Germany

Negotiated M&A Guide

Corporate and M&A Law Committee

Contact

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A. Introduction

In Germany, there are no laws relating specifically to the acquisition of business entities. Therefore, the general laws in relation to civil and commercial contracts, the various types of companies, employment regulations and merger control rules apply. Most notably, this includes the German Civil Code ("**BGB**"), the German Commercial Code ("**HGB**"), the Act on Limited Liability Companies ("**GmbHG**"), the Act on Stock Corporations ("**AktG**"), the Act against Restraints of Competition ("**GWB**") and the European Merger Control Regulation. Depending on the type of business sold, the Foreign Trade Regulation ("**AWV**") (protecting the public order and security of Germany) or sector specific laws such as the German Financial Services Act and supplementing regulations ("**KWG**" and "*Inhaberkontrollverordnung*") or the German Broadcasting Treaty ("**RStV**") may apply. Employment related regulations can be found in statutes such as the Works Council Act ("**BetrVG**") and the relevant codetermination laws ("**DrittelbG**", "**MitbestG**") as well as the German Civil Code and several other specific laws and regulations. When an M&A transaction is preceded by corporate restructuring measures or implemented by means of a merger, split or spin-off, the Transformation Act ("**UmwG**") may be relevant.

This paper attempts to provide a comprehensive summary with respect to the sale and purchase of private companies. It puts a specific focus on the limited liability company (*Gesellschaft mit beschränkter Haftung* - "**GmbH**") which represents the vast majority of the German companies, followed by the limited liability partnership ("**GmbH & Co. KG**") which, in those aspects which are relevant to M&A transactions, is similar to the GmbH. The stock corporation (*Aktiengesellschaft* - "**AG**") is used mostly for public companies or companies where a flotation is intended and therefore is less relevant in the context of private M&A.

Although it is true that in the past German M&A documentation used to be relatively short and the typical process was fairly simple, the last 20 years have seen significant convergence with international practice, as would be typical in the United States and the UK. As a result, agreements have become much more detailed and the M&A process often includes an extensive due diligence phase. Many of the contractual elements used elsewhere in international practice have become widely recognized elements of German M&A documentation. Still, one may find differences depending on whether dealing with large institutional parties or privately held companies.

B. Overview on German Business Organizations

As to the target company, it is essential to understand the differences between the various types of companies under German law and the implications for an acquisition.

(1) Limited Liability Company (GmbH)

The GmbH is the corporate entity most commonly used in Germany. The structure of a GmbH is rather straightforward and flexible. It is designed for closely held businesses with a limited and stable shareholder base, often only one shareholder.

The characteristics of a GmbH are as follows:

The incorporation of a GmbH is rather simple, as standard articles of association (*Gesellschaftsvertrag*) may be quite short, relying mostly on the statutory rules. However, the articles may also be crafted very specifically including detailed provisions on shareholders' rights and obligations, providing for management guidelines, restrictions on the transfer of shares, provisions on competition or the distribution of profits. It is possible to form a GmbH with one shareholder only. In terms of form the incorporation of a GmbH requires a notarial deed, even if standard form articles provided in the GmbHG are used.

The shareholders of a GmbH may give binding instructions to the managing directors and can thereby exercise direct influence on the management of the GmbH. The articles of association may tie management actions to shareholder consent requirements.

The articles of association of a GmbH can be adapted easily to the specific requirements of the shareholders. Few of the statutory regulations are mandatory and therefore cannot be adjusted to the specific case.

Once registered in the commercial register, only the company itself is liable for its debts with its assets, including the share capital. The liability of the shareholders is limited to their investment in the company. “Piercing of the corporate veil” is a recognized concept, but the threshold is rather high.

