German Takeover Barriers: Myths and Realities

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Introduction

There exists a widely shared attitude among European M & A specialists that German stock corporations are virtually immune to unsolicited takeovers due to existing and allegedly substantial, if not insurmountable, legal and structural obstacles enabling their boards to fend off any unfriendly acquisitions. Coopers & Lybrand's study for the British Department of Trade and Industry (DTI), for example, identified as most effective takeover barriers: (1) the influence of the big German banks exercised through their proxy powers, stakeholdings and supervisory board seats; (2) the two-tier board system; (3) voting right limitations; (4) significant cross-shareholdings; and (5) a corporate culture discouraging the short-term profit motive which drives many of the Anglo-American hostile deals.[1] Similar conclusions, in particular regarding the role of the German banks, were drawn in Booz Allen's 'Study on obstacles to takeover bids in the European Community' which was conducted in 1989 for the European Commission.[2]

In this article the validity of the main arguments put forward for the thesis of a 'fortress Germany' will be discussed in more detail.

Voting Right Limitations

Voting right limitations, introduced by many large German corporations,[3] restrict the voting powers of single shareholders to, for instance, five per cent, regardless of the size of their stake. This forms the most obvious impediment to unwelcome bids. In addition, such clauses contained in the corporations' Articles of Association always prohibit the evasion of voting right limitation by holding parcels of five per cent each through related companies or through trustees.[4] Nevertheless, a group of non-related shareholders may work together in a takeover, even if the voting rights of the shares are subject to a pooling agreement under which one of them assumes a lead function.[5]

Such co-operation of the shareholders might, however, carry the risk that important shareholders' resolutions initiated by them, in particular a resolution on the elimination of the voting rights clause, might be attacked in court by the company's board and/or by minority shareholders, with sufficient existing evidence to support the suspicion that some members of the shareholders' group are only acting on behalf of others so that their votes have to be added together. If such an argument has some plausibility the Registrar of Companies will normally postpone the registration of the resolved change to the Articles of Association until the court has rendered a final judgment, which can take several years. As a resolution to abolish the voting rights clause – like any other amendment to the Articles – does not become effective until it is registered in the Company Register (Handelsregister), tactical litigation could severely damage any attempt by the shareholders' group to gain control, even if it holds the majority of the shares.

However, this does not make the corporation immune to an unsolicited takeover. In the light of eventual problems connected with the so-called 'concert party' approach, a would-be acquirer could instead achieve his purpose by launching a full-scale, or even a partial, bid which is made contingent on the shareholders passing a resolution on the elimination of the voting rights clause.[6] If the bidder has already acquired five per cent of the share capital he would himself be entitled to demand the calling of an Extraordinary General Meeting (EGM) for such a purpose.[7] In connection with the regular Annual General Meeting (AGM), shares in the nominal amount of DM 1 million would be sufficient to entitle him to put such a motion to the vote of the shareholders.[8]

Little doubt remains that the shareholders would vote in favour of such a change in the Articles of Association if the bidder offers them an attractive premium on the share price. The proxy powers of the banks could not be exercised against such a resolution (see below). Further, tactical litigation initiated in order to delay the registration of the change to the Articles of Association could

1 Department of Trade and Industry (ed.), *Barriers to Takeovers in the European Community. A study by Coopers & Lybrand for the DTI* (1989), vol. 1 at page 23 onward, vol. 2 at pages 1 to 43.
2 Commission of the European Communities, *Study on Obstacles to Takeover Bids in the European Community* (1989), at pages 29, 52.
3 Section 134 paragraph 1 sentence 2 of the German Stock Corporation Law (Aktiengesetz 'AktG') provides that the Articles of Association of a stock corporation may restrict the voting power of single shareholders to a certain maximum percentage of the outstanding share capital (for example five per cent or ten per cent) regardless of the size of his stake.

