of strictness of the mandatory offer rule depends largely on whether or not the rules are applied to offers added to increase shares of the company.

We can address the strict mandatory offer rule by adjusting such creeping. There is almost such a strict mandatory offer rule in Germany.

MÜLBERT: No, you have to launch a bid only when you cross the 30% threshold. If for whatever reason you are exempt from making a mandatory offer at that point, you are forever be exempt from making a mandatory offer, regardless of whether you will acquire additional shares or not.

The Takeover Act provides for some exemptions from the mandatory bid rule. For example, if a person acquires control because he inherits the shares from his parents, he will be exempt by law from making a mandatory offer. In addition, in certain cases specified by Sect. 37 of the Takeover Act (WpÜG), the BaFin has the power to waive the mandatory-offer obligation.

Given one of these situations, a person who later acquires additional shares will not have to launch a bid. In other words, the German legislature has chosen to either require a bid at a specific point in time or none at all. Subsequent acquisitions of shares will never trigger a mandatory bid obligation if the bidder was exempt from making a mandatory offer at the time he acquired control.

The practical effect of this version of the mandatory bid rule, inter alia, depends on whether the exemptions from launching a bid at the 30% threshold are broadly interpreted or narrowly interpreted. If the law accepts only a few exceptions from the mandatory bid requirement, a big loophole does not ensue if a person who did not have to launch a mandatory bid at the time of acquiring control is also not obliged to launch a mandatory bid when acquiring additional shares.

However, if exemptions from launching a bid are broadly interpreted, if there were many situations in which you would not have to launch a bid, it might be advisable to provide for a requirement to launch a bid once the controlling shareholder buys additional shares.

Under German takeover law, in practice, the most important situation in which you are exempt from launching a mandatory bid is the work-out situation. If a company is financially distressed and a bidder acquires 30% of the shares or more, The BaFin will waive the bid obligation if certain requirements are met, i.e. the bidder providing financial support to the company and not limiting his investment to paying the share price to the previous owners.

Since that is the most important exemption, I guess the fact that we don’t have rules on a mandatory offer following subsequent acquisitions of shares is not really a big problem in Germany.

I am not aware of any recent article in a legal journal or statement by a practitioner urging the in-
roduction of a rule requiring a controlling shareholder to launch a bid once he steps up his stake in the company. (Please note that subsequent to our conversation the situation has changed somewhat because of the successful takeover of Hochtief by ACS. In particular, while the bid was still open the Social Democratic Party introduced a proposal in Parliament to amend the Takeover Act by adding a creeping-in provision modeled on the French law. However, the underlying motive was not to improve a target’s shareholders position but to make a takeover bid more costly to the bidder and, thus, more rare. In particular, it was hoped that ACS would either have to raise the bid price if it wanted to avoid having to launch a subsequent mandatory offer or would have to offer a higher price in a subsequent mandatory offer and, finding it difficult or impossible to secure the financing needed, would give up its plans. In the end, ACS was able to raise the offer price and cross the threshold for control while Parliament with a view to the imminent revision of the Takeover Directive decided not to table the amendment for the moment.

WATANABE: I suppose the cases you explain just now covers this type of mandatory offer rule. The second rule is where the acquirer already has a controlling block of shares.

MÜLBERT: That is right. Basically, two situations exist in which a block owner holds a controlling stake of at least 30% of the voting shares from the outset. One situation would be that the block owner held the stake before the Takeover Act went into effect, i.e. on January 1, 2002; the second situation being an IPO of a company, i.e. its listing on a stock exchange, whose shareholder(s) continue(s) to hold a controlling stake.

In both cases, requiring a controlling shareholder to launch a bid once he steps up his stake would be problematic.

WATANABE: I suppose he is regarded as a person who already made a mandatory offer.

MÜLBERT: Exactly. I am not aware of anyone who, following the enactment of the German Takeover Act, has claimed that the lack of such a rule creates a problem. Nobody has complained about the nonexistence of such a provision.

In fact, in political terms, it made it easier to enact the law, because controlling shareholders would not fight as hard against the mandatory bid rule as they might have. If as a controlling shareholder you are forever exempt from the mandatory offer obligation there is no need to fight against the mandatory offer rule. You are already in control and you never will have to make a mandatory offer.

The exemption regarding existing controlling shareholders made it much easier for the government to enact the rule, even though we did not face too many problems arising from that rule.

WATANABE: I suppose the type of second mandatory-offer rule is too strict, except in the UK and Ireland.

MÜLBERT: Yes, I would agree.

WATANABE: Such rules are very hostile to takeovers, like anti-takeover rules.

MÜLBERT: Yes. In political terms it makes it difficult for the government to have that rule implemented, because not only would future block shareholders fight the rule, but also existing block shareholders would strongly oppose any such rule.