The minimum share capital of a GmbH is EUR 25,000, divided into shares (*Geschäftsanteile*) that can have different nominal amounts, but not less than EUR 1. As an alternative a special form of GmbH may be founded with a share capital of even less than EUR 25,000. In this case the company has to denominate itself as "*Unternehmergesellschaft (haftungsbeschränkt)*" or "*UG (haftungsbeschränkt)*" and 25 percent of its annual profit must be allocated to a special reserve until its capital reaches EUR 25,000.

A GmbH is managed and legally represented by at least one managing director (*Geschäftsführer*), who does not have to be a shareholder. Only an individual, not a corporate entity, may be appointed as managing director. If one managing director is appointed, he/she is the sole representative of the GmbH. If several managing directors are appointed, they represent the company jointly, unless the shareholders resolve that one of them shall have the right to represent the GmbH individually or to represent the GmbH jointly with one or more other managing directors or an authorized officer with broad statutory power to represent the company (*Prokurist*).

Towards third parties the power of the managing director to act on behalf of the GmbH cannot be restricted, except for such requirements of several having to act together. However, the authority may be limited internally, i.e. as between the company and the managing director(s), by the articles of association, standing orders fort he management, shareholders' resolutions or by the managing director's service agreement. Thus, particular business activities of a certain importance for the GmbH are often subject to prior approval by the shareholders. The breach thereof by the managing director may give rise to a claim for damages by the company against the managing director.

A GmbH may establish a voluntary supervisory or other similar board consisting of "non-executive" members. However, if a GmbH has more than 500 employees, a supervisory board subject to specific statutory rules set forth in the DrittelbG must be formed with one third of its members being employee representatives. If the number of employees of the company exceeds 2,000, a different regulatory regime, the MitbestG, applies and half of the members of the supervisory board must be employee representatives. In the case of the voluntary establishment of a supervisory board, the functions of the supervisory board may be stipulated in the articles of association. The members of the board can be elected by the shareholders’ meeting or appointed by certain shareholders or shareholders’ groups if the articles of association stipulate such appointment rights. The basic function of the supervisory board is to supervise the management of the company and it may also be assigned the right to appoint and remove the managing directors, to adopt the annual financial statements and to call shareholders' meetings.

The shareholders exercise their powers by passing resolutions in general meetings or, subject to certain conditions, in writing. A shareholder will generally have one vote per EUR 1 of share capital, unless otherwise provided by the articles of association. Shareholders' resolutions generally require a simple majority (i.e., more than 50% of the votes cast) unless mandatory law (e.g. in case of changes to the articles of association, including capital increases) or the articles themselves require a greater majority or the consent of certain individual shareholders.

(2) Stock Corporation (AG)

The AG is the corporate form generally adopted by larger corporations, although some very large German companies are indeed organized as GmbH. The shares of an AG, unlike those of a GmbH, may be transferred without a notarial deed and can be listed on a stock exchange. However, the statutory framework for the AG is generally much more detailed and rigid than that for the GmbH, making its administration more formal and costly.

The AG is represented by the management board, its members having either individual or joint signing power. Certain management acts may be subjected, by the articles of association or resolution of the supervisory board, to the consent of the supervisory board. Such limitations do not, however, affect the validity of the actions of the management board towards third parties. One of the main differences to the GmbH is the fact that the management of an AG is not subject to instructions by the shareholders (or by the supervisory board, except for any such consent requirements) but runs the business in a fairly independent way.

Unlike the GmbH, a supervisory board is mandatory for the AG (dual board structure). Its main functions are:

- Appointment and removal of the members of the management board;
- Supervision of the management board, involving both legal and commercial aspects of management actions;
- Representation of the AG in its dealings with the management board;
- Consent to major business decisions of the management board to the extent required by the articles of association or by the supervisory board;
- Retaining the statutory auditor (appointed by the general shareholders meeting), review and approval of the annual financial statements.