4 For a calculation of the number of shares actually held by the shareholder, the Articles may provide that shares of related companies or shares held by third parties on his account or on account of companies related to him have to be added together. See section 134 paragraph 1 sentences 3 and 4 of the AktG.
5 See, for example, Lutter/Schneider, Zeitschrift für Gesellschaftsrecht, 1975, at page 194; Overrath, *Die Stimmrechtsbindung*, 1973, at page 43 onward; Baums, Die Aktiengesellschaft 1990, at page 225; Otto, Der Betrieb-Supplement No. 12/1988, at page 7; more restrictive: U. H. Schneider, Die Aktiengesellschaft 1990, at page 59 onward.
6 See Otto, *Financial Times*, 20 February 1991, at page 15.
7 See section 122 paragraph 1 of the AktG.
8 See section 122 paragraph 2 of the AktG.

hardly succeed. In the absence of any co-operation whatsoever between the bidder and other important shareholders no plausible argument can be put forward that such other shareholders are acting on behalf of the bidder and that their votes could therefore not be counted to the extent that their votes and the bidder's together exceed five per cent. In such a situation the mere fact of an apparently arbitrary action for annulment of the shareholders' resolution would not stand in the way of the registration of the changed clause of the corporation's Articles of Association.

Vinkulierung

To the extent that the outstanding stock of a corporation consists of nominative shares, that is to say shares which are registered in the stock ledger of the corporation stating the holder by name, domicile and profession, the Articles of Association may make the transfer dependent on the consent of the association.[9] Usually the granting or refusing of such consent falls within the competence of the board of management and can be exercised at its discretion. The existence of such provisions in the Articles of Association is known as 'Vinkulierung'.

The Vinkulierung of nominative shares is the 'classical' defence measure the Aktiengesetz ('AktG' – the German Stock Corporation Law) provides for corporations against unwelcome new shareholders. Respective clauses may either be contained in the original charter or – in the case of a later amendment – require the consent of each single shareholder,[10] which is practically impossible in the case of a publicly quoted company. Although the large German corporations have therefore only very rarely made use of such a possibility to restrict the transfer of their shares, the Vinkulierung is still an important anti-takeover measure insofar as – for historical reasons – nearly all German insurance corporations have issued nominative shares (instead of the normal bearer shares) the transfer of which is subject to Vinkulierung provisions.[11]

A would-be acquirer who cannot expect the board to grant the required consent for him to be registered as a shareholder might try to enter into agreements with registered shareholders under which they on the one hand sell their economic interests connected with the shares to him and are on the other hand obliged to exercise their shareholder rights, in particular their voting rights, according to his instructions. Such arrangements would, however, constitute an unlawful evasion of the Vinkulierung provision and could therefore not create legally binding obligations of the registered shareholders *vis-à-vis* 'the acquirer'.[12] Nevertheless, if the registered shareholders exercise their voting rights in favour of the 'acquirer's' intentions in spite of not being obliged to do so, there are good arguments that the votes cast by them cannot be judged to be invalid and would thus have to be counted in a shareholders' meeting.[13] Irrespective of this legal situation the board would be confronted with the difficulty of proving the existence of any allegedly unlawful agreements.

Finally, not unlike the case of voting right limitations, the takeover defence of a Vinkulierung can be overcome by way of shareholder democracy. Motivated by an attractive takeover bid which is conditional on the elimination of the Vinkulierung provisions in the corporation's Articles of Association, the shareholders might pass a resolution making the way free for the bidder to acquire a majority of the outstanding stock without any board consent requirements.

Majority Requirements for Changes to the Articles of Association

As a rule, changes to the Articles of Association, in particular an eventual elimination of clauses stipulating a Vinkulierung or a voting right limitation, require at least a majority of 75 per cent of the share capital which is represented in the shareholders' meeting and simultaneously a simple majority of the votes present (in other words 50 per cent plus one vote).[14] An existing voting right limitation is relevant only for the calculation of the votes present, not for the determination of the share capital present.

