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A legal update from Dechert's Financial Services Group

German Federal Cabinet Approves Investment Risk Limitation Act

Increased Notification Requirements for Holdings in German Listed Companies

Introduction

New restraints on undesirable practices that have developed in certain areas of the financial markets under current German law were recently approved. Among other measures, the Investment Risk Limitation Act ("Act") will increase notification requirements and require disclosure of the objectives underlying the holding of shares in German listed companies at or above certain thresholds. These changes will affect financial investors, including hedge funds and private equity funds. The Act, approved by the German Federal Cabinet (Bundeskabinett) on October 24, 2007, is expected to come into force during 2008, although it is still the subject of political discussion and must be approved by the German Parliament (Bundestag).

Notification Requirements

The current notification regime under the German Securities Trading Act establishes separate notification thresholds for the holding of (1) financial instruments that include a vested right to acquire voting shares of an issuer and (2) the actual holding of voting rights of an issuer. These notification thresholds are not currently aggregated. So if a shareholder holds a percentage of voting shares and the right to acquire a percentage of voting shares and both percentages are under the respective notification threshold, no notification is required, even if the shares in the aggregate exceed either or both thresholds.

The Investment Risk Limitation Act will amend this regime by requiring aggregation with respect to the notification threshold regarding rights to acquire voting shares. Thus, in determining whether it must notify as a result of its rights to acquire a percentage of voting shares, a shareholder must consider both the percentage of shares it has a right to acquire and the percentage of shares it actually holds. If the total percentage exceeds the relevant thresholds, notification will be required. If a shareholder has already issued notice that it exceeds a relevant threshold, fresh notification pursuant to an aggregation calculation will not be required unless a further specified threshold is met or exceeded. The change is intended to increase transparency in financial holdings.

In addition to the above change, the content of future notifications will also have to change. For notifications pursuant to actual holdings, a shareholder must state how many of its voting rights were acquired by exercising financial instruments. For notifications pursuant to rights to acquire shares, the amount and percentages of both shares that the notifying party has a right to acquire and shares it currently holds must be made explicit.

Under current law, failure to comply with notification requirements results in the loss of the rights in respect of which notification is required until the failure is corrected. In the event of such correction, rights to receive dividends or to participate in liquidation proceedings are applied retroactively to cover the suspended period. The Act further strengthens the consequences for failing to comply with notification requirements by instituting a suspension of voting rights for the six-month period following correction of the failure if the failure is deemed to have been caused by gross or willful negligence.

Disclosure Regarding the Acquisition of Voting Rights

In an effort to mirror the disclosure regimes in place in the United States and France, the Act will require that once the 10% notification

threshold or any higher threshold is met, the notifying party must disclose, at the issuer's request, the objectives behind its holding of the issued shares. Such a request by the issuer must be complied with within ten trading days. If a shareholder's underlying objectives change after such disclosure is made, the shareholder must issue updated disclosure in a timely fashion. The Act specifies certain objectives that must be disclosed, if present, including:

- generating profits or implementing strategic objectives;
- obtaining further voting rights within the next twelve months;
- obtaining control within the meaning of Section 29 of the German Securities Acquisition and Takeover Act;
- influencing the make-up of the issuer's administrative or supervisory bodies; and
- introducing a substantial change to the issuer's capital structure or dividend policy.

The issuer, in turn, is required to publish the disclosure, or, in the event that a shareholder does not comply with a request for disclosure, such lack of compliance. Lack of compliance by a shareholder does not, however, result in substantive sanctions such as the loss of voting rights.

Acting in Concert

A key element of the Act is a series of amendments to the Securities Trading Act and the Securities Acquisition and Takeover Act that expand and make more concrete the legal concept of "acting in concert" with respect to held securities. Under the newly adopted Act, acting in concert is deemed to occur if two shareholders coordinate their conduct to influence the business direction of the issuer, whether pursuant to an agreement or not. Such coordinated conduct can involve the attribution of voting rights or other conduct prior to a shareholders' meeting. Under vaguely worded previous law, German courts had established that only an attribution of voting rights at a general meeting constituted acting in concert pursuant to the Securities Trading Act. The Investment Risk Limitation Act extends the scope of acting in concert to include conduct relating, not only to the holding and managing of an issuer's shares, but also to the purchase of an issuer's shares.

Further, the scope of acting in concert will be extended to include individual cases of coordinated conduct where the effects on the course of the issuer's business are deemed to be substantial. Coordinated conduct that does not result in sufficiently substantial effects is explicitly excepted from the scope of acting in concert. Thus, the determination of whether coordinated activity amounts to acting in concert shifts from the nature and degree of the coordinated activity to the effect of such activity. For example, coordinated action (e.g., an agreement) regarding the election of supervisory board members will not be deemed to constitute acting in concert unless it is determined that an effect of the agreement is to bring about concrete changes to the issuer's business direction.

Strengthening the Share Register

Additionally, the Act strengthens the legal provisions intended to require a comprehensive share register of true shareholders. Though such a register is contemplated under present law, in practice it has proved easy to avoid through the use of banks, brokers or investment advisers as nominees in place of true shareholders on the register. Though it will still be possible under the Act to register through a nominee, true shareholders will be required to provide information requested by the company that is necessary to maintain the register and must indicate to the company prior to registration that it intends to register via a nominee.

The company will be able to identify, through this right to request information, the true shareholder, but other shareholders in the company or third parties will not have such a right, and companies are not obliged to exercise their right. It is possible under the Act that, in practice, companies will only request information once a certain shareholding threshold is reached. If a company's request is not honored within a reasonable time, the rights attached to the relevant shares will become invalid. Further, registration through nominees may be prohibited or restricted (e.g., up to a certain shareholding threshold) in a company's articles of association.

Finance Committee Responsibilities

The Act also contemplates an amendment to the German Works Constitution Act that will include "the takeover of a company if this takeover implies acquisition of control" as one of the financial matters that must be discussed by a company's finance committee. If a company does not have a finance committee, a new clause of the German

Works Constitution Act designates the company's works council to assume the role a finance committee would have in the event of a takeover. It is already established under German case law that one of the financial matters of which a finance committee must be informed includes the sale of all the shares of the company. The Act, however clarifies that the requirement exists in any case that involves a change of control (i.e., the purchase of at least 30% of the voting rights).

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