The shareholders of the AG exercise their powers by passing shareholders' resolutions in general meetings. Shareholders' resolutions require a simple majority (more than 50% of the votes cast), unless mandatory law or the articles of association set a higher threshold. For example, a 75% majority of the votes cast is required for any amendments to the articles of association, increases or decreases in share capital, control agreements with other companies (i.e., agreements whereby a corporation submits itself to the control of another or agreements on the pooling of profits), the transfer of all assets and the change of corporate form. Furthermore, the AktG requires the consent of certain shareholders when their rights are affected by fundamental business decisions of the corporation.

(3) Partnerships

The two most common partnerships under German commercial law are the general partnership (*offene Handelsgesellschaft* - **OHG**) and the limited partnership (*Kommanditgesellschaft* - **KG**).

The major difference between the two forms is the liability of its partners. While all partners of an OHG are subject to unlimited liability for the partnership's debts and liabilities, a KG consists of at least one general partner with unlimited liability and at least one limited partner whose liability is restricted to the subscribed and registered partnership share.

The major reasons for investors to use a partnership instead of a corporate structure are:

- The greater flexibility in tailoring the internal affairs to the individual needs of the partners;
- Limited publication requirements (e.g., the partnership agreement does not need to be filed with the Commercial Register);
- Easier to dissolve a partnership and to distribute the liquidation proceeds to the partners;

- Direct management of the partnership by the (general) partners or managing limited partners;
- As the partnership is a pass-through entity for income tax purposes it is often used to achieve a tax pooling with the partner level;
- The partnership also may be exempt from trade tax which can result in an overall lower tax burden, especially if the partnership is not engaged in a commercial business but e.g. only in the holding of participations;
- The structure of a limited partnership can be combined with the general partner being a GmbH whose shares are held by the limited partner(s), thus indirectly achieving a limitation of liability to the assets of the KG and its GmbH general partner, creating a "*GmbH & Co. KG*".

Partnership structures are commonly used for smaller and family-owned business entities but, as is the case in relation to the GmbH, even some very large German companies are organized in the form of a KG. Also, investment funds and holding companies are often structured as GmbH &Co. KGs.

To set up a partnership at least two partners are required. Possible partners (general as well as limited partners) of a German partnership can be individuals, corporate entities or other partnerships. The formation of a partnership requires the execution of a partnership agreement. While it is possible to have an oral partnership agreement (unlike as is the case in relation to companies such as GmbH and AG, there is no notarization requirement), it is more common and preferable for it to be in writing. The partnership must then be registered with the relevant Commercial Register. To achieve the liability protection for the limited partners, the amount of the liability limitation (typically equal to the subscribed partnership contribution) must be properly registered to become legally effective.

The transfer of any partnership interest (as limited or general partner) requires an agreement (written or oral) between the transferor and the transferee in combination with the consent of all other partners, unless the partnership agreement provides otherwise. The partnership agreement may also impose restrictions in relation to a transfer of the partnership interest. The change of partners must be registered with the Commercial Register as well.

In principle, the partners may freely agree upon their rights and obligations in the partnership agreement. Unless stipulated otherwise, the limited partners are excluded from managing the partnership and have no authority to represent the KG towards third parties. Thus, under the statutory model, the limited partners are seen as "inactive investors", whereas the general partner is considered the "entrepreneur". If the general partner is a company (as is the case in the common structure of a GmbH & Co. KG), the management of such company manages and legally represents the partnership.

The partners determine the affairs of the partnership by partnership resolutions. Under the statutory rules, partnership resolutions must be passed unanimously, although the partnership agreement may modify this.

C. Formal Requirements in M&A Transactions

Although the international standards for M&A contracts that have emanated mostly from the U.S. and the UK are increasingly adopted in Germany, a contract governed by German law may still be shorter and less detail-oriented than a typical common law contract. In view of the more widely codified and principles driven approach of German law there is (at least perceived) less need for very specific contractual provisions describing and defining every single detail or scenarios with only remote probability, as is often the case in relation to common law contracts.