The 75 per cent requirement regarding the present share capital is, however, of a dispositive nature. Pursuant to section 179 paragraph 2 sentence 2 of the AktG, the Articles of Association may stipulate another majority. Most large German stock corporations have made use of this possibility and allowed a simple majority of the present share capital to be sufficient. Therefore a change to the Articles of Association – except for a change in the purpose of the enterprise – normally requires only a simple majority of the votes present and of the share capital present as well.

This does not, however, mean that a bidder would in fact need 51 per cent of the outstanding stock to eliminate a Vinkulierung or a voting right limitation. In view of the usually low quote of the share capital represented in shareholders' meetings of corporations with widespread shareholdings (normally between 40 per cent and 60 per cent) a substantially lower percentage would be sufficient. Even bearing in mind that in a bid situation the presence in the shareholders' meeting would probably be higher, a quota of 35 per cent of the outstanding stock should be sufficient in most cases. A bidder who has already acquired five per cent of the stock would therefore need only about 30 per cent of the votes of the other shareholders for a resolution on the elimination of a voting right clause. In combination with a public bid which offers an attractive premium on the share price to the other shareholders, such support seems more than realistic.

9 See sections 67 paragraph 1 and 68 paragraph 2 of the AktG.

10 See section 180 paragraph 2 of the AktG.

11 See, for example, Otto, Note 5 above, at page 6.

12 See Lutter/Grunewald, Die Aktiengesellschaft 1989, at page 112; Hefermehl/Bungeroth in: Geßler, Hefermehl, Eckardt, Kropff, Die Aktiengesellschaft 1983, section 68 note 72.

13 See Overrath, Note 5 above, at page 51; Otto, Note 5 above, at page 6; this is disputed, however, by Lutter/Grunewald, Note 12 above, at page 114.

14 See section 179 paragraph 2 and 133 paragraph 1 of the AktG.

In the light of these relatively low requirements for changes to the Articles of Association, such as the elimination of a Vinkulierung or a voting right clause, the common belief that such clauses constiture a severe takeover barrier seems hardly justified. In essence, such clauses simply put the success of the takeover to the vote of the shareholders' meeting. As long as Germany has not adopted Article 4 of the European Commission's Proposal for a 13th Directive regarding takeover bids under which an acquirer of more than 33 per cent of a corporation's stock is obliged to make an offer to all shareholders, the clause even serves the interest of the shareholders to benefit equally from the premium the bidder is prepared to pay for gaining control.

Bid Requirements: Possibility of Partial Bids

As already mentioned above, unlike British or French law, there exists no obligation under German law to make a share purchase offer to all shareholders irrespective of how many shares a person has already acquired. The only exceptions to this rule are the conclusion of a so-called domination and/or profit transfer agreement with a subsidiary[15] (majority requirement: at least 50 per cent plus one share) and the so-called integration of the subsidiary into the parent company (majority requirement: at least 95 per cent).[16] Thus, in order to acquire such quota of the outstanding stock as is required for eliminating a voting right limitation or Vinkulierung clause (see above, 'Majority Requirements') and gaining control over the management (see below) the bidder may make only a partial bid and thereby keep his financial exposure relatively low.

Up to now, there have not been any unsolicired public takeover bids in Germany nor does any special legal framework for such bids exist. In 1979 a German Stock Exchange Committee of Experts promulgated some recommendations regarding procedural rules for public bids.[17] Compliance with these guidelines is voluntary.