WATANABE: But under this second type of mandatory offer, if there is some reasonable creeping rule, such as that in France, it is possible to get shares up to 2% in a year. It’s not strict. But I suppose in France it is not much of a problem.

MÜLBERT: I guess, you can soften the rule. Still, it will make at least some takeovers more expensive
and, thus, have a dampening effect on the market for corporate control.

**WATANABE:** Yes. It functions as a cushion.

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

**WATANABE:** Next, I’d like to ask you a question about the conditions allowed to make for a mandatory offer. The European takeover 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 he offeror fails to acquire the minimum percentage of shares initially set during the offer period (generally 50% or two-thirds). Under these conditions, theoretically the issue of coerciveness would not arise.

This is the only condition allowed to make for a mandatory offer in the UK, whereas Germany and France do not allow making a condition of the minimum percentage of shares. But on the other hand, this condition is allowed in the case of a voluntary offer.

So, to my understanding, 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.

**MÜLBERT:** To begin with, for the most part, the EU Takeover Directive deals only with mandatory offers. Second, with respect to mandatory offers, at first glance at least, it is not easy to understand why a takeover regulation would allow a condition such as the minimum percentage of shares tendered. The purpose of the mandatory offer rule is to give all shareholders the possibility to tender their shares.

If a takeover regime allows for mandatory bids to be conditioned on a minimum acceptance threshold the law must also make sure that the acquisition of control will be unwound if the bidder fails to meet the threshold. Otherwise, target shareholders would face the risk that even though the bidder is in control of the target company, they cannot tender their shares since the offer fails to reach the (very) high minimum acceptance threshold.

Moreover, from the German perspective, the unwinding of control can be more difficult if the acquisition of control does not require an acquisition of shares, but can occur because of an attribution of voting rights resulting from a contract, e.g. a pooling of voting rights (acting in concert). This concern becomes even more important since many bids are mandatory bids.

To conclude, my intuition is that a minimum acceptance threshold should not be allowed for mandatory offers whereas in the case of voluntary offers such a condition is perfectly legitimate.

**WATANABE:** In France, many lawyers said similar to what you have been saying.

I understand the meaning of such a system. But I think the UK system is also reasonable. The goal of the UK system is to eliminate coerciveness of offers completely.

**MÜLBERT:** Yes, but from the German point of view the problem of a coercive offer arises in situations where shareholders should be free to decide whether or not they will tender their shares, i.e. the problem only arises in situations where the bidder has not already acquired control.

If the bidder is a controlling shareholder, it doesn’t really make sense to ask whether his offer is coercive or not. Since the bidder already controls 30% of the shares, the offer inherently has a coercive element. Being faced with a controlling shareholder, the target’s shareholders are no longer completely
free in deciding whether to tender their shares or not. On the contrary, it is rational to tender. Even if the structure of the bid is not coercive the fact that the bidder has control has a coercive effect.

This is why we think that mandatory bids and voluntary bids should be treated differently with respect to the conditions allowed.

**WATANABE:** In the UK, if you acquire over 30%, the mandatory offer rule will be applied again, after the offer. Do you disagree with this method?

**MÜLBERT:** Yes. But still, I don't see why it should be possible for the offeror to launch a mandatory bid with a minimum threshold acceptance level. Let's take the case where the offeror first launches a bid (in the UK situation) and acquires 33% of the shares. He will then have to launch a mandatory bid for the rest of the outstanding shares (67%). Why should he be allowed to say “I will only buy all the shares if 50% of all outstanding shares are tendered”? If, for example, only 49% of the shares are tendered, then the mandatory offer falls flat. Or why should he be allowed to say, for example “The bid is subject to the condition that 99% of the outstanding shares are tendered”? It’s highly unlikely that 99% will be tendered.

A bidder could even set a 100% minus one share minimum acceptance threshold. If a takeover regime allows for mandatory bids to be subject to such conditions, the bidder is in an excellent position to control the effect of his mandatory bid.

**WATANABE:** It's unreasonable.

**MÜLBERT:** Yes, because providing for a minimum acceptance threshold condition allows the bidder to manipulate the probability that the mandatory bid will be successful. Put differently, allowing for such a condition is acceptable for voluntary bids but not for mandatory bids, precisely because a bidder, who is under an obligation to launch a mandatory bid, could incorporate an element that makes it highly improbable that his bid would be successful.

As a corollary, in the case of a mandatory bid, it does not make sense to say that the bid is successful or not. The mandatory bid is not a mechanism that cuts in favor of the bidder but instead in favor of the existing shareholders. In the case of a mandatory bid, we should not talk about successful bids from the perspective of a bidder but instead from the that of the shareholders. From that advantage point, a mandatory bid is successful if all target shareholders have the possibility to tender their shares, regardless of whether or not other target shareholders do in fact tender their shares.

