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Amendments to the German Securities Trading Act and new regulation of delisting. Implementation of the Amendment Directive to the Transparency Directive resolved

The application of the Transparency Directive (2004/109/EG) was examined by the European Commission five years after its entry into force. The amendments resulting hereof were summarised in the Amendment Directive to the Transparency Directive (2013/50/EU – the "**Amendment Directive**"), which entered into force on 27 November 2013 and shall be implemented into national law until 27 November 2015. The implementation of the Amendment Directive into German national law requires in particular amendments to the German Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*), the subordinated legislation based thereon, as well as the German Securities Prospectus Act (*Wertpapierprospektgesetz – WpPG*), the Capital Investments Act (*Kapitalanlagegesetzbuch – KAGB*), the German Securities Acquisition and Takeover Act (*Wertpapierübernahmegesetz – WpÜG*) and the German Commercial Code (*Handelsgesetzbuch – HGB*). In addition to this "compulsory program" the German legislator has adopted a statutory regulation of the delisting process.

Introduction

The following briefing presents the main aspects of the German Amendment Directive Implementation Act and illustrates in particular the comprehensive amendments to the system of reporting obligations under the WpHG (including the intensified and extended sanction measures) as well as the new regulation of the delisting process

Reporting obligations

The reporting obligations in connection with shareholdings and financial instruments have been restructured and adjusted to the European requirements. Currently, the new Section 21 WpHG regulates the reporting obligations regarding voting rights from shares and the new Section 25 WpHG the reporting obligations for all reportable financial instruments. The new Section 25a WpHG imposes a reporting obligation for the sum of instruments held pursuant to Sections 21 and 25 WpHG. Furthermore, the new Section 22a WpHG contains comprehensive provisions concerning the qualification of a company as an affiliate company, which were previously spread across the WpHG and the KAGB.

While the reporting thresholds and the reporting obligations for holders of significant shareholdings have remained unaltered, the legislator has introduced adjustments to the time of reporting, the attribution of voting rights as well as the reporting obliga-

tions for financial and other instruments.

Reporting time and deadline

Under previous regulations, the time of reporting was governed by the transfer of ownership in the shares (i.e. the receipt of the shares in the securities account or their exit thereof) as a holder of shares could only then exercise his voting rights.

In future the reporting obligation will begin when there is an unconditional obligation to transfer the shares with no delay or when there is an obligation of a similar kind. Since an unconditional obligation can already trigger the reporting obligation, the reporting time has been brought forward compared to the previous legal regulations. Although the new legal framework serves the purpose of adjusting the previous regulations to the current legal situation in the majority of European countries, it is not consistent with the traditional approach and the understanding of German law (a main principle of which is the separation between obligation and transfer).

Focussing on an unconditional obligation which is performed with no delay has the practical consequence that the reporting obligation is applicable to all unconditional acquisition and sale transactions in the sport market (in or outside of stock exchanges), which are to be performed within two trading days.

A conditional spot transaction triggers the reporting obligation if the condition has been fulfilled. The practical issues with regard to German takeover law resulting out of the deviation from the point of time, at which the acquisition of control takes place under the regulations of WpÜG, shall remain manageable, as transactions related to the acquisition of control are regularly concluded outside of stock exchanges and are subject to numerous conditions (i.e. the approval of the Federal Cartel Office). In each case, the option to simultaneously report the acquisition of voting rights and the acquisition of control remains preserved.

In addition to bringing the reporting time forward, the legislator has adopted a distinction between active and passive triggering of the relevant threshold in order to establish the beginning of the deadline for the reporting obligation. In case the threshold is actively triggered, the reporting deadline begins at the time at which the party subject to the reporting obligation has or should have the knowledge that its voting share reaches, exceeds or falls below the thresholds, whereby such knowledge is presumed after two trading days.

In contrast, the reporting deadline in the case of passive triggering of the relevant threshold begins when the party subject to reporting obligations obtains knowledge of reaching the threshold, or at latest upon the publication pursuant to Section 26a WpHG. Any lack of knowledge due to gross negligence shall not be relevant for the passive triggering of the threshold.