Nevertheless, the terms and conditions of a public offer should take due account of the typical interest of the target shareholders with respect to, for instance, equal treatment of all acceptances in the case of a subsequent improvement of the offer, pro rata allocation in the case of oversubscription of a partial bid, adequate withdrawal rights of the shareholders in the case of a competing bid or a material prolongation of the acceptance period and so on.[18] In addition, an offeror would have to consider the fact that a public bid would be subject to the German Law on General Business Terms and Conditions.[19] Finally, the special interest of the bidder to protect himself against any risks resulting from eventual defensive measures of the target's board, a possible competing bid, consent requirements under cartel law, litigation, a material adverse change and any other events endangering the success of the bid would, of course, have to be duly taken care of in the offer document. All these requirements, although important enough, do not, however, create more difficulties for a bidder than is the case in other countries like the United States or the United Kingdom where unsolicited bids are more common.

The launching of a bid is even facilitated by the fact that all German depository banks are legally obliged to send all offer documents to their shareholder-depositors, so that a bidder should normally have no problem in notifying the overwhelming majority of the target shareholders, in particular the small private shareholders, of his offer. All German banks have stipulated in their (identical) General Terms and Condirions that their obligation to notify their depositors is dependent on the publication of the bid in a special gazette.[20] As the bidder can easily comply with this requirement, the alleged takeover barrier in the form of a lack of access to shareholders (through use of bearer shares and non-existence of a share register) mentioned in Coopers & Lybrand's study[21] is of virtually no concern to a bidder in Germany.

Influence of the German Banks as a Takeover Barrier?

Perhaps the greates mystique, in particular abroad, surrounds the alleged powers of the big German banks, which are believed to be capable of fending off any unwelcome takeover bid for a German blue chip corporation. Yet German banks are normally not important stakeholders. The sizeable stake of Deutsche Bank in Daimler Benz is an exception to the rule thus far. In particular, if the target company has inrroduced a voting right limitation clause in its Articles, the incentive for banks to purchase a stake exceeding the voting limit set by such clause is, of course, very low.

The influence which is indeed exerted on 'corporate Germany' through the big German banks does not stem from stakeholdings but from supervisory board seats and, in particular, from the proxy votes exercised in their function as deposirories of shareholders holding their shares in bank deposits. Pursuant to section 135 of the AktG a depository bank may exercise voting rights for bearer shares deposited with it if it is so authorised by the shareholder-depositor in writing. Such general authorisation is normally granted by signing a form which the

15 See section 291 onward of the AktG.

16 See section 320 of the AktG.

17 'Leitsätze der Börsensachverständigenkommission', *BMF-Finanznachrichten* of 31 January 1979, at pages 1 to 8.

18 See, for instance, Assmann/Bozenhard, in: Assmann/Basaldua/Bozenhard/Peltzer, 'Übernahmeangebote', ZGR-Sonderheft 9, 1990, at page 1 onward; Grunewald, WM 1989, at page 1235; Otto, *Op. cit.*, at page 5.

19 See Assmann/Bozenhard, Note 18 above, at page 83 onward.

20 See No. 39 of the German banks' 'General Terms and Conditions' (Banken-AGB) under which the depository banks are obliged to inform their depositors if the offer is published in the 'Wertpapiermitteilungen (III)'.

21 *Op. cit.*, vol. 1, at page 24; nevertheless, it is true that ascertaining ownership structures before making the bid involves some difficulties in the case of bearer shares being issued. These difficulties result from the fact that pursuant to section 20 of the AktG only share acquisitions of more than 25 per cent of the outstanding stock have to be disclosed.

banks send annually to the depositors. Under such power of attorney, which expires after 15 months at the latest,[22] the bank may exercise voting rights for bearer shares without disclosing the name of the shareholder in the meeting.[23] Most important is that section 135 paragraph 5 authorises the bank to exercise voting rights in accordance with its own proposals communicated in advance to the shareholder-depositors unless the latter instruct the bank otherwise. As most shareholders do not give any directions to the bank for exercising voting rights, the depository banks can nearly always vote the shares according to their own proposals. In the light of this situation in law and fact it is certainly correct to state that the German proxy system entrusts the banks with a far-reaching influence in the decision-making process of the large German corporations. This influence is exercised in particular with respect to the election of supervisory board members who in turn have exclusive authority for the appointment and replacement of the management.