In Germany, the documentation of many M&A transactions requires the formal act of notarization. This relates to any sale and purchase as well as transfer and assignment (under German law, these are two legal acts to be regarded separately) of shares in a GmbH or of real property. Notarization is also required for certain corporate acts (e.g. change of articles, capital measures) for a limited liability company or stock corporation and in relation to certain reorganization measures under the Transformation Act. If the notarization requirement is not duly satisfied, the legal act will typically be void and cannot be implemented in public registers as the Commercial Register or the Land Register.

In an asset deal involving all or substantially all of the assets of the company, a shareholders' resolution will be required which approves the sale. If the seller is a GmbH, this shareholders' resolution needs to be notarized. Also in a share deal, it needs to be reviewed for each selling shareholder whether a shareholders' resolution at the level of such seller is required, either by its articles of association or pursuant to statutory law if the sold shares constitute all or substantially all assets of the seller. If the seller is a GmbH, again such shareholders' resolution approving the sale of all or substantially all assets will need to be notarized.

Notarization in Germany involves not only a more mechanical "stamping" but it is a rather serious affair. The notary is always a fully trained lawyer, who in some regions can only act as a notary whereas in other regions notaries can at the same time be practicing attorneys. The notary has the responsibility of advising the parties on the legality and appropriateness of the documentation and may suggest changes to already negotiated documentation in order to ensure its legality and expedient implementation (in particular with a view to public registers where some documents need to be filed). The notary shall always be neutral and will attempt to balance the interests of the parties and to make sure their intentions are properly reflected in the notarized documentation. Furthermore, the notary may supervise the satisfaction of the closing conditions and may notify the buyer when the payment for the purchase price is due. The notary may also monitor payments and set up escrow arrangements.

One of the most remarkable aspects of the notarization process is the fact that the complete documentation must be notarized which, in principle, entails reading aloud all its parts, including ancillary contracts, exhibits and attachments. There are a few exceptions for balance sheets, inventory lists etc. but it is not unusual in a larger transaction with extensive documentation that the notarization (after the parties and their counsel have finished their negotiations) takes several hours to complete. There are ways to make this more efficient, e.g. by limiting the number of exhibits which form an integral part of the documentation or by separately notarizing the exhibits with special proxies appearing instead of the authorized representatives of the parties who would later ratify such reference deeds.

Since the whole agreement, including all side agreements, has to be notarized, any violation is likely to void not only the part left out but also those parts of the documentation which were notarized.

German law does not follow a strict "parol evidence rule" but allows the courts to use elements outside of the formal contractual deed (such as negotiation minutes, correspondence or other informal expressions of the intentions of the parties) to interpret the contract. It is therefore advisable to keep a good record of the negotiations and the various drafts of the transaction documentation, in case a dispute arises later.

The fees of the notary are based on a statutory fee schedule and are not negotiable, although there may be some flexibility in how to properly calculate the value of the transaction for the purpose of assessing the notary fees. For a transaction of a relatively low value the fees may be low, in fact less than the time spent by the notary multiplied by a reasonable hourly rate. In transactions of significant value the notary fee may be as high as approx. EUR 74,000.00 (plus VAT) which, except for some ancillary charges, presents an overall cap.

In view of the fee issue, there exists a practice of using foreign (e.g. Swiss, Dutch, French, Italian or Spanish, but due to the different role and training not U.S. or English) notaries in lieu of a German notary in corporate transactions (not in real estate). Notwithstanding some court decisions upholding such foreign notarizations, the specific circumstances must be reviewed carefully. The risks are significant, and typically German law firms will not render unqualified legal opinions on foreign notarizations. The remaining risks may often not be worth the cost savings which, taking into account additional advisory fees and travel expenses, will often be lower than initially thought.

It is always a good suggestion, in particular where the documentation is in English or another foreign language, to find a German notary with ample experience and excellent language skills who can handle the process swiftly and will limit any suggestion for changes to the necessary minimum rather than causing an (unwanted) renegotiation of the documentation.