**WATANABE:** The AMF and the French academics said things similar to what you have been saying.

**MÜLBERT:** That is indeed very encouraging to hear.

4. Shareholder decision-making and worker protection

**WATANABE:** Next, I have a question about the distinction between shareholder decision-making and worker protection. In European countries there exists a distinction between shareholder decision-making and worker protection in cases of takeover. Is that right?

**MÜLBERT:** Yes. This is very much correct.

**WATANABE:** So, I’d like to ask you my next question on shareholder decision-making, workers’ influence in takeover bids, and statements by the board of auditors of the target company.

According to our research in Germany, a surprising balance is maintained regarding the takeover rule. Workers’ influence is strong in Germany, which has laws like the codetermination law. Adoption of
defensive measures based on the approval of the general shareholder meeting or the consent of auditors as stipulated in German takeover law seems to be very strong measures against takeovers.

But in practice, these defensive measures against takeovers bids are rarely taken, and the outcome of a takeover bid is ultimately left up to the judgment of the shareholders. If the offer price is high, the takeover bid is basically successful. But due to potent worker protection, it is difficult to run the company without workers’ cooperation even if a takeover bid is successful.

As a result, there are few hostile takeover bids and so far, all cases that have started as hostile takeover bids ended up turning into friendly takeover bids.

So Germany keeps a balance by having potent worker protection as a cushion against shareholder decision-making in the case of takeover bid.

This is my understanding. Please comment on it.

MÜLBERT: First of all, your understanding is correct. You will find writings, for example by my academic teacher Professor Klaus J. Hopt, dating back to the early 1990s arguing that codetermination at the level of the supervisory board is the most effective anti-takeover device that exists in Germany. For example, U.S. companies are said to be reluctant to make a tender offer for German companies that are subject to codetermination, and in particular for those that are subject to the extensive codetermination mandated by the Codetermination Act of 1976 (Gesetz über die Mitbestimmung der Arbeitnehmer – MitbestG, 1976).

In reality, the situation is much more complicated. Codetermination at the level of the supervisory board will only deter some bidders.

One type of bidder, sometimes called a “corporate raider,” is more interested in breaking up the company and selling off the various parts. His strategy can be summarized as follows: “The stock market undervalues the company since the market share price is lower than the intrinsic value of the shares. We would realize a profit if we acquired the company and sold off the various parts of the company to various interested parties.”

Such a bidder might be deterred by codetermination since he would face difficulties at the level of the supervisory board; worker representatives would strongly oppose such plans.

In contrast, a bidder who is interested in the company because of its business and its future prospects will not be deterred by codetermination. He might even speculate that codetermination induces a higher level of commitment in the workers and, hence, will benefit him in making the company even more profitable. At any rate, such a bidder will not be deterred by codetermination.

In all, the deterrent effect of codetermination depends crucially on the bidder’s preferences and intent. Bidders who are known to have difficulties in their relationship with labor will be more reluctant to bid for a company subject to codetermination. In contrast, bidders who have working relationships with their employees will not be deterred by codetermination.

The deterrence effect may work most strongly with respect to potential U.S. bidders. On the other hand, the U.S. is the largest investor in Germany. Therefore, even from the U.S. perspective, the level of deterrence should not be overestimated.

In addition, the deterrent effects of codetermination are less important in takeover situations. If, for example, a German company and a U.S. company were considering setting up a joint venture, they may wish to avoid codetermination and may well set up the joint venture outside of Germany.
WATANABE: The situation you explained is very interesting and puzzling for the Japanese. On the one hand, you have a codetermination law and strong worker protection, and on the other hand, there is the consensus that it is the shareholders that make the final decision. It is very puzzling and interesting for the Japanese.

When Japanese lawyers first heard about this, they could not believe it.

MÜLBERT: Indeed, codetermination presents a fundamental problem for traditional concepts of corporate law, namely how to reconcile codetermination with the corporate form as a legal entity established by shareholders.

This problem relates to the notion of the interest of the enterprise as a goal. Most German commentators agree with the idea that both the management board and the supervisory board are under the obligation to pursue the interests of the enterprise, not the interests of the company in the sense of the interests of all shareholders.

One of the reasons given is the sheer existence of codetermination at the level of the supervisory board. Because of this feature, the argument goes, both the supervisory board and the management board should not only pursue the interests of the company but a broader set of stakeholder interests.

However, this proposition is supported by neither existing statutory law nor jurisprudence. In particular, no provision of German law explicitly provides that the board has a duty to pursue the interests of the enterprise and not the interests of the company.

WATANABE: Do you mean so-called “Unternehmensinteresse” by that?