However, it appears to be highly questionable whether the proxy powers of German banks described above put them in a position to fend off a takeover attempt. In a bid situation where the usually dormant shareholders are roused by the chance to make a substantial and, moreover, tax-free capital gain by accepting the bidder's offer, the banks' influence connected with their proxy powers would wane significantly. If the bid is made contingent on the passing of certain shareholders' resolutions as, for instance, the elimination of Vinkulierung or voting right clauses, special instructions to the banks by the shareholder-depositors could be expected. Moreover, as a consequence of their contractual obligations *vis-à-vis* their depositors, and following from section 128 paragraph 2 sentence 2 of the AktG under which the banks are obliged to exercise proxy votes in the shareholders' interest, the depository banks would even in the absence of special instructions be obliged to exercise the voting rights in favour of shareholders' resolutions removing statutory obstacles which would otherwise inhibit a favourable share sale by the depositors to the bidder.

Two-tier Board System

Coopers & Lybrand's study, reflecting a widespread belief, identified as one major and 'particularly frustrating'[24] takeover barrier the German two-tier board system under which only the members of the supervisory board (not the members of the board of management) are elected and replaced by the shareholders. Appointment and replacement of the managers falls within the exclusive competence of the supervisory board. The conclusions drawn in Coopers & Lybrand's study are the following:

> Removal of the members of the supervisory board requires a majority of 75% of the shareholders which is essentially the level at which effective control is obtained.
>
> Removal of the board of management can only be achieved for just cause or after expiry of the term of office, which can be up to five years. As a result effective management control can be delayed until the expiry of the term of office of the board of managing directors even when 100% of the shares have been acquired.[25]

This description of the legal situation and, even more, the conclusions drawn from it, are grossly erroneous. The reality is as follows.

The 75 per cent requirement provided by section 103 paragraph 1 of the AktG for a shareholder resolution regarding a removal of supervisory board members is – like the majority requirements for a change to the Articles of Association – of a merely optional nature and has been reduced to simple majority by nearly all publicly quoted corporations with widespread shareholdings. The reason is to avoid a situation in which a minority shareholder could exert too much influence by acquiring a blocking minority of 25 per cent of the shares represented in the shareholders' meeting (in other words, in the light of a low presence in German shareholders' meetings, a quota of about 10 to 15 per cent of the outstanding stock would suffice to build up a blocking minority). Therefore, for ousting supervisory board members elected by the shareholders the same majority requirements of about 25 to 35 per cent of the outstanding stock apply as already outlined above ('Majority Requirements for Changes to the Articles of Association').

Having gained control over the supervisory board, it is normally no problem to gain management control. First, new managers could be appointed in addition to the existing board members, thereby changing the competence within the management board; second, management board members unwilling to co-operate can be replaced with immediate effect by decision of the supervisory board if the shareholders' meeting passes with simple majority a resolution on a so-called withdrawal of confidence.[26] In any case, the removal of management board members by the supervisory board becomes effective immediately and continues to be effective until its ineffectiveness has been determined by a final court judgment,[27] which, however, would take years. Management control could therefore be obtained immediately even if the removal of managers is after some years rendered illegal by a final court judgment which at that time would normally only be of importance with respect to the managers' claims for arrears of salaries.

Anti-takeover Measures Available for the Management Board in a Bid Situation

There is no room in this article for an extensive discussion of all measures a board theoretically might apply if an unwelcome bid is imminent.[28] It should be pointed out,

22 See section 135 paragraph 2 of the AktG.

23 See section 135 paragraph 4 sentence 2 of the AktG.

24 *Op. cit.*, vol. II, at page 28; vol. I, at page 23.

25 *Op. cit.*, vol. II, at page 20.

26 See section 84 paragraph 3 sentence 2 of the AktG. The only exception is that the shareholders' resolution on the withdrawal of confidence was based on apparently unreasonable arguments.

