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**Proposed Changes to the German Transformation Act:
Upstream Mergers and Squeeze-Outs to be Simplified**

On March 15, 2010, the German Federal Ministry of Justice has published a draft bill under the title "Third Amendment to the Transformation Act" (*Drittes Gesetz zur Änderung des Umwandlungsgesetzes*). By way of this bill, the German legislature plans to incorporate European concepts (*cf.* European Directive 2009/109/EC of September 16, 2009 [OJ L 259 of October 2, 2009, p. 14]) into German law. The Directive has been designed mainly to reduce the obligations of companies contemplating mergers (*Verschmelzungen*) or demergers (*Spaltungen*) as regards reporting and documentation requirements. The German government is expected to resolve upon the draft bill before the summer break. Thereafter, the bill would have to pass through the German parliament, the *Bundestag*, to become effective. In the following, we would like to draw your attention to two of the proposed changes of particular importance and interest: Upstream mergers into a stock corporation (*Aktiengesellschaft*) shall be simplified and, even more importantly, the relevant shareholding threshold for effecting a squeeze-out shall be, in the context of a merger, reduced by 5 per cent down to 90 per cent.

The squeeze-out procedure, allowing for the expulsion of minority shareholders against their will, is governed by the German Stock Corporation Act (*Aktiengesetz*). As a rule, it is required that the majority shareholder own at least 95 per cent of the issued stock capital. Only then can he adopt a resolution of the General Meeting on the transfer of the shares of the minority shareholders to himself

(against payment of appropriate compensation). Such resolution must be registered in the commercial register. Upon registration, the shares of the minority shareholders devolve upon the majority shareholder by operation of law. The draft bill now provides for lowering the required shareholding threshold to 90 per cent of the issued share capital, if and only if, the squeeze-out shall be effected in the context of a merger. The proposed squeeze-out must therefore, according to the draft bill, be mentioned in the respective merger agreement. It will further be required that the squeeze-out be resolved upon within three months following the conclusion of the merger agreement (or following the publication of its draft). Further, the merger agreement or its draft must be, together with the documents normally prescribed for in squeeze-out proceedings, made available for inspection to the shareholders in preparation of the General Meeting in which the squeeze-out shall be decided upon. When the squeeze-out is reported for registration to the commercial register, the merger agreement must be attached as well. Upon registration of the squeeze-out in the commercial register (and therefore upon the majority shareholder becoming the only shareholder), the merger may be consummated without a general or shareholders' meeting of the disappearing entity as also provided for in the draft bill (see below), since the once majority shareholder will then be the only shareholder.

The other of the more interesting proposed changes concerns upstream mergers into a stock corporation. The standard procedure for effecting a merger in Germany usually is as follows: the surviving and the disappearing entity must enter into a merger agreement and the shareholders' meetings of both the surviving and the disappearing entity must consent to the merger. The merger agreement and the consenting merger resolutions must be notarized by a German notary. German transformation law as in force today provides for an exception to the basic rule just described in the event that a company shall be merged into a stock corporation (*Aktiengesellschaft*) that holds 90 per cent or more of the issued stock of the disappearing company. If this is so, a resolution of the general meeting of the surviving stock corporation becomes moot. Only if shareholders of the surviving stock corporation with at least 5 per cent of the issued stock capital put forward a formal request, must a general meeting of the surviving stock corporation be convened and held. This being said about the law as it stands today, the draft bill now proposes introducing a new provision into the Transformation Act pursuant to which not even a general or shareholders' meeting of the disappearing entity need be held, if the surviving stock corporation holds 100 per cent of the issued share capital of the disappearing entity (which must be either a stock

corporation or a limited liability company). Therefore, in upstream mergers of this sort, it would in the future be sufficient to have executed a merger agreement only, without the need of either one of the general or shareholders' meetings of the two entities involved in the merger consenting to the transaction. The same would apply, *mutatis mutandis*, to demergers if the receiving entity is a stock corporation and the only shareholder of the transferring entity.

Apart from these two proposed changes of particular interest, the draft bill contains a couple of minor adjustments, predominantly facilitating the merger (and demerger) proceedings. The only proposal introducing, or more precisely: extending an obligation deals with changes of the economic situation of the disappearing or transferring entities in a merger or demerger: the board of management must notify the shareholders (and the board of the other entity involved) of major changes in the time between the merger or demerger agreement and the shareholders' meeting. This notification requirement applies, today, exclusively to demergers of stock corporations and shall now be extended to mergers and also cover entities other than stock corporations.

All in all, if the plans of the German Federal Ministry of Justice should come to fruition, they would boost entrepreneurial flexibility, in particular in view of the proposed reduction of the shareholding threshold from 95 to 90 per cent for a squeeze-out in the context of a merger. It is to be expected, though, that this topic will be, on the grounds of the German constitutional civil rights to private property of the affected minority shareholders, hotly debated in the course of the forthcoming legislative procedure. The other parts of the draft bill will most likely pass through parliament without any significant modification. We will keep you posted.

If you have questions on the foregoing, please contact Klaus J. Müller (muel-ler@schiedermair.com). Please note that the information contained in this newsletter is not meant to replace legal counsel. You should seek specific advice before taking any action with regard to the matters discussed above. All of our newsletters are available at www.schiedermair.com.