MÜLBERT: Yes. The presence of employees on the supervisory board does not imply that the board’s duties differ according to whether the board is subject to codetermination or not. To the contrary, according to the Bundesgerichtshof and most commentators, labor representatives and shareholder representatives are under the same duties and are held to uniform standards. In this respect, no differences exist between the two classes of supervisory boards’ members.

Regarding the substantive rules for running the company, the rules established by the Takeover Act clearly show that the board has to pursue the interests of the shareholders, not of the employees. Labor representation on the supervisory board only allows employees to make themselves heard at the top level but does not require the board to incorporate their interests in its decision-making or even to take positions in their interests.

Still, employees can make themselves heard at the top level and because of that, they will be able to influence the decisions taken by the supervisory board with respect to the long-term interests of the company. Even if the (supervisory) board is not required by law to incorporate workers’ interests in its decision-making, it will very often do that since, in the long run at least, it would indeed be difficult to run a company by disregarding the workers’ interests.

Against this backdrop, in takeover situations the supervisory board has to consider primarily whether the offer price is fair or not. Put more generally, the board has primarily take the interests of existing shareholders into account. The interests of the employees come only second.

WATANABE: Even so, why is the validity of the offer price the main topic in the statement made by the supervisory board of the target company in Germany where workers’ influence is so strong?

As you said, the shareholders come first, then the employees second.

MÜLBERT: In practice, employees occupy an important and strong position. Sitting on the supervisory board...
board makes it even easier for them to make themselves heard. However, at the end of the day, a supervisory board can take decisions even if all the labor representatives disagree. Even under the codetermination regime introduced by the Codetermination Act 1976, the ultimate decision-making power rests with the shareholder representatives.

WATANABE: Do you mean that it is ultimately decided by the chairman’s voting?

MÜLBERT: Yes, exactly, by virtue of the chairman’s second vote. To be more precise, if the supervisory board takes a tie vote, the chairman is allowed to cast a second vote to break the tie.

However, despite the chairman’s tie-breaking second vote, in procedural terms, workers have a very strong position, and the procedural rules allow them to make themselves heard very clearly. This is because the chairman can cast a second vote not at once, i.e., not immediately following the tie vote but only at a subsequent meeting of the supervisory and only if the board arrives at a tie vote a second time. Moreover, the supervisory board’s second meeting must be held at least one month after the first meeting, at the earliest.

Still, at the end of the day, if the owners decide to disregard workers’ interest, the owners will have their way. As a corollary, the supervisory board can disregard workers’ interests in taking decisions even if that may not benefit the company in the long term. As an extension, the target boards’ statement regarding the offer will primarily focus on the bid price, and whether the bidder offers adequate compensation, in particular.

WATANABE: It seems convincing.

MÜLBERT: In practice, shareholder representatives will very rarely make use of the chairman’s tie-breaking second vote. First, this mechanism entails a delay in decision-taking by one month, at a minimum. Second, and probably more importantly, the working-relationship between shareholder and labor representatives would be negatively affected by the controversies preceding and following such a decision. As a result, not because of any substantive rules, but because of the procedural rules for decisions taken at the level of supervisory board, employees have some substantial bargaining power vis-à-vis their company.

WATANABE: It’s all very tactical.

MÜLBERT: Indeed it is.

WATANABE: Are such tactics very important?

MÜLBERT: Yes. German supervisory boards of companies that are subject to the Codetermination Act of 1976 work like that, in essence. Labor representatives because of their strong position in procedural terms, will be able to strike bargains with management and with the owners. There are not many cases, and even fewer cases that were publicly reported in the press in which the chairman of the supervisory board had to resort to casting a second vote.

As a corollary, the effects of minority shareholder representation on the supervisory boards depend on whether the company is subject to codetermination or not. Codetermination substantially strengthens a minority shareholder’s bargaining position vis-à-vis the majority. Again, this follows from procedural rules. For the chairman to cast his tie-breaking second vote presupposes two tie votes in two subsequent meetings. If all labor representatives attend the meetings, all shareholder representatives must also attend both meetings and cast their votes in order to reach a tie. If just one shareholder representative were to abstain from voting or even from attending the meeting, then there would be not tie
vote, but a majority vote by labor representatives. Because of this threat, minority shareholders represented on the supervisory board will be in a position to negotiate deals with the majority shareholders by threatening to vote alongside labor or at least to abstain from voting, thus handing the majority to labor.

In fact, such a situation recently occurred at Volkswagen. According to press reports, Ferdinand Piëch was dissatisfied with the way his cousins were behaving as shareholders and board members of Porsche and Volkswagen. To make his point, he failed to attend a meeting of the VW supervisory board, and the labor representatives being in the majority made use of that opportunity.