27 See section 84 paragraph 3 sentence 4 of the AktG.

28 For a detailed discussion of anti-takeover measures see: Hauschka/Roth, Die Aktiengesellschaft 1988, at page 181 onward; Otto, *Op. cit.*; Peltzer, Zeitschrift für das Kreditwesen, 1988, at page 577 onward; Werner, 'Probleme "feindlicher" Übernahmeangebote' (1989); Stoll, Der Betriebsberater, 1989, at page 301 onward; Assmann/Bozenhard, Note 18 above, at page 112 onward.

however, that the application of most of those anti-takeover devices which are, for instance, available to US corporations (like the so-called poison pills, shark repellents and so on), is virtually impossible under German law, as this would violate the principle of equal treatment of all shareholders as laid down in section 53(a) of the AktG.

A capital increase by which the pre-emptive rights of the shareholders are excluded in order to sell the new shares to a 'white knight' or a 'white squire' is judged illegal by the majority of the commentators in the legal literature[29] and would involve substantial liability risks for the management. Further, an exclusion of pre-emptive rights of the shareholders requires a shareholders' resolution with a 75 per cent majority of the share capital present. The calling of an EGM in a bid situation would hardly be practicable for this purpose, in particular as a period of one month would have to be complied with. The use of an existing authorised capital might be possible from a practical point of view but would be illegal for defence purposes.

Finally, the acquisition of own shares by a German stock corporation is permitted only for a very limited number of reasons enumerated in section 71 paragraph 1 of the AktG, which do not include the defence against an unwelcome shareholder[30] and may under no circumstances exceed a quota of ten per cent of the share capital.[31] Moreover, the corporation may not exercise any voting rights connected with own shares, irrespective of whether the acquisition has been legal or illegal.[32]

Details may be found in the extensive literature which has recently developed as a reaction to the takeover boom of the late 1980s.[33] By way of conclusion, it can be stated that the arsenal of defence devices which might be applied by the management board against an unwelcome bidder is poor compared with the situation in countries where hostile bids are a more common phenomenon.

Co-determination Issues

The German Co-determination Law (Mitbestimmungsgesetz) is often taken to be one of the most effective anti-takeover weapons German law provides. This appears to be highly exaggerated.

Co-determination law provides that 50 per cent of the supervisory board members of large stock corporations are exclusively appointed and replaced by the employees.[34] Therefore, members elected by the shareholders and members elected by the employees are equally represented on the board. The chairman, however, is always a representative of the shareholders.[35] If the majority required for a resolution of the supervisory board cannot be achieved, the votes have to be taken again, if necessary several times.[36] In the last and decisive voting procedure the chairman has two votes.[37] Therefore, the representatives of the shareholders, provided all of them speak with one voice, can always cause the supervisory board to decide according to their proposals. For a bidder who has staffed the supervisory board – to the extent that this is composed of members to be elected by the shareholders – with persons in whom he has confidence, co-determination law could not create a severe takeover barrier.

The employees' influence on the supervisory board is particularly strong in publicly quoted corporations as long as there is no dominant shareholder. Here there is a higher probability that among those supervisory board members elected by the shareholders there might exist different opinions, for instance in connection with decisions regarding the appointment and replacement of managers. In such cases the votes of the representatives of the employees could be decisive, which in turn causes the managers hoping for a prolongation of their tenure to give favourable and, if necessary, preferential consideration to the employees' matters of concern. This situation would obviously change after a successful bid.

Moreover, section 32 of the Co-determination Law stipulates that important shareholder rights of the corporation regarding its subsidiaries, provided that these are themselves subject to co-determination, are exercised by board resolutions which have to be passed exclusively by the shareholder representatives on the supervisory board. This implies, for instance, decisions regarding the appointment and removal of the subsidiary's managers, the dissolution, merger or transformation of the subsidiary or the sale of all of its assets. Such resolutions, for which a simple majority of the board members elected by the shareholders is sufficient, are binding on the corporation's management. This legal situation is of substantial importance to a bidder who, after a successful bid, wishes to dispose of some of the investments the target holds in other enterprises, in particular if the target is a mere holding company.

