German Public M&A Q1 – Q3 2017: Overview and current issues

German Takeovers in the headlines of the press

So far this year, three takeover bids have made headlines in the German financial press.

After major struggles between the executive board, supervisory board and shareholders, pharma manufacturer Stada chose to receive a joint bid from the private equity firms Bain and Cinven. Their first takeover attempt nevertheless failed when the acceptance threshold was not met, despite being lowered from 75 percent to 67.5 percent during the offer period. A second attempt was then made, in which the threshold was cut to 63 percent (plus the treasury shares held by Stada). This percentage was only just surpassed, and the PE investors succeeded in taking over the company.

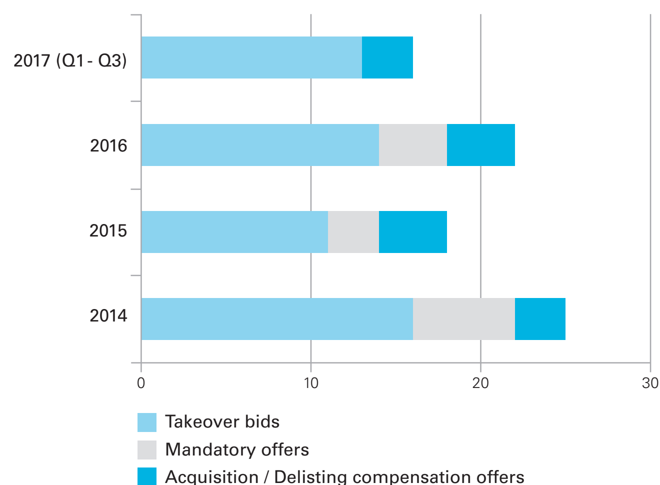
Stada is a good example of how German law allows shareholders to maximize their exit price once the takeover procedure under the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz, WpÜG) has been completed. Activist shareholders bought into Stada in July 2017, following which they gradually built up a stake of over 15 percent without relinquishing their shares under the second takeover offer. Such shareholders may be speculating that the remaining minority shareholders will receive a high pay-off (i.e. above the takeover price) for consenting to a control and profit transfer agreement.

The Busch Group's initial attempt to acquire Pfeiffer Vacuum AG also failed when a condition of the offer was not met, in this case the requirement that the target company should not hold a general meeting. However, just two weeks after the bid collapsed, Busch announced a new higher-priced bid through its investment vehicle Pangea GmbH. This second takeover offer enabled Busch to surpass the 30 percent control threshold, meaning it can now further increase its shareholding without being obliged to make a mandatory offer.

The ongoing merger of DAX-listed Linde AG with US rival Praxair, which is structured as a takeover bid, has also been closely watched by the press, and due to a change in the terms of the offer, the deadline for acceptance had been extended until 7 November 2017.

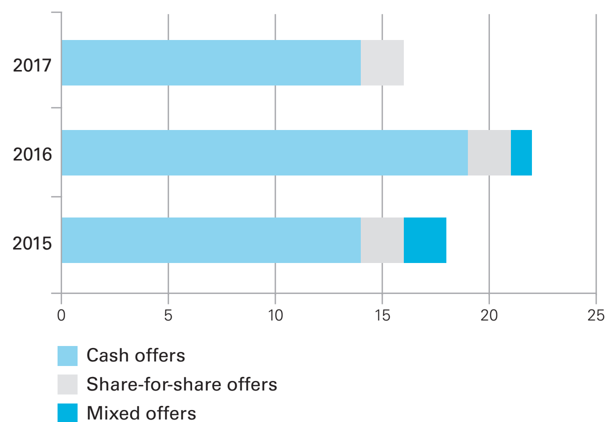
The German public M&A market in figures (to 30 September 2017)

A total of sixteen takeover offers were conducted in the first nine months of 2017, leading up to a lively quarter end in which three more offers were also announced. In 2016, only 22 WpÜG offer documents were issued in the entire year, with ten issued in the final quarter. Only three of the bids issued in 2017 were delisting compensation offers; the others were all non-mandatory takeover bids, and unlike in previous years, no mandatory offers at all have been made in the first three quarters of this year.



One DAX-listed company (Linde AG) and one MDAX-listed company (Stada) were takeover targets. The €29.8 billion bid for Linde is the largest offer made this year, followed by Bain and Cinven's €4.3 billion bid for Stada and the €2.5 billion offer by United Internet for Drillisch. Total transaction volume for the first three quarters of 2017 has already reached around the €40 billion mark; substantially above the full-year total of around €33.5 billion for 2016.