In a nutshell, these procedural rules open up the possibility for all kinds of deals and bargains among and between the various stakeholder groups, most notably between shareholders and workers.

WATANABE: The situation is very interesting. It may even be a very surprising story for many Japanese lawyers who have studied German law.

MÜLBERT: Yes. I can understand that.

5. “Unternehmensinteresse” and “corporate value”

WATANABE: You referred to the notion of the interest of the enterprise (Unternehmensinteresse) and brought up the concept of defensive measures. In the UK, where the institutional investors have a huge amount of influence, most shareholders are opposed to 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 the enterprise and is regarded as grounds for raising the issue of the responsibility of the directors.

I would like to confirm this. Is it actually regarded as grounds for raising the issue of the responsibility of the directors in Germany? Is it seen as that problematic?

MÜLBERT: So far, case law does not exist. However, whenever a bidder launches an unsolicited or unfriendly bid, lawyers from different law firms will advise the target and the supervisory board on the defensive measures permitted by the Takeover Act and the Stock Corporation Act as well as the liability risks board members face when taking or authorizing defensive measures. Moreover, a lot of academic work discusses whether and to what extend defensive measures are permitted by German law, whereas the implications for board member liability is much less discussed.

WATANABE: So there is a potential threat in raising the possibility.

MÜLBERT: It’s a potential threat, yes.

WATANABE: A strong potential or weak?

And I’ll continue: In relation to the concept of interest of the enterprise, there is no specific criterion as to what would or would not actually be in the interest of the enterprise in the midst of a takeover. This concept has the same problem as that involved in the concept of corporate value in Japanese law.

MÜLBERT: I’m afraid I do not know much about the Japanese discussion.

WATANABE: On corporate value, yes. The concept of corporate value is very influential in Japan. It divides takeovers into good takeovers and bad takeovers, the criterion being corporate value, i.e., whether the corporate value is raised or diminished.

MÜLBERT: This seems to be an interesting approach. The idea of discriminating between value-enhancing takeovers and other takeovers is more ambitious than the German approach, regardless of whether
you compare it to the interest of the enterprise approach or the interest of the company approach.

Building on the notion of the interest of the enterprise, we cannot determine whether a takeover is in the interest of the enterprise or not. All we can say is that there are takeovers that are clearly not in the interest of the company and of the enterprise, respectively. Examples given in academic literature are, for example, a takeover bid launched by a criminal organization, e.g., if the Italian mafia tried to invest in Germany—things like that, pretty outrageous situations.

As a corollary, defensive measures against a takeover are only admissible if the takeover is clearly not in the interest of the company. Apart from more outrageous scenarios such as the acquirer being a criminal organization, some of the most intriguing situations involve bidders from the hedge fund and/or private equity industry. Are defensive measures admissible if such a bidder plans to burden the company with additional debt? What if the bidder plans to use the target’s assets to pay back the loans taken out to finance the takeover? Finally, what if, because of limited operational resources, a bidder were not able to effectively manage the company unless the incumbent management were to stay with the company? Yet, situations like these have not been extensively discussed so far.

Even the notion of corporate value, i.e., whether a takeover will increase or decrease the value of the company does not provide a clear guideline. At least in theory, increasing a company’s leverage can increase a company’s profitability. In addition, such financing structures may well enhance social welfare by making value-enhancing takeovers possible that otherwise, without the bidder’s access to the target’s assets, would not be possible.

WATANABE: I suppose such concepts are good for explanation, but only in retrospect.

MÜLBERT: Yes, indeed. For example, the question of whether the takeover is value-enhancing or not will probably depend, among other things, on whether the incumbent management team stays with the company or whether most of the managers leave. The second scenario would probably be a value-destroying one, since the company would lose costly human resources.

However, whether most of the management team will leave or not will hardly be known at the time of the takeover bid, but only in retrospect. On a more theoretical level, numerous empirical studies have shown that more than 50% of all transactions – and this holds true not only for public takeovers but also for other acquisitions and mergers - will not be successful in the long term.

The companies know that. The consultants know that. The lawyers know that. We all know that fact. And still, many companies are trying to expand by acquiring other companies, even though the success rate is below 50%.

So why is everybody trying? Because it is incredibly hard to determine at the outset whether a transaction will be successful in the long run or not. Every bidder is convinced that he will turn the acquisition or the merger into a success story even though, with hindsight, he will see that he made any number of mistakes during the integration process.

WATANABE: If such a concept of the interest of the enterprise in the context of takeovers, just . . .

MÜLBERT: That line of argument has never been invoked in the German discussion to justify defensive measures as being in the interest of the company.

WATANABE: There are no actual cases. So, what the responsibilities of the target company are remain purely theoretical?