It should be mentioned that some of the large German corporations, which are predominantly active in the mining, coal or steel industry,[38] are snbject to a special Co-determination Law (Montan-Mitbestimmungsgesetz; Mitbestimmungsergänzungsgesetz), under which the votes of the employees' representatives on the supervisory board cannot be overruled by a decisive second vote of a chairman being a shareholder representative.[39] Nevertheless, even in these cases the exercise of shareholder rights in subsidiaries will, like the provisions laid down in section 32 of the Co-determination Law,[40] often fall within the exclusive competence of those supervisory board members who are elected by the shareholders.

29 See the commentators quoted Note 28 above.

30 See, for instance, the decision of the Federal Supreme Court of Finance (BFH) of 2 February 1977, AG 1977, at page 230 onward.

31 See section 71 paragraph 2 sentence 1 of the AktG.

32 See section 71(b) of the AktG.

33 See the commentators quoted Note 28 above for further references.

34 See section 7 paragraph 1 of the Mitbestimmungsgesetz.

35 For details of the voting procedure see section 27 paragraphs 1 and 2 of the Mitbestimmungsgesetz.

36 For details, see sections 29 and 31 of the Mitbestimmungsgesetz.

37 See section 29 paragraph 2 and section 31 paragraph 3 of the Mitbestimmungsgesetz.

38 For instance, Mannesmann AG, Hoesch AG, Thyssen AG.

39 For details see section 4 paragraph 2(d) and section 8 of the Montan-Mitbestimmungsgesetz.

40 See section 15 of the Mitbestimmungsergänzungsgesetz which contains provisions correspondent to those laid down in section 32 of the Mitbestimmungsgesetz.

Tax Aspects of Post-acquisition Restructuring

The financing of many takeovers depends on the possibility of a subsequent divestiture of some of the target's assets, in particular of the target's investments in subsidiaries which do not form part of its core business. If capital gains realised by such asset sales are fully subject to German trade and corporation tax (total tax burden about 60 per cent) this might severely reduce the return flow from such disposals and could even depending on the extent of debt finance used by the bidder, make a takeover unattractive. German tax law, however, offers the possibility of setting off tax liabilities resulting from the target's asset disposals against a write-down of the bidder's investment in the target, to the extent the share value is decreased after a full distribution of the capital gains realised by the target. Ideally, corporation tax levied on capital gains realised by the target is fully neutralised by such a write-down of the investment in the target.[41]

The above structure requires the target's shares to be held in a German company used as an acquisition vehicle by the bidder. Further, it is necessary for the share purchase also to be made through such German entity without the shares having been held at any time directly by the (foreign) bidder or any other foreign entity. The reason for this requirement is the fact that section 50(c) of the German Income Tax Law prohibits the abovementioned write-down of the investment in the target if the target shares have been held by foreigners at any time within the last ten years before their acquisition. In the case of shares of publicly quoted corporations an important exemption is made, however, with respect to the period before the share purchase if the shares are purchased on the stock exchange.[42]

Trade tax levied on capital gains realised by the target cannot be neutralised by a write-down of the investment as a consequence of correspondent dividend distributions.[43] However, the same result might be achieved if, for trade tax purposes, a so-called 'organship' (gewerbesteuerliche Organschaft) is implemented; although this strategy is subject to controversial discussion between commentators in the literature and the tax authorities,[44] in most cases it should be possible to reach a stay of execution until the German Federal Supreme Court of Finance has handed down a final judgment on the question.