Attribution of voting rights

The attribution provisions of Section 22 WpHG have been supplemented by the case, in which the voting right is transferred separately from the underlying shares on a temporary basis. Although such separation would not be permissible under German law, it is partially permitted in foreign legal systems. In order to close potential gaps in cases involving a foreign element, the legislator has introduced an attribution of voting rights applicable to such cases.

A new provision has been adopted with regard to voting rights from shares, which are held by the party subject to reporting obligations as security, provided that such party holds the voting rights and expresses the intention to exercise them. Until now, such cases could be subject to reporting obligations according to Section 22 para. 1 sentence 2 No. 2 – 6 WpHG. In this sense, the new provision provides additional legal certainty. In the case of a classical transfer of shares as security (*Sicherungsübereignung*) No. 3 still remains *lex specialis*. By adopting this new attribution provision the legislator has abandoned the so called "alternative attribution of voting rights", meaning the optional attribution to either the transferor or the transferee as their owner. By doing so, the legislator has achieved a synchronisation with the legal requirements under the WpÜG, according to which both the transferor and the transferee could be subject to reporting obligations in connection with the same shares.

Reporting obligations of group companies

Following the objective to secure an appropriate amount of transparency for third parties with respect to group companies, the reporting thresholds will be calculated on a consolidated group basis in the future.

Moreover, the fulfilment of the reporting obligation by the parent company will have a discharging effect on its affiliates company (new Section 24 WpHG). This provision is also applicable to relations between parent companies and affiliates, which are not structured as a group in the meaning of Sections 290, 340i HGB.

Other financial instruments

Within Sections 25 and 25a WpHG, the legislator has regulated the previous reporting system for financial and other instruments in a new way by

abandoning the terminological distinction between those trading objects and summarising both categories as instruments.

With regard to the instruments subject to reporting obligations, there is still a distinction between instruments with physical settlement by delivery, where the acquisition of shares depends only on the owner of the instrument or time lapse (Acquisition rights) and instruments with comparable economical effect, without further distinguishing if these are settled physically by delivery or by way of a cash compensation.

The legislator generally does not intend to widen this scope. For this reason, option, forward and swap transactions as well as contracts for differences will remain subject to reporting obligations in future, provided that there is a sufficient relationship between the instrument and the underlying share. According to the explanatory memorandum of the German Amendment Directive Implementation Act, even an indirect connection – i.e. chain instruments – shall be sufficient.

The number of voting rights subject to reporting obligations shall continue to be calculated on the basis of the full number of shares underlying the instrument. For instruments which provide for a cash compensation and no linear, symmetrical payment profile, the number of the relevant voting rights will be determined on the basis of a generally recognised pricing model. For this purpose, the European Commission has adopted a Delegated Regulation (2015/761) which shall enter into force on 26 November 2015.

Delisting

A complete withdrawal of the issuer from the regulated market ("Delisting") now requires a simultaneous acquisition offer but no resolution of the general meeting of the issuer. There is no compensation review procedure ("*Spruchverfahren*") in which the adequacy of the offered compensation is scrutinised.

The legislator has hereby put an end to the state which was brought about by the Federal Court of Justice in 2013 through its widely observed and in part sharply criticized "Frosta" – decision. According to "Frosta" the issuers of listed shares could spontaneously and hence to the surprise of the shareholders revoke the listing of the shares in whole or in part without observing the requirement to hold a general meeting or to offer a compensation to the shareholders. This frequently caused a price decline of the shares as the perspective of not being able to trade them within a regulated market generated selling pressure and consequently led to falling share prices, not least due to the fact that certain institutional investors are not permitted to hold shares which are not trade (any longer)within a regulated market with certain minimum requirements.

The legislator has restored the most significant part of the legal situation prior to the "Frosta"– decision. The revocation of the listing upon request of the issuer requires a simultaneous acquisition offer to all other shareholders, which essentially corresponds to an offer pursuant to WpÜG and even constitutes stricter requirements. However, a general meeting remains dispensable for the withdrawal from the stock exchange.

Within the new regulation of the delisting process the legislator has chosen a capital markets law by tightening the requirements in the new Section 39 of the Stock Exchange Act ("*Börsengesetz*" – *BörsG*), which shall be observed by stock exchanges in the case of a request by the issuer to revoke the listing. There was no need to amend the Stock Corporation Act, since the legislator did not intent to impose the requirement of a general meeting for a delisting and thereby did not intend to adopt the principles stated in the "*Marcotron*" – decision.