MÜLBERT: We discussed a target management’s responsibility extensively even before the enactment of
the Takeover Act. And, as I said, the examples give then (in the 1990s) as to scenarios in which manage-
ment would be allowed to take defensive measures with a view to the interest of the company involved
situations like the bidder being a criminal organization, and similar situations.

**WATANABE:** If so, why would they take such defensive measures in Germany? I suppose it is linked to
the concept of interest of the enterprise.

**MÜLBERT:** This probably depends on what the lawyers tell the management. Take, for example, the
Schaeffler/Continental case. Continental’s lawyers may well have pointed out that Continental’s board
members could be held liable for taking defensive measures, since it was hard to see or to even argue that
protection against Schaeffler’s bid would be in the interest of Continental.

This touches on a problem that is rarely discussed, namely whether the notion of the interest of
the enterprise or the interest of the company includes the interest in being an independent company, i.e.
a company without a controlling shareholder.

If independence from a block shareholder or majority shareholder or controlling shareholder is
part of the interest of the enterprise, then taking defensive measures is obviously in the interest of the
enterprise or the company. Conversely, if independence as such is not part of the interest of the enter-
prise or of the company, then it becomes much more difficult to justify defensive measures by referring to
the interest of the enterprise or the company. For example, what could have been the interest of Conti-
nental in not being taken over by Schaeffler?

In particular, if a bidder announces that he will not substantially reduce the number of employees
or if he even guarantees that no lay-offs will occur, what would be the interest of the target that would
justify defensive measures under the heading of interest of the company? If independence from a large
shareholder is not a part of the interest of the enterprise or of the company - and the majority of German
commentators would probably say that being independent is not - it becomes difficult to justify defensive
measures. Then the fact of being taken over by another company in and of itself is not enough. This is why
German commentators in the 1990s referred to situations like being taken over by a criminal organization,
etc.

I hope I answered your question.

**WATANABE:** I understand now. Thank you.

6. Equity derivatives and “hidden ownership”

**WATANABE:** I’d like to move on to the next question about hidden ownership acquired through the use
of equity derivatives.

Recently, the UK, Switzerland, and France have taken actions to tackle this problem by imposing
general regulations on acquisitions of hidden ownership through the use of equity derivatives, rather than
stipulating a specific definition of this manner of shareholding.

This regulatory policy adopted by these countries is a very good example for Japan of an effort to
avoid the cycle of revision and evasion of rules.

And why is it difficult to regulate equity derivatives in the context of takeover in Germany? To my
understanding, up until now it is has been very hard to regulate.

If so, is it a result of the strong influence of the banking system?
MÜLBERT: No, I don't think so. Banks will find themselves on both sides of such transactions. Hence, they are probably rather neutral in the sense that they do not favor one type of regulation for derivatives over another.

Besides, the situation in Germany is also changing. Some large companies wrote to the Ministry of Finance (10 or 12 DAX30 companies, I think) and requested that the Securities Trading Act (Wertpapierhandelsgesetz – WpHG be amended by introducing increased disclosure obligations regarding equity derivatives. The Ministry of Finance is now preparing such a bill.1

The fundamental problem in this context is to distinguish between efficient and inefficient uses of derivatives. However, it is inherently difficult to draw the appropriate line.

At a more practical level, for the past, the German legislature avoids the use of sweeping clauses. Instead, precisely-worded rules enable market participants to know for sure, or at least with reasonable certainty, whether they are under an obligation to disclose share holdings and equity-related derivative position, and whether there are under the obligation to launch a bid or not. The downside of this preference for precisely worded rules is that such rules are much easier to evade than a sweeping clause and give rise to the problem of evasion of laws.

In addition, the German legislature has so far avoided an FSA-like empowering of Germany's financial markets supervisory authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin). Arguably, such a broad empowerment of an agency would be prohibited by principles of German constitutional law.

Coming back to regulating the disclosure of derivatives, practical experience seems to indicate that there is only one way to avoid this spiral of revision and evasion of rules: to use a sweeping clause or to complement some precisely-worded rules by a catch-all clause. This is the line of thinking now favored by the Ministry of Finance and also by some academics. In fact, a couple of months ago, Professor Uwe H. Schneider (my co-director here at the Institute) wrote an article favoring a sweeping clause. His article was inspired by a provision in our tax code.

Admittedly, this approach is fraught with some problems; in particular, if a violation is punished by a fine, German constitutional law requires that the rule itself be reasonably specific.

WATANABE: The principle of criminal law.

MÜLBERT: Yes. The combination of a sweeping clause and criminal sanctions raises the question of whether such a regulatory system is unconstitutional and whether the legislature should provide for different sanctions.

WATANABE: There has been a similar situation in Japan.