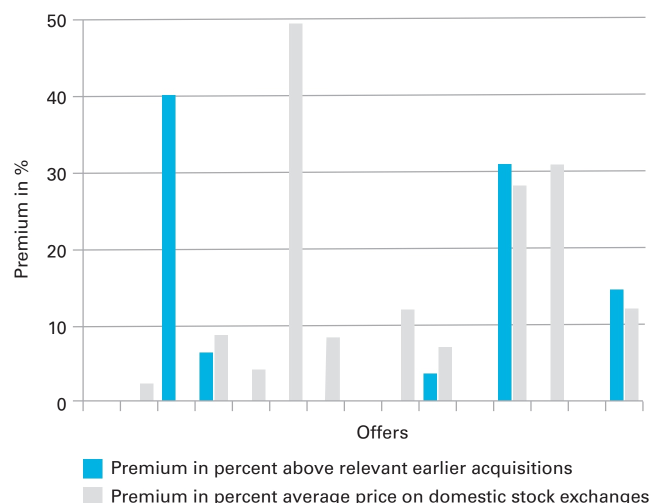
Cash offers remain standard for public takeovers with only two securities exchange offers issued so far this year. The share-for-share offer made by Linde plc for Linde AG, published on 15 August, is a precondition for its planned merger with US rival Praxair. Since 2014, share-for-share and cash-and-share offers have predominantly been made in the property sector (Adler Real Estate/Estavis, Vonovia/Deutsche Wohnen, Adler Real Estate/Westgrund, Deutsche Annington/GAGFAH). This year, another real estate takeover (TLG Immobilien/WCM Beteiligungs- und Grundbesitz-AG) has been conducted in the form of a share-for-share exchange. No mixed consideration (i.e. cash-and-share) offers have been issued in the year to date.



Buyer premiums have been within the usual range. No so-called 'lowball' offers, i.e. bids with an intentionally unattractive, zero-premium offer price, have been issued so far this year. Five of the 13 non-mandatory takeovers offered a premium of over 10 percent on the average share price in the three months before the offer was made under section 10 WpÜG, this being the relevant share price as per section 5 of the WpÜG Offer Ordinance (*WpÜG-Angebotsverordnung*). However, premium alone is not the sole determinant of a bid's success: the offer made by a Chinese-owned acquisition vehicle for Epigenomics AG fell short of the acceptance threshold despite a premium of almost 50 percent.

The ongoing takeover process designed to prepare the ground for the Praxair/Linde merger was the only case in which a valuation opinion pursuant to section 7 *WpÜG-Angebotsverordnung* was obtained. In this case, an enterprise valuation had to be performed as the acquisition vehicle had no listed share price that could serve to determine the ratio for the share-for-share exchange.

No premiums were paid in any of the three delisting compensation offers.



A striking number of takeover deals related to tech businesses, including Pfeiffer Vacuum (a specialist in vacuum technology), SinnerSchrader (internet agency) and Drillisch (telecoms). Two takeovers this year have targeted pharmaceutical firms, namely Biotest and Stada.

As in previous years, private equity investors are largely steering clear of the German market, although Bain and Cinven's joint purchase of Stada AG stands out. The takeover battle that preceded the offer for Stada also saw interest from the financial investor Advent, in conjunction with a Chinese strategic investor. Activity from foreign investors continued, although only one investment (the takeover of Biotest AG) has been made by a Chinese bidder; this deal is still awaiting clearance from the competition authorities. The attempted purchase of Epigenomics by a Chinese-backed acquisition vehicle fell through, having failed to reach its acceptance threshold within the standard offer period.

Pre-transaction preparation and safety measures

Due Diligence

Performing due diligence is standard practice in Private M&A transactions. No buyer would purchase a company without first investigating the specific risks associated with the target's business and scrutinizing the basis for the purchase price. Due to insider dealing laws, however, the ability to perform due diligence is restricted when the target is a public company. BaFin has not yet conclusively ruled on whether carrying out due diligence constitutes insider information (see the BaFin Issuer Guideline, p. 33). Legal commentary frequently characterizes the performance of due diligence as an event that may trigger a duty of disclosure under insider dealing rules. Therefore, once exclusivity has been agreed, it is recommended that potential buyers consider obtaining an exemption pursuant to article 17(4) of the Market Abuse Regulation (*Marktmissbrauchsverordnung*, MAR).