In principal, a stock exchange is only permitted to revoke the listing upon request of the issuer, if the share is either traded within the regulated market in a domestic or a foreign stock exchange (in such cases there is no complete delisting) or if an acquisition offer is published simultaneously to the request for revocation.

Key issues

- Bringing forward of the reporting obligation
- Consolidated calculation of the reporting thresholds in groups
- Reporting obligation with respect to instruments with cash compensation
- New statutory regulation of delisting
- Abolition of the interim reporting obligation and deadline extension for publication of the half year financial report to three months
- Intensification of the sanction regime, in particular by explicit mentioning of the names of the affected ("naming and shaming")

The criteria which shall be met by such request, in particular with respect to the adequacy of the compen-

sation, are also subject matter of the new regulation.

First of all, the offer must seek to acquire all shares, partial offers are not permissible. According to the new Section 39 para. 3 BörsG the offer may not contain any conditions (except for compulsory conditions pursuant to statutory law such as the approval of the Federal Cartel Office).

Section 31 WpÜG shall be applied with certain additional requirements with regard to the compensation: The compensation may only be offered as a cash payment in Euro. The amount of the cash compensation is based on the average domestic stock exchange price of the respective share in the last 6 months (instead of the 3 months which would otherwise apply according to takeover law) prior to the publication of the decision to submit an acquisition offer or the publication of the acquisition of control – new Section 39 para. 3 sentence 2 BörsG). By contrast to this, the company value shall be relevant for the calculation of the compensation if the issuer has violated ad-hoc publication obligations or in the event that the issuer or the bidder have violated market manipulation provision, unless these violations have only had a marginal effect on the average stock exchange price.

In the case of market narrowness, meaning that stock market prices have been detected on less than one third of the trading days within the relevant period of time, the stock market price is not an appropriate basis for the calculation of the compensation. This finding is consistent with the traditional legal situation under the WpÜG and is also implemented in the BörsG. For such cases the new Section 39 para. 3 sentence 3 BörsG states that the amount of the compensation shall be calculated on the basis of a company evaluation.

Finally it is also noteworthy that a review of the adequacy of the compensation is consequently conducted according to the rules of WpÜG, which does not provide for compensation proceedings. Shareholders who deem the compensation inappropriately low can pursue their claim before civil courts only on the grounds of Section 31 WpÜG.

Supervision of financial reporting

Under the previous regulations, the financial reporting of companies whose securities were admitted for trade on a domestic stock exchange within the regulated market were subject to supervision by the German Financial Supervisory Authority ("*Bundesanstalt für Finanzdienstleistungsaufsich*t" – *BaFin*) – the so called "Enforcement Procedure". Thereby the place of the company's registered office was irrelevant so that even foreign companies could be subject to the Enforcement Procedure. This resulted in double audits when the company's securities were admitted to trading at several European stock exchanges.

Currently, such companies being issuer of securities admitted for trading are subject to the Enforcement Procedure whose state of origin is the Federal Republic of Germany. An admission of the securities for trading within the regulated market on a domestic stock exchange is no longer a decisive facto. This serves the purpose of avoiding double audits and closing potential supervisory gaps within the European Union.

In which cases the Federal Republic of Germany shall be the state of origin of issuers is determined pursuant to the new Section 2 para. 6 WpHG.

Furthermore, the new Section 37x WpHG extends the subject of supervision to the group payment reports (*Konzernzahlungsbericht*), which shall be issued by companies active in the mineral gaining industry. In addition, indication-based audits (*Anlassprüfungen*) may also be conducted for the previous financial year, whereby it is expressly specified that random audits (*stichprobenartige Prüfung*) are no longer permitted.

Periodical financial reports

Abolition of interim reporting obligations

Under the previous regulations (Section 37x WpHG), issuers of securities which are admitted for trading within the regulated market are obliged to publish interim reports (i.e. quarterly reports).

This obligation to publish interim reports has now been abolished. The European legislator takes the view that financial information during the year has a negative effect on long-term oriented investments and causes an inappropriate administrative effort for small and medium sized companies without being necessary to protect investors.