D. Structure of the Transaction

The sale of a business entity can be accomplished either in the traditional way of individual negotiations or by a (typically limited) auction process.

(1) Procedure of the Corporate Acquisition

(i) Individual Negotiation Process

In a traditional M&A transaction, the seller is in contact with a single potential buyer and negotiations are conducted only between the two of them. In this case, procedures are typically not that formal and the negotiation process can be structured according to the needs of these two participants. The parties may sign pre-contractual documents such as non-disclosure agreements or letters of intent in order to show their mutual commitment to a serious negotiation.

(ii) Auction Process

Transactions where several potential buyers are played off against each other, intended to optimize the sales proceeds and to limit the risk of failure because of a potential buyer withdrawing, will be carried out in the form of an auction. Such a bidding process is characterized by a much higher degree of formality, requiring detailed and tight coordination of the process, typically by external M&A advisors.

The seller will often carry out due diligence of the business to be sold and will include the main findings in a transaction memorandum, which will be sent to all potential buyers, often as part of a staged process with increasing degrees of specificity. This is intended to create interest among potential buyers and to keep their transaction costs low, at least during the early stages.

Specific details will be set out in a process letter. Any bidder will have to agree to its contents and to acknowledge the pertinent rules, together with entering into a non-disclosure agreement. At the initial stage the prospective buyer will be asked to submit a non-binding, indicative offer which may contain information along the following lines:

– Purchase price offered;

– Assumptions and conditions the indicated purchase price is based on;

– How the purchase price will be financed, together with a commitment letter from the financing bank;

– Conditions precedent for the signing of the sale and purchase agreement;

– Regulatory agencies’ (e.g. antitrust authority) approvals required;

– Estimated time frame for the submission of these approvals;

– Detailed information about the buyer and explanation of its short and long term intentions regarding the business, its management and employees;

- Information required by the buyer to proceed with the transaction, especially for submitting a final and binding offer;

- List of the advisors used in the transaction (e.g. lawyers, accountants);

- Other information which might be of specific relevance to either party in the course of the transaction.

During the bidding process, the bidder will typically be prohibited from contacting the seller, the target company and/or its employees or advisors outside of defined information channels supervised by the seller or its advisors. Furthermore, the seller usually maintains full discretion, without giving any reason and without being liable for any damages, to stop or continue the process and to select those bidders with whom to continue to the next stage and eventually to sell the business.

(2) Types of Corporate Acquisition

Early in the process the seller and potential buyers need to decide whether to structure the transaction as an asset deal or a share deal.

(i) Acquisition of Individual Assets (Asset Deal)

When a business is sold (in whole or in part) in an asset deal, the buyer acquires individual assets that in the aggregate make up the operations sold. This kind of deal structure is often used if the buyer is not interested in acquiring the whole business or if certain risks have been identified which the buyer does not want to take on. To some extent, an asset deal enables the buyer to engage in "cherry picking". Tax aspects may also be relevant in the decision as the asset deal allows the buyer to step-up the book value of certain assets to a higher amount, by allocating the aggregate purchase price to individual assets.

The following aspects should be highlighted with respect to asset deals:

- The asset purchase agreement (“**APA**”) has to describe and define the assets (and liabilities) being sold and conveyed to the buyer specifically and completely. General descriptions like "all assets and inventory relating to the target business" are not sufficient. The parties often include extensive lists of the assets to be sold in an annex to the APA.

- The transfer of accounts payable and of contracts typically requires the consent of the respective creditors and contracting parties. This consent may be, and usually is, obtained after the execution of the APA. In this case, the buyer has to insist on specific provisions in the event that such consent will not be granted (e.g., servicing by the seller on behalf of the buyer, reduction of the purchase price, right of withdrawal, damages). If real estate is sold and conveyed by way of an asset deal, it has to be noted that lease agreements will transfer to the buyer by operation of law.