The performance of restricted due diligence has become established practice prior to a public takeover offer. According to the offer documents, such exercises were performed in nine of the 14 takeovers this year. In the Stada deal, due diligence was not repeated for the second bid after the first takeover bid fell through. At Pfeiffer Vacuum, the target company viewed the takeover attempt as hostile, meaning that the Busch Group was unable to perform due diligence before either of its two offers.

In the course of due diligence, bidders regularly receive access to documents containing information on the target's commercial, financial, tax, legal and contractual relationships, as well as information on planning and forecasts. In the case of the Linde-Praxair deal, mutual due diligence was stipulated in the preparations for the offer as a precondition of the planned merger.

Business combination agreements: essential for a successful takeover?

Strategic bidders in particular regularly attempt to have the objectives of an acquisition laid down in an agreement with the target company. This year, a business combination agreement (BCA) or similar arrangement, such as an investor agreement was made in nearly half of all cases. The level of detail contained in these agreements varies according to the objectives pursued by the parties.

Busch Group, for instance, sent a business combination letter to its target Pfeiffer Vacuum Technology AG before publication of its offer. The target declined to enter into an agreement and took the same stance in response to the second offer made by Busch.

The investor agreement that was closed between Bain, Cinven and Stada was preceded by a proxy fight and bidding war that was unusual in the takeover of a German listed company. Two groups of financial bidders, comprising Advent and Permira on the one hand and Bain and Cinven on the other, initially courted the MDAX-listed group in a beauty contest overseen by its executive board. Stada then broke off talks with a view to obtaining a higher purchase price. The takeover battle was accompanied by a power struggle within the company's management.

In 2016, in the run-up to the poker game over Stada, activist shareholders conducted a proxy fight. Active Ownership Capital (AOC), an activist investor which invests in substantially undervalued companies, attempted to alter the composition of the supervisory board at the company's annual general meeting. After allowing a supplementary

proposal for resolutions concerning the appointment of new board members, Stada initially postponed the Shareholders' Meeting by two months. The activists ultimately scored at least a partial success when the supervisory board chairman was replaced. The requirement for the company to approve all transfers of registered shares was also abolished at AOC's proposal. Bearing in mind subsequent events, AOC clearly succeeded in its primary aim of increasing the share price as Bain and Cinven's second offer was for €65.53 per share - substantially higher than Stada's share price of €50 in August 2016.

Moreover, in the midst of the proxy fight, long-standing CEO Hartmut Retzlaff stepped down in mid-August 2016, citing health reasons. His successor Matthias Wiedenfels, who successfully negotiated an investor agreement with Stada's bidders, was in office only until July 2017. The new CEO Coster Tjeenk Willink, under whose aegis the second takeover offer was carried out, initially received only a six-month contract to serve on the executive board, expiring on 31 December 2017. Following the success of the second offer, Bain and Cinven announced that they in fact expected to replace both the CEO and CFO as from the start of the fourth quarter, before the expiry of their current contracts. The poker game surrounding Stada is not yet over, as the struggle over post-acquisition integration measures shows. These will be discussed later on.

Is pre-bid stakebuilding essential for a successful takeover?

The two largest deals – Bain and Cinven's takeover of Stada and the merger of Linde and Praxair – were not preceded by the acquisition of shareholdings. Unlike in previous years, the market did not view it as essential to underpin an offer either through pre-bid stakebuilding or though procuring irrevocable undertakings from key shareholders to accept the offer once it was made. Only in the acquisitions of Biotest AG (by the Chinese acquisition vehicle Tiancheng (Germany) Pharmaceutical Holdings AG) and Drillisch (by United Internet) were irrevocable undertakings obtained in advance of the bid. United Internet also secured a stake in its target via capital increases against contributions in kind that were carried out before the takeover offer was made. Advance share purchase agreements were only signed in three deals this year. However, the activist shareholder's renewed intervention in Stada may prompt a reassessment of the market's view that pre-deal safety measures are not essential.

Hedging against regulatory risks: foreign investment reviews

Excursus: Tougher foreign investment reviews in major jurisdictions

Especially since the US government's review of the takeover of Aixtron SE, when President Obama vetoed the purchase of the company by Chinese investor Grand Chip Investment, investors' attention has been drawn to the need to hedge against the potential prohibition of a takeover under foreign investment control laws. In the Aixtron case, the German Ministry for Economic Affairs also retracted the approval it had initially granted for the deal before Obama's veto.