For corporation tax purposes the possibility of the above explained write-down of the investment is undisputed by the tax authorities. If, however, only a part of the target's assets is sold off, it could eventually be argued that the decrease in share value resulting from a corresponding profit distribution is smaller than the taxable gain realised by the subsidiary. From a tax point of view it might therefore be advisable to sell all or substantially all of the target's assets in an internal asset deal following the share purchase to the bidder's German holding company (NewCo) which has acquired the shares.[45] NewCo could afterwards sell on parts of the assets to third parties, thereby realising only a small or even no capital gain at all due to the previous (tax-neutral) step-up of the assets' book value in the internal asset deal. This structure has meanwhile – for reasons of corporation law and of tax law – become standard procedure in German leveraged buyouts. All big German banks have established subsidiaries specialising in such LBO/MBO transactions.

In practice, LBO/MBO transactions have up to now been confined to small or medium-sized companies. In principle, similar acquisition techniques might, however, also be applied in a takeover of a publicly quoted stock corporation,[46] although the existence of minority shareholders would make this rather complex takeover structure even more difficult. To date, a 'classical' buyout of a publicly quoted company has not been tested in practice.

Conclusions

The above review of the most important arguments put forward for the thesis of allegedly severe legal and structural obstacles to takeovers in Germany has shown that the discussion, in particular abroad, suffers to some extent from ill-founded assumptions, which do not stand the test of closer legal examination. Ironically enough, many interpretations of the situation in the German capital markets – as for instance low shareholder activity and a correspondingly large influence of German banks resulting from the exercise of proxy votes – are correct only if and as long as no public takeover bid is launched. There is clearly a risk that a wrong perception of the facts could become a takeover barrier, perhaps even the most effective, of its own.

One argument has not been and cannot be dealt with here: the assumption that there exists a corporate culture dominated by the big German banks which is thought to be adverse to unsolicited takeovers and Anglo-American-style corporate restructurings. Although there is much truth in the assumption that the leading banks would not like to lose influence due to new concepts of corporate control which are more shareholder-driven and less monitored by themselves, it is hardly conceivable that they could prevent such developments which will inevitably dominate future market trends. Further, the banks' position cannot simply be identified with public opinion. In the case of Conti/Pirelli, for instance, public opinion tended to support Pirelli's proposals. In particular, an unsolicited takeover attempt by a British company would, after the joint Siemens/GEC hostile takeover of Plessey, be virtually immune to 'cultural' arguments.

41 For details, see Otto, Der Betrieb 1989, at page 1389 onward.
42 See section 50(c) paragraph 8 of the Income Tax Law.
43 See section 8 paragraph 10 of the Trade Tax Law. The trade tax on earnings rate depends on the community in which the corporations headquarters are located and normally varies between 15 per cent and 20 per cent. Trade tax is deductible for corporation tax purposes.
44 See, for instance, on the one hand, Goutier, Der Betrieb 1989, at page 244 onward; and on the other hand Pöllath/Wenzel, Der Betrieb 1989, at page 797 onward and Fin M. NRW DB 1989, at page 656.
45 See Otto, Note 41 above, at page 1383 onward.
46 See Otto, Note 41 above, at page 1396.

Another issue is the acceptance of leveraged buyouts. A public relations war of words would probably have to be anticipated by any hostile bidder raising, for instance, the case for 'unbundling' a target-conglomerate by implementing LBO techniques. The situation in Germany does not seem, however, to be very different from that in Britain or the United States, where the usual defence tactics may also include starting a press campaign reproaching the bidder for crude asset stripping, and so on. Moreover, the question arises as to how convincing it may be to blame the bidder for applying LBO techniques when the same financing techniques are standard procedure for all specialised German market practitioners, including the bank-owned equity investors, in transactions with small or medium-sized target companies.

It seems reasonable to conclude that German capital markets, although underdeveloped as compared wirh the British or US markets, are not shielded against foreign takeovers through irresistible legal and structural barriers. Necessary restructuring activities anticipating the requirements of the forthcoming Common European Market will soon produce evidence for this analysis.