- As a general rule, public licences and permits relating to the operation of the business (e.g. building permissions) will be transferred to the buyer. On the other hand, licences and permits relating to a specific person, especially if a certain kind of knowledge or expertise was a precondition to granting the licence, cannot easily be transferred from the seller to the buyer but need to be reissued. As a consequence, the buyer needs to apply for a new licence in order to continue the acquired business operations.

- Pursuant to Section 613a BGB the employment relationships of all employees belonging to the business sold are transferred to the buyer by operation of law. The buyer assumes all rights and obligations resulting from the employment relationship existing at the time of transfer. The seller or the buyer must notify the employees of the transfer of the business prior to such transfer, with some rather rigid formal requirements to be observed. Note that only the notice to the employees must be issued prior to the transfer of the business but that the parties are free to conclude the APA prior to notifying the employees and that (in contrast to the legal regime in other European countries such as France and the Netherlands) there is no waiting period which must be observed after issuing the notice before closing the purchase agreement. The employees then have a right to object, in which case they would remain with the seller. In some transactions this can pose a significant risk for the seller and/or the purchaser which will need to be addressed by appropriate contractual provisions. Although the continuing employment relationship cannot be terminated merely based upon the business transfer, termination for other reasons, e.g. because of reorganization measures following the transfer of the business, will still be possible and therefore employees may often not be likely to exercise such objection right. Under certain circumstances such, as the carve-out and subsequent sale of a division from a large corporation with a high level of employee protection to a foreign buyer or private equity investor this may be different.

– The sale and transfer agreement only needs a specific form if (i) assets are sold whose sale and transfer mandatorily requires execution in a specific form (e.g., the sale and transfer of real property trigger the need to notarize the entire transaction) or (ii) all or substantially all assets of a company are sold in an asset deal in which case the APA will need to be notarized (pursuant to Section 311 b subpara. 3 BGB). Otherwise, for purposes of proof, the written form is advisable.

    – In particular, care needs to be taken with respect to the VAT treatment of an asset deal. Pursuant to Section 1 para. 1a *Umsatzsteuergesetz* ("**UStG**") the sale is only exempt from VAT if it is considered to be the sale of a business as a whole within the meaning of that provision.

(ii) Acquisition of Shares or Participation in an Enterprise (Share Deal)

In a share deal, the buyer acquires the shares in the company that operates a business. As a share deal does not affect the ownership of the company's assets, the buyer acquires the company with all its assets, receivables, liabilities, obligations (even those it does not know about), contracts and, in principle, public licences and permits. The possibility for the buyer to continue the business "as is" may be the decisive argument for carrying out a share deal.

The following two aspects should be highlighted with respect to share deals:

Since the interests in German partnerships (OHG, KG, GmbH & Co. KG) are not freely transferable, such transfer always requires the approval of all other partners, unless the partnership agreement provides otherwise. In comparison, shares in a German company (e.g. GmbH, AG) are freely transferable unless stipulated otherwise in its articles. The by-laws of family-owned GmbHs or joint venture type companies often contain such restrictions (e.g., approval by the company itself or by the shareholders' meeting).

The sale and transfer of interests in a partnership and of shares in an AG do not need to be executed in a specific form; simple written form of the relevant contracts, depending upon the circumstances even oral agreements, will be sufficient. If an AG has issued share certificates, the shares may be transferred by endorsement (and delivery of the share certificate) or by simple transfer of the right, with title to the share certificate following by law. In contrast, contracts for the sale and transfer of shares in a GmbH must be executed in notarized form.