In Germany, the Ninth Amendment Regulation to the Foreign Trade Ordinance (*Außenwirtschaftsverordnung*, AWV), which substantially increases the powers of the Federal Ministry for Economic Affairs and Energy to scrutinize investments, came into force on 18 July 2017. German foreign trade law continues to distinguish between a sector-specific review, which applies only to highly sensitive industries such as arms, military equipment and cryptography, and a general review, under which an acquisition may only be blocked if it endangers the public order and safety of the Federal Republic of Germany. However, the new amendment clarifies what the AWV actually means by a 'danger to public order and safety' and establishes specific rights of scrutiny in an additional range of specified sectors. Companies operating in these sectors are now required to notify transactions instigated by non-EU/EFTA buyers.

The EU Commission has also begun to act in response to the urging of certain Member States. In mid-September, Commission President Juncker presented a draft EU Regulation establishing a framework for the review of foreign direct investments into the EU. The Commission will in future pay particular attention to investments affecting projects or programmes that receive extensive EU funding or relate to certain critical industries. The new EU Regulation will not, however, cause any major changes to the substantive review performed under German investment control procedures. The proposal falls short of previously mooted ideas on reciprocity. The proposed regulation has not yet run through the EU's legislative procedures and will not come into force before late 2018 at the earliest.

Various reform proposals are currently being debated in relation to the investment review procedures of the Committee on Foreign Investments in the United States (CFIUS). In late 2016, Congress tasked the Government Accountability Office with the evaluation of proposed reforms. Given the current majorities in the Houses of Congress, the likeliest to succeed is the Foreign Investment Risk Review Modernization Bill proposed by Republican Senator John Cornyn on 22 June 2017, which sets out substantial changes to the CFIUS procedure.

Under the Cornyn Bill, as it is known, a threat to the national security of the United States will remain the sole substantive test. The bill rejects additional scrutiny criteria such as reciprocity and net benefits.

Hedging regulatory risks in takeovers

Deciding on the inclusion of a condition precedent in relation to the successful outcome of a regulatory foreign investment review is in principle a matter for the parties. Nevertheless, in practice, public takeover offers are made conditional on approval from the relevant foreign investment bodies, with distinctions being drawn between different jurisdictions as necessary.

In Germany, section 18(1) WpÜG allows foreign investment approval to be included among the conditions of a public takeover bid, on the grounds that it is outside the bidder's control. Section 2 no. 8 *WpÜG-Angebotsverordnung* requires the status of regulatory procedures to be described in the offer document. In some circumstances the foreign investment review procedure is technically non-mandatory and will not necessarily prevent completion. It is therefore legally possible under the terms of section 21(1) sentence 1 no. 4 WpÜG to waive such a condition up until the penultimate business day of the standard or extended acceptance period. Freedom of choice in relation to such conditions is thus (theoretically) maintained up until the end of the acceptance period.

As the timing of foreign investment review procedures, of which there may be more than one, is independent of the timing of a public takeover process under WpÜG rules, the foreign investment review condition in the offer document must state a 'long-stop date' by which the transaction must be completed. This is in line with the practice regularly followed in relation to antitrust procedures affecting M&A transactions.

This year, the successful outcome of foreign investment control reviews was a condition of three bids: 1. the share-for-share offer for Linde AG is conditional on the CFIUS issuing a written declaration that the transaction is not a covered transaction under the US Defense Protection Act, that the Committee finds no objections to the deal and that the US President will neither prohibit the decision nor grant only conditional approval. The Linde bid also stipulates more generally that the takeover must be legally permissible in Ireland, the UK, Germany and the US; 2. the Chinese bidder Tiancheng's takeover of Biotest AG is subject to the condition that foreign investment approval is granted under the German Foreign Trade Act (*Außenwirtschaftsgesetz*, AWG) and by the CFIUS. The Biotest offer specified a long-stop date of 20 January 2018, i.e. seven months after publication of the offer document. The German clearance certificate has now been issued, although the CFIUS review is still under way; and 3. the offer made by Chinese bidders for Epigenomics was conditional on the successful outcome of foreign investment review procedures, although the deal fell through when the minimum acceptance threshold was not met.