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7. The regulatory philosophy of the BaFin and UK-style takeover regulation

WATANABE: I'd like to move on to the next question about the regulatory philosophy of BaFin. In Germany, BaFin is in charge of takeover regulations under statutory law, and the regulatory staff finds problems with their limited discretion in legal construction, according to our research last year.

Those engaged in regulatory activities have the widespread idea that they cannot take adequate measure unless necessary legislation is put in place, in order to apply the disclosure regulations to hidden ownership by equity derivatives or to have a bidder who offers an inappropriate price to compensate the
shareholders of the target company.

And if consultation-based takeover regulations are possible, there will be almost no unintentional violation of the takeover rules; 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 would be good or bad? The Japanese FSA (Financial Service Agency) also has such a problem.

MÜLBERT: It seems to me that this is really a two-part question, since, to my understanding, the problem with the first part is that indeed the BaFin would find it difficult to do so, for the simple reason that the BaFin needs a statutory basis for intervening. This is related to the general idea under German constitutional law that a statutory basis is needed for any action of a German administrative authority that impinges on a private person's - and this also includes companies - freedom. You need a statutory basis if you take any action that prohibits some action by citizens or companies.

Their complaint, then, is that either the legislative basis is either worded too narrowly, or that they are bound by the law. I don't know if they complain or just state it as fact. At any rate, they point out that because the way the law is written, they cannot apply the statutory rules to some situations. And they cannot make use of analogies in applying the law to new situations, because they are bound by fundamental principles of the administrative law and even of constitutional law.

This problem also relates to the use of sweeping clauses in takeover law and financial markets law, in general. Given the background of our administrative law and constitutional law, it is difficult, at best to empower the BaFin to take a decision in a particular case without providing any clear legislative guidance.

WATANABE: Even in the UK there are not only catch-all clauses but also specific reasonable exceptions, for example, about equity derivatives.

MÜLBERT: Yes, okay, you refer to the safe-harbor provisions. However, the sheer idea of safe-harbor provisions is somewhat alien to the German understanding of how the law should operate.

German administrative law operates on the principle of “Everything is admissible if not prohibited by law”. Starting from there, there is no need for safe-harbor rules, since the law itself defines which behaviors and actions are prohibited. The BaFin only has to apply the rules and to enforce the prohibitions, but, with one exception, is not empowered to define behaviors that per se will not violate provisions of the Takeover or other statutes.

Constitutional law principles even prevent the German legislature from enacting non-specific rules along the following lines “Well, there are a huge number of possible actions, and we don't say which actions are forbidden by law, just that you have this type of action that is clearly not prohibited. But we don't tell you with respect to the rest. We don't tell you whether that's admissible or not. That's basically up to the BaFin or the courts to decide whether or not that is admissible.”

Statutory provisions have to specify as clearly as possible what is prohibited, thereby providing legal certainty for market participants. From their perspective, the law tells them the following “There is a well-defined regulatory framework in place that you have to follow. By taking a close look at these rules, and by asking for advice from lawyers, you will know the actions and behaviors that are forbidden. If an
activity is not covered by these rules, you are okay.”

The upshot is, that the UK safe-harbor approach, on a very fundamental level, is rather the opposite of the German approach.

WATANABE: But, as you know, whatever detailed rules we make, there remain many uncertainties inevitably.

MÜLBERT: For sure, but we would still say that there is less uncertainty and less discretion on the part of the BaFin.

WATANABE: But it’s not perfect.

MÜLBERT: No. We all agree that it’s not perfect. But still, when I talk to practitioners who also are familiar with the UK, they would clearly prefer the German system to the UK system, because according to them, taking a look at the statutes and implementing rules does not help you much “You are basically at the mercy of the UK Takeover Panel and the FSA, respectively”.

A related concern was voiced strongly by a friend of mine, “In the UK, you have no chance in understanding the legal situation by reading the legal materials. You need a specialized lawyer to guide you through this maze of rules. And you simply cannot predict with any degree of certainty what will be the outcome in individual cases by simply reading published materials, whereas in German you will get a good idea of the legal situation by reading a couple of legal commentaries.”

WATANABE: I suppose it may be good only if the claimant who is dissatisfied with a petition of the regulator can go to court.

MÜLBERT: Why would that be?

WATANABE: If the route of going to court is assured, the German approach and UK approach are not opposite, I suppose.

It’s less clear, and less uncertain, but there is much uncertainty.

MÜLBERT: Okay, we do not manage to avoid all uncertainties. Indeed, there is inevitably uncertainty as to the interpretation of the law. And lawyers will always test the uncertainties.

WATANABE: I think what is important is the right of the claimant to go to court.

MÜLBERT: Even under the German system, there are hardly any lawsuits. You just do not go to court if you are dissatisfied with a BaFin decision. Most participants in the financial markets are repeat players. That is to say, banks have to deal with the BaFin all the time, particularly since the BaFin is also the banking supervisor. Because of that, they discuss with the BaFin, but they would not go to court with their supervisor.