Issuers whose shares are listed in premium segments of stock exchanges are not expected to be affected by this new regulation. The regulations of stock exchanges will likely continue to oblige such issuers to publish interim reports so that the implementation of the Amendment Directive will not result in any noticeable changes with respect to interim reporting obligations.

Deadline for the half year financial report

Additionally, the new Section 37w para. 1 sentence 1 WpHG extends the deadline to three months for the half year financial report to be pub-

lished (in comparison with the previous deadline of 2 months).

Payment report obligations for certain branches

The new Section 37x WpHG imposes a state-based reporting obligation concerning payments to public authorities on issuers in the industries of mineral gaining and logging in primary forests (*Primärwälder*). Pursuant to this regulation such issuers shall disclose annual (group) payment reports with respect to payments to public authorities.

Intensified sanction regime

The Amended Regulation also provides for a comprehensive sanction regime, which encapsulates new regulations concerning the loss of rights, the announcement of measures and sanctions by the authorities with explicit mentioning of those affected ("Naming and Shaming") as well as an intensification of the fines. In implementing the Amended Regulation the German legislator has exceeded its provisions.

Loss of rights

Pursuant to the new Section 28 WpHG the parties subject to reporting obligations shall loose certain rights – in particular their voting right – if the applicable reporting obligations in connection with own or attributed shares are not fulfilled. In contrast to the previous legal situation under which only certain attribution provisions of Section 22 WpHG were relevant for the loss of rights, the scope under the new framework will be widened to the extent that all attribution provisions shall be relevant.

In future, the failure to comply with reporting obligations in connection with (financial) instruments will trigger the loss of rights pursuant to Section 25 WpHG as well as the new Section 25a WpHG. The loss of rights affects underlying shares of the same issuer, which are owned by the party subject to reporting obligations. The time at which the underlying shares have been acquired shall not be relevant.

The loss of rights is restricted to the party subject to reporting obligations. An owner of voting rights who complies with the obligations shall not lose his voting right. The failure to comply with reporting obligations ends as soon as the party subject to reporting obligations duly fulfils its reporting obligation or no longer holds the relevant (financial) instruments (i.e. after selling or exercising). In case of a deliberate (*vorsätzlich*) or grossly negligent (*grob fahrlässig*) failure to comply with the reporting obligations, the time period in which the rights may not be exercised is prolonged to six months upon the end of the failure to comply.

Publication of failure to comply

In future, the BaFin promptly publishes its decisions regarding measures and sanctions, which were imposed in connection with failure to comply with reporting obligations (Sections 21 et seq. WpHG), certain information obligations (Sections 30a et seq. WpHG) as well as the periodical financial reporting obligations (Sections 37v et seq. WpHG), on its website by mentioning in particular the names of the natural or legal persons or association of individuals responsible for the respective failure to comply.

Fines against capital market oriented corporations or members of their organs pursuant to Sec 335 para. 1 HGB will also be published in such manner.

The publication is a decision which is not at the discretion of the BaFin and it shall be undertaken before the measure or sanction becomes binding, yet in such cases it shall contain a reference to the lack of binding effect or eventual proceedings initiated against such measures or sanctions.

In the event that the publication appears to be inappropriate with respect to personal information, expected damages of those affected or a threat to the stability of the financial system, the publication may be anonymised or postponed.

Higher fines

The scope of fines regarding the failure to comply with reporting and publication obligations will be widened and there will be different fine frames for natural and legal persons.

Physical persons may be fined up to a maximum amount of EUR 2 million and legal persons as well as associations of individuals up to a maximum amount of EUR 10 million. or five per cent of the total revenues generated by the legal person or association of individuals in the previous financial year. The total revenues of groups shall be calculated on a consolidated basis.

In addition, the failure to comply with obligations may be penalized with a further fine of up to the double amount of the profits gained from the failure to comply with obligations. The aforementioned profit encompasses the profits which were gained as well as the losses which were avoided by the failure to comply. The profit may be estimated by the BaFin.

Entry into force

The German Amendment Directive Implementation Act is expected to enter into force in the 47. calendar week of 2015.

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