Special case: Regulatory MAC clauses

When examining a planned merger, it sometimes becomes clear at an early stage whether particular parts of the target company's business will be subject to national security concerns. Where this is of crucial importance, the parties to a deal may have to allay such concerns by accepting conditions imposed by the German Ministry of Economic Affairs, or through consenting or agreeing to mitigation measures under a National Security Agreement with the CFIUS. Depending on their nature, such regulatory impositions can have a material adverse impact on potential synergies and the ability of the parties to achieve their deal objectives. Attention thus falls on the question of what government-imposed corrective measures the parties are willing to put up with. In practice, this is dealt with by including a regulatory material adverse change (MAC) clause among the offer conditions; this is particularly true for CFIUS risks. Such clauses contractually specify which regulatory impositions a buyer is expected to comply with in order to obtain the authorization it needs. If the regulatory MAC is triggered, however, the buyer may withdraw from the transaction (and where applicable, the public takover bid). In some cases, this may be subject to payment of a 'reverse break fee' (see below).

Depending on jurisdiction, regulatory MAC clauses in takeover offers may only be effective if they are sufficiently clearly defined and the existence of a material adverse change can be identified by independent experts. BaFin regards MAC clauses as permissible in an offer if they are linked to hard financial indicators such as EBIT or EBITDA.

None of this year's takeover bids have included a MAC clause pertaining to potential restrictions imposed under foreign investment rules.

Reverse Break Fees

As international investments come under tighter official scrutiny, sellers or target companies increasingly feel the need to incorporate a reverse break fee (an 'RBF') into business combination agreements. Payable by the bidder, such fees cover the risk that the transaction collapses due to the denial of regulatory approval or the impending breach of one or more regulatory conditions. In addition to providing insurance against the collapse of the deal, they are also intended inter alia to incentivize buyers to do their utmost to obtain the requisite authorizations under the laws on foreign investment.

To ensure that a reverse break fee is actually paid, escrow agreements are frequently put in place whereby part or (usually) all of the fee is placed in an escrow deposit in favour of the target/seller. Depending on the buyer's home country and the location of the funds, payment of the break fee may itself be subject to capital controls.

The importance of hedging regulatory risks, especially in relation to non-approval by the CFIUS, is shown not least by the steadily maturing market for M&A insurance policies that help to cover precisely this kind of regulatory contingency. In practice, however, premiums for break fee insurance have generally been around 10-15 percent, a disproportionately high amount in comparison to the range of 1-1.5 percent that is normal for other warranty & indemnity policies.

Break fee agreements are frequently kept confidential by the parties and thus it is not known whether any break fees were agreed in connection with this year's WpÜG takeover offers.

Stumbling blocks for bidders

Too many conditions spoil the bid?

The Busch Group was the first bidder this year to fall foul of an offer condition it had imposed itself. The original offer, in which Busch offered €96.20 per share for Pfeiffer Vacuum AG, was unsuccessful, lapsing because the calling of an extraordinary general meeting by the target during the offer period breached one of the offer's conditions. In this case, BaFin quickly acceded to the bidder's request to waive section 26 WpÜG, which bars bidders from submitting a new offer for a period of one year. In the second bid, launched only two months later, Busch substantially raised the offer price to €110.00 per share, but ultimately managed to acquire only 35 percent of Pfeiffer Vacuum's shares in the face of continued opposition from the target company.

As in other cases in recent years, some offers found it particularly hard to achieve their minimum acceptance threshold.

After Busch/Pfeiffer, the second takeover to collapse after its conditions were not met was Bain and Cinven's bid for Stada. The bidders initially entered the offer phase with an offer of €65.28 per share, representing a premium of just under 20 percent over the three-monthly average share price, subject to a minimum acceptance level of 75 percent. This initial takeover approach failed when not enough shareholders were induced to accept it, even after the bid price was raised by €0.72 to €66 per share and the acceptance threshold was reduced to 67.5 percent.

Bain and Cinven, too, were able to issue a renewed offer, after Stada agreed to waive the one-year blocking period under section 26 WpÜG. This second offer, which was slightly increased to €66.25 per share, and the acceptance threshold cut to 63 percent, ultimately went through.

A minimum acceptance threshold, in this case 30 percent, also threatened to frustrate the takeover bid made by Austria's Pierer Industrie AG for SHW AG. This time, the bidder waived the minimum threshold before the acceptance period had expired, so that the offer still went through despite being accepted by the holders of only 25.72 percent of the shares. However, some 47 percent of the shares were ultimately transferred to the bidder at the end of the extended offer period.

