

Activist Investor Beware: Government Approves Basic Rules for New Risk Limitation Act

On October 24, 2007 the German Government approved a new Risk Limitation Act (“*Risikobegrenzungsgesetz*”) that will increase the transparency requirements for financial market players including hedge funds. The proposed changes — already heavily criticized by activist investors — are seen as a reaction to “undesirable” activities of hedge funds and certain other financial investors. The new law will become effective in spring 2008 after having been adopted by the Lower House of German Parliament. Although changes to the current draft are likely, even a less stringent final version will have a deep impact on minority investments in German companies.

Acting in Concert

For the first time, the Risk Limitation Act will define “acting in concert” as a cooperation between the bidder and a third party regarding an action related to the company, which may permanently or significantly influence the operational purpose of the company.

Activist investors can often run afoul of “acting in concert” rules. Since “acting in concert” may trigger the obligation to publish the shareholding, the new definition may be helpful to better understand the scope of this legal term, even where some points remain unclear in the definition, *e.g.*, the understanding of “significantly” regarding the influence on the company’s operational purpose. The definition will also be applicable within the German Takeover Act. Under the German Takeover Act, an “acting in concert” results in a combining of the shares and thus may lead to a mandatory tender offer where a 30% threshold of the voting rights is surpassed.

Information Requirements

The information requirements for major participations in publicly listed companies will be extended. Currently, the shares held in a company are considered separately from other financial instruments. This is now regarded as insufficient for purposes of giving both the company and other shareholders “the whole picture” concerning the influence exerted on the company by any single investor. As a result, the proposal provides for both forms of participations (*i.e.*, shareholdings and financial instruments) to be combined. Consequently, the obligation to publish the participation above a 3% threshold will be expanded.

In addition, a shareholder whose participation exceeds 10% of the shares will be obliged to inform the company within ten days about the excess amount. The information notice must also include:

- the purpose of the participation, *i.e.*, whether the participation is of a strategic or financial kind;
- a statement as to whether the shareholder intends to acquire further shares/voting rights;
- a statement as to whether the shareholder intends to gain control over the company (which is deemed to exist at a participation of at least 30%);
- a statement as to whether the shareholder intends to influence the composition of the management or the German two-board system supervisory board;
- a statement as to whether the shareholder intends to make changes to the company’s capital structure, *e.g.*, the debt/equity ratio or the dividend payment policies; and
- the source of capital tapped to acquire the participation.

The information may be withheld where the company does not ask for it. The company, however, has to be informed immediately about any change in the shareholder’s intent.

Sanctions

Sanctions for a breach of the information obligation will also be tightened. Currently, a shareholder is allowed to acquire shares and inform the company only shortly prior to the shareholders' meeting without worrying that his voting rights will be negatively affected. The change in law will result in an exclusion from voting rights not only for the time of non-disclosure but also for a total of six months.

Nominee Shareholders/Registered Shares

If the company has issued registered shares, the owner can circumvent his personal entry into the shareholder's register by installing a nominee shareholder. The proposal holds that as this has disadvantages for the company, no voting rights shall exist as long as the actual economic owner of the shares has not been registered.

Employee Information Rights

The information rights currently available to employees of publicly listed companies only shall be extended to employees of non-listed companies, provided control over the company is acquired.

Outlook

In addition to these tightened rules, the government will examine whether new legislation is necessary in the areas of real estate or non-performing loan transactions. If this is the case, appropriate provisions shall be added to the Risk Limitation Act within the ongoing legislative process.

It remains to be seen whether the proposed changes will help to establish a new level of corporate governance or simply make investments in German companies more complicated and demanding, and therefore less appealing for international investors.

If you have any questions regarding the new Risk Limitation Act, please feel free to contact us.

Dr. Thomas A. Jesch

phone: +1 49.69.25494.220

email: tjesch@kayescholer.com

Dr. Martin Weger

phone: +1 49.69.25494.270

email: mweger@kayescholer.com

New York Office

+1 212.836.8000

London Office

+1 44.20.7105.0500

Chicago Office

+1 312.583.2300

Frankfurt Office

+1 49.69.25494.0

Los Angeles Office

+1 310.788.1000

Shanghai Office

+1 86.21.2208.3600

Washington, DC Office

+1 202.682.3500

West Palm Beach Office

+1 561.802.3230

Copyright ©2007 by Kaye Scholer LLP. All Rights Reserved. This publication is intended as a general guide only. It does not contain a general legal analysis or constitute an opinion of Kaye Scholer LLP or any member of the firm on the legal issues described. It is recommended that readers not rely on this general guide but that professional advice be sought in connection with individual matters. References herein to "Kaye Scholer LLP & Affiliates," "Kaye Scholer," "Kaye Scholer LLP," "the firm" and terms of similar import refer to Kaye Scholer LLP and its affiliates operating in various jurisdictions.