(iii) Joint Venture

A joint venture is a commercial arrangement between at least two economically and legally independent partners. The establishment of a joint venture may be effected by (i) creating a new company, (ii) acquiring existing or new shares (e.g. following a capital increase) in an existing company (thus becoming the joint venture vehicle) or (iii) by agreeing to collaborate on a contractual basis. In the first two cases, the parties become joint shareholders of the joint venture company. Therefore, the company's articles (*Gesellschaftsverträge, Satzungen*) constitute the basis for the rights and duties of the parties as shareholders. However, since the articles of companies (AG, GmbH) are registered in the Commercial Register and thus become public knowledge, the shareholders will often opt for an additional shareholders' agreement (*Gesellschaftervereinbarung, Konsortialvertrag*) in order to provide for those matters to be kept confidential. Shareholders' agreements may set out detailed rules on the management of the company and its business (e.g., appointment of the members of management and other corporate bodies, management actions requiring shareholder approval), exercise of voting rights, financing, put and call options, etc.

When the parties agree to collaborate on a contractual basis without forming a joint company (often called a strategic alliance), the agreement will set out similar provisions, such as the scope and financing of the venture, the rights and duties of the participants, the sharing of returns and related costs, the duration of the legal relationship, termination and buy-out rights, etc.

E. Early Negotiation Stage

The first contact between the seller and the buyer is frequently organized by an M&A advisor. In the initial phase, the M&A advisor will often provide an information memorandum setting out key data of the target business to stimulate interest with potential buyers.

(1) Types of Agreements

(i) Confidentiality Agreement

After the initial contact between the parties, a first step to start the negotiation procedure is to sign a confidentiality or non-disclosure agreement ("**NDA**"). The seller will often ask for an NDA as a means of protecting the interests of the target company (and, in turn, its corporate officers) before disclosing confidential information concerning the target (and possibly the seller) to the potential buyer and its advisors. In such an NDA, the potential buyer undertakes to use the information submitted in the course of the due diligence only for purposes of the intended transaction without using it for its own business and to keep it secret towards persons not involved in the transaction and third parties. Furthermore, the NDA will often stipulate that the negotiations themselves shall be kept confidential as well.

In general, a German NDA is often shorter than a comparable standard U.S. or UK form. Using a long and exhaustive NDA draft entails the risk that a German counterparty might be put off by assuming a complicated approach by the other side in relation to the further transaction documentation.

The legal sanctions in case of breach of such an agreement will not always be very effective, because proving the existence and the amount of damages may be difficult. German sellers therefore often propose clauses on contractual penalties and liquidated damages in case of breach of the NDA. However, such clauses are rarely accepted in international and even in a German practice.

(ii) Letter of Intent

As an interim step the parties often use a letter of intent ("**LoI**") or similar agreements such as memorandum of understanding, heads of terms or term sheet to record their understanding reached and to set out the further process. The following statements regarding the LoI also apply, *mutatis mutandis*, to these other types of documents.

A letter of intent is usually rather short (about three to ten pages) and contains the key parameters of the intended transaction, such as a definition of the assets and liabilities or shares to be sold, the purchase price (amount or formula), payment of the purchase price, main closing conditions and perhaps an outline of representations and warranties. As the buyer incurs considerable costs and expenses during the pre-contractual period, in particular in connection with the due diligence review of the target business, but also to increase its bargaining power, the buyer will try to obtain an exclusivity undertaking from the seller for a defined period of time.

Although the LoI could be legally binding, the parties normally agree that it shall be a non-binding document. The non-binding nature of the LoI should always be explicitly stated in the document. Often, a generally non-binding LoI, however, contains certain binding provisions; in particular in relation to exclusivity, costs and non-solicitation.

Under German law, a party may be liable for damages in case of willful breach (e.g. discontinuation) of negotiations without legitimate reasons (Sections 311 subpara. 2, 280 subpara. 1 BGB). Examples would be a party making false statements about its own willingness to enter into the agreement or not disclosing to the other party that, according to new information, the deal is not of interest anymore. A party in breach typically would not be obligated to enter into the transaction but to reimburse transaction costs (in particular, advisors' fees) the other party has incurred while relying on the seriousness of the other side in continuing the negotiations.