The offer made by Summit Hero Holding GmbH, an investment vehicle set up by Chinese investors, for Berlin's Epigenomics AG failed to go through when the acceptance threshold of 75 percent was not met. This is despite the fact the bidder and target had set down the general terms of their future cooperation in a business combination agreement and both the executive and supervisory boards had expressly supported the bid.

The offer period for the share-for-share offer underpinning the Linde-Praxair merger originally ran until the end of October. Here, the bidder (Linde plc) made the bid conditional inter alia on obtaining 75 percent minimum acceptance. To ensure that the offer was a success, the bidder then cut the acceptance threshold to 60 percent one day before the original offer period expired.

Role of the target company

For all bids in 2017, the opinion required under section 27 WpÜG was issued jointly by the executive board and supervisory board. Generally, the executive and/or supervisory board of the target obtain either a fairness opinion or an opinion letter from a bank or audit firm which reviews the appropriateness of the valuation. In most cases this year, the offer was positively endorsed by the target. By contrast, Pfeiffer Vacuum regarded the Busch Group's offer as hostile and, as already mentioned, thwarted the initial bid by calling an extraordinary general meeting. The executive board of Clere AG also responded negatively to the non-mandatory public buyout-and-delisting offer made by Elector GmbH. In this case, the compensation on offer was considered to be inadequate. This is remarkable, as the market expectation is that delisting offers will generally only be published after approval has been obtained by the executive board of the target company.

Pierer Industrie AG also failed to obtain support from the executive and supervisory boards of SHW AG in Aalen; the takeover offer only succeeded once the minimum acceptance threshold was waived.

Post-transaction scenarios: control and profit transfer agreements, squeeze-outs, delisting

Once a takeover is complete, many bidders plan the signing of a control and profit transfer agreement along with a squeeze-out and/or delisting, provided that the minimum quorum thresholds are met.

The Stada case provides an example of how German company law continues to offer a wide range of options to individual shareholders. Where there is a large free float, this can make it extremely difficult to reach the 75 percent majority required to take structural measures. In legal policy terms, it seems desirable that legislation sets a clear and foreseeable path for a bidder to acquire a majority stake whilst guaranteeing the equal treatment of all shareholders.

Since November 2015, delisting has been governed by the amended section 39 (2) sentence 1 of the German Stock Exchange Act (*Börsengesetz*), which states the removal of a company from the stock exchange is only possible in conjunction with a compensation offer; BaFin allows such a delisting compensation offer to be combined with a non-mandatory or a mandatory takeover bid. The delisting offer for Rheintex Verwaltungs-AG, published on 1 August 2017, follows a novel process based entirely on share buybacks.

A successful takeover is frequently followed by a squeeze-out. This structural measure can take various forms, referred to as a 'takeover squeeze-out', 'Stock Corporation Act squeeze-out' or 'Transformation Act squeeze-out' in accordance with their legal basis. The takeover squeeze-out remains an exception. Under this procedure, the majority owner – who must hold at least 95 percent of the share capital – must formally apply to the courts no later than three months after the expiry of the acceptance period; such applications fall under the exclusive jurisdiction of the Regional Court of Frankfurt am Main. To our knowledge, this route has not been followed in any case to date this year.

The ‘conversion’ or ‘merger’ squeeze-out is based on section 62(5) of the Transformation Act (*Umwandlungsgesetz*, UmwG), which took effect in July 2011. This grants bidders a further post-takeover integration option by enabling them to force out minority shareholders seeking to block a company-law squeeze-out. The ‘conversion squeeze-out’ enables buyers holding (only) 90 percent of the target’s share capital to pass a resolution for a merger between target and bidder and include a term in the merger agreement stating that the minority shareholders of the transferring entity will be squeezed out. We are not aware of any instances this year of a takeover target merging with its buyer where this type of squeeze-out has been used.

Where an investor bids via an SPV (special purpose vehicle), however, the SPV is now regularly incorporated as an AG in order to keep the option of a merger squeeze-out open. This was the case, for instance, in this year’s takeover of Stada by a Bain/Cinven SPV, the takeover of Oldenburger Landesbank by an US buyer, the acquisition of Biotest by a Chinese investor and the takeover of BHS Tabletop.

However, the ‘Stock Corporation Act squeeze-out’, which requires bidders to obtain a 95 percent shareholding, remains the usual option. This year, White & Case advised on the squeeze-out performed at GfK SE, which was taken over by KKR at the end of 2016. The delisting of GfK SE is now planned.

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