

## Alert Memorandum regarding the German Draft Bill of a “Risk Reduction Act” as of September 2007 (abstract in English)

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### I. DRAFT BILL

In September 2007, the German Federal Ministry of Finance issued a draft bill of the *Act to Reduce Risks Associated with Financial Investments* (“*Risk Reduction Act*”) to improve transparency in order to address the Federal Government’s concerns related to certain activities of financial investors. The draft has recently been sent to the business and legal community for first comments. If and to what extent it will finally become binding law remains to be seen.

### II. THE PROPOSED LEGISLATIVE AMENDMENTS IN DETAIL

#### 1. *Acting in concert* – significant extension of scope

Of particular interest in the draft is the modified definition of coordinated conduct between investors. Such coordinated conduct or “*acting in concert*” may lead to an attribution of the investors’ respective shareholdings for purposes of certain notification obligations under the German Securities Trading Act (“WpHG”) and the obligation to make a mandatory bid for the outstanding share capital under German law. While the existing rules – following a judgment of the German Federal Court of Justice – are construed narrowly, the draft aims to broaden and clarify the scope of such *acting in concert*.

According to the draft, *acting in concert* may in the future also be relevant if

- the coordinated conduct of two or more investors is (only) directed toward the parallel acquisition of shares,
- the coordinated conduct occurs on a one-time basis, and/or
- the coordinated conduct occurs outside of a shareholders’ meeting.

However, the draft bill also introduces an additional requirement for coordinated conduct according to which the investors “**have to cooperate in a way that is suited to influence the corporate policy (unternehmerische Ausrichtung) of the issuer permanently or extensively**”.

Nonetheless, the **draft overall extends the scope of *acting in concert***. Thus, parallel acquisitions of shares, parallel exercise of influence *vis-à-vis* the board of directors to reach certain objectives or one-time agreements relating to the election of supervisory board members may in the future constitute coordinated conduct if such behavior is suited to influence the corporate policy of a listed company permanently or extensively. The investors' intentions would not necessarily be relevant for assessing *acting in concert* under the new definition.

Furthermore, the draft will make the determination of *acting in concert* more difficult in practice, as easy ascertainable requirements such as acting in a company's shareholders' meeting would be eliminated. In combination with the broadened definition of coordinated conduct such ambiguity will have the consequence that any cooperation between investors regarding a listed company and/or its shares must be analyzed in detail to minimize potential risks.

## 2. Additional disclosure following substantial acquisitions in shares

Pursuant to the draft, investors whose shareholding in a German listed company reaches or exceeds 10%, 15%, 20%, 25%, 30%, 50% and 75% of the voting rights shall upon request disclose to the company **additional information on their goals and the source of their funds** used in the acquisition. In detail, the investors have to disclose whether they are pursuing strategic goals or only intend to gain trading profits, whether they intend to acquire additional shares of the company in the next twelve months or even control (*i.e.*, acquisition of more than 30% of the voting rights), whether they plan to modify the composition of the company's management or supervisory board, its capital structure or its dividend policy as well as the source of their funds (*i.e.*, acquisition with own resources and/or borrowed funds). The company is required to publicly disclose this information.

## 3. Tightened sanctions for violations of notification obligations

The draft bill also intends to tighten the consequences for non-compliance with the mandatory notification obligations pursuant to Section 21 WpHG. The (principal) loss of rights attached to the shares during non-compliance shall be **extended for an additional period of six months following valid notification** if the obligation was violated deliberately or due to gross negligence.

## 4. Improved identification of registered shareholders

Under the current regime, a corporation with registered shares does not necessarily have full insight into its shareholder structure as the shareholder register may also contain shareholders' representatives. To enable a corporation to identify its shareholder base, the draft bill authorizes the shareholders to amend the **corporation's articles to prohibit or restrict the inclusion of representatives** in the shareholder register.

In addition, the corporation's board of directors may **inquire from persons listed in the shareholder register whether they are in fact shareholders or only placeholders**. In the latter instance, placeholders have to disclose their principals and the board of directors may inquire whether these principals themselves are true shareholders or mere placeholders. Shareholders who refuse to give such information to the corporation will lose the rights attached to their shares during non-compliance.

#### 5. Meaningful notification relating to holdings in financial instruments

The draft bill intends to improve the significance of notifications relating to holdings in financial instruments. Therefore, **voting rights resulting from shares and from comparable positions in financial instruments** (*i.e.*, instruments that entitle a person to acquire, on such person's initiative alone, shares to which voting rights are attached) **will be added** for purposes of establishing the thresholds of the notification obligations under Section 25 WpHG for financial instruments. To avoid double notification obligations, notifications under Section 25 WpHG are only necessary if and to the extent no notification occurs pursuant to Section 21 WpHG.

#### 6. Improved information of the workforce

A company will further be required to **inform its Economic Advisory Committee (*Wirtschaftsausschuss*) if a new investor acquires control**, *i.e.*, acquires more than 30% of the voting rights of the company. If no Economic Advisory Committee exists, the work council of the company has to be informed accordingly. This proposal principally has only relevance for share deals in non-listed companies as otherwise comparable obligations already exist.

### III. ADDITIONAL MEASURES

Two further issues are mentioned in the explanations to the draft bill which have not resulted in legislative amendments, namely additional rules for the transfer of (credit) claims to third parties and the supervision of hedge and private equity funds. While rules for the transfer of credit claims are still discussed, it is only intended to intensify the supervision of hedge and private equity funds under the existing rules with no additional legislative measures.

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