WATANABE: If so, to my understanding, the BaFin is exercising substantial judicial power.

MÜLBERT: In practical effect, yes. The BaFin’s interpretation of the rules of the Takeover Act, and also of the Securities Trading Act (Wertpapierhandelsgesetz – WpHG), are of immense practical importance. If the BaFin favors a different reading of the law, in most cases you would try to persuade them to adopt your understanding but if you cannot convince them, then you will probably proceed on the basis of BaFin’s interpretation, in particular if you asked the BaFin to approve, e.g., a tender offer document or a securities prospectus. So indeed, the BaFin is powerful.

On the other hand, the BaFin is powerful only insofar as the pertinent provisions and rules leave some room for diverging interpretations. From that perspective, the BaFin is much less powerful than the Takeover Panel and the FSA, because the provisions and rules are more specific, more precisely-word-
ed.

**WATANABE:** I suppose recently the rules in the UK have become rather detailed, more specific. So the difference is whether or not we use the principle-based rules in the last place. In Germany, no, as in Japan. In the UK, yes. It’s a big problem. The Japanese situation is similar to that in Germany.

**MÜLBERT:** Indeed, the national traditions with respect to administrative law are rather different and, in particular, the English tradition is a very different one.

In addition, as a more general observation, the number of lawsuits in the UK is lower than in Germany. To name but one reason, lawsuits are much more expensive in the UK than in Germany. More specifically, with respect to takeovers, for a long time, the UK, by setting up the Takeover Panel, tried to prevent any lawsuits regarding takeover bid and only relented somewhat because of the EU Takeover Directive.

**WATANABE:** Especially in the context of takeovers.

**MÜLBERT:** Another important factor worth mentioning is that takeover rules operate within a given framework for enforcing these rules. The substantive rules are only one part; the way you set up the supervisory agency is the other important aspect.

The way the BaFin operates is governed by the principles and rules of administrative law, more specifically by the principles and rules collectively labeled as regulatory law.

As to the second part of your question, I don’t know. This question is more for practitioners and consultants. My understanding is that BaFin is open to discussions.

**WATANABE:** Yes.

**MÜLBERT:** You can go to the BaFin and discuss with them. They will not just say “No” and “This is not admissible.” You can discuss with people from the BaFin as to their readings of the law, and you will find out what they would and would not accept.

**WATANABE:** So I suppose the BaFin’s activity in the ordinary course is very similar to that of the Takeover Panel in the UK.

**MÜLBERT:** I can’t really say. You would have to ask a lawyer who is familiar with both.

**WATANABE:** So it is consultant-based. Both are open to discussion.

**MÜLBERT:** They are open to discussion, yes, although this assessment is not based on personal experience, but on the impressions I gained from discussions with practitioners. Support comes from the fact that people from the BaFin will attend conferences, seminars, and workshops, not only as listeners, but also as speakers and lecturers, presenting the BaFin’s position and/or their own understanding. Discussions will ensue quite naturally in such a setting.

**WATANABE:** It’s similar to the activities of the Takeover Panel.

My impression after visiting the BaFin is that it is very similar to the Takeover Panel.

**MÜLBERT:** I imagine that the people working for the BaFin are not interested in being regarded as inflexible or even as outright obstructive. They see the Takeover Panel and the FSA and partly as rivals, but also as bodies which have a lot of practical experience and can serve as an example. Quite naturally, then, they want to compare favorably to the Takeover Panel and to the FSA, not be viewed negatively in comparison to these bodies.

**WATANABE:** Yes.

**MÜLBERT:** I’m afraid I can’t tell you anything more on that.
WATANABE: The issues for takeovers are very interesting, but, on the other hand, are a very difficult issue. I will study and research this topic some more, and if possible, get back to you on it.

MÜLBERT: It will be my pleasure, then. Will Japanese takeover law soon be completely overhauled?

WATANABE: The debates for the reform is very active. However, at this point there is no definite consensus. As you know well, the issue of takeovers is a very sensitive one.

MÜLBERT: That’s for sure. And I guess it will be very difficult to reach a consensus. That’s inevitable.

WATANABE: Thank you very much indeed for taking time out of your schedule today.

MÜLBERT: As always, it has been a great pleasure. Takeover law not only is a fascinating topic, but is also of great interest to me. Hence, I am always happy to talk to people from other countries on takeover issues, because it helps me enrich my understanding not only of the German takeover law but also of the understanding of takeover law at the international level, which is so very different in different countries.

So I thank you for giving me the opportunity to play a very minor role in the Japanese reform process.

WATANABE: I thank you for all your valuable advice and concerns, Professor Mülbert.