(iii) Options

An option is characterized as a party's right to conclude an agreement by unilateral declaration, without any additional agreement of the other party. In M&A practice, options are used to create a binding agreement in favor of the buyer (call option) or in favor of the seller (put option). For the option, similar aspects apply as for the pre-contract, except that typically a fully negotiated and detailed share purchase agreement ("**SPA**") form will be attached to the agreement granting the option. Under German law no consideration is required to create a binding option. The same formalities apply as for the final agreement resulting from the exercise of the option. As a consequence, an option to buy shares in a GmbH or to buy real property requires notarization. Put or call options are used in the M&A context for example if the parties want to structure an acquisition in several stages in order to retain and incentivize sellers who also play a role in the management of the company at least during a transition phase. The purchase price under the option is then often variable and dependent on the economic development of the business (similar to an earn-out).

(2) Due Diligence and Disclosure

In most cases there will be a due diligence review of the target's business, financial, legal, personnel, tax and other affairs. It will be carried out by the buyer and its advisors unless a vendor due diligence report with reliance has been provided. Even then there will often be some level of supplemental due diligence by the buyer.

Generally, the target's management will be provided with a request list containing the relevant due diligence requests, unless the seller provides a pre-arranged data room as is common in an auction process. Virtual data rooms to provide the requested documentation online have become the norm. In more advanced phases of the transaction the potential buyer will often be given access to the target's premises, and the process will be supplemented by management meetings and Q&A sessions with experts.

The purpose of the legal due diligence is for the potential buyer to obtain information regarding the corporate structure of the target company, real estate, IP rights, financing, insurance agreements, any kinds of debts and obligations, and the most important contractual agreements between the target business and other parties, such as lease agreements, service agreements or agreements for the delivery of goods, employment issues, disputes, pending and threatened lawsuits, compliance, public permits, environmental matters and other related issues. This can be of particular relevance where a restructuring or carve-out needs to precede the sale.

The scope and contents of information given to the potential buyer during the due diligence may have a critical impact on the purchase price as known risks can be accounted for or covered by specific contractual arrangements, whereas unspecified risks may trigger large (and possibly excessive) deductions from the purchase price offered. Obviously, there is also a strong interdependence with the scope of the representations and warranties to be included in the SPA. The lower the information level of the buyer the more it will insist on specific protection in the SPA.

Under German law, the buyer has no rights against the seller if he has positive knowledge (*positives Wissen*) of certain defects of the object of purchase. If the seller is unacquainted with the defects because of gross negligence, the seller is only liable in case of willful misrepresentation or if a specific warranty has been given (Section 442 BGB). Unless otherwise agreed, the knowledge of employees and advisors will be imputed upon their principal. Therefore, the parties will typically have tough negotiations as to the possible limitation of express warranties resulting from disclosures within the due diligence process or knowledge otherwise obtained. In German M&A practice it is quite common to accept the contents of the virtual data room to the extent that facts are reasonably disclosed therein as disclosures against the warranties. This is a contrast to the standard practice in the United States which requires the seller, even if he has made available documents to the purchaser in a due diligence, to disclose all relevant facts against each separate representation and warranty in an annex to that warranty.

The concept of due diligence is based on the common law concept of caveat emptor under which the buyer is generally obligated to examine and review the object of purchase. German legal tradition, however, does not impose such a broad duty to inspect the object to be purchased upon the buyer and therefore the rights of the buyer are not excluded if it does not carry out due diligence. However, some authors and German higher regional courts argue that in particular in larger business transactions due diligence proceedings have become market standard and therefore a prospective buyer has to carry out due diligence. Otherwise, he will lose his rights and remedies against the seller. Not conducting a due diligence exercise without excellent contractual protection may also form the basis of claims against the officers of a buyer, invoking a violation of fiduciary duties in case the acquisition shows unfavorable results. Still the trend in the past years has been that buyers only commission a high level red flag due diligence review of the target company in order to contain transaction costs and only cover the most significant risks.

It should be noted that German case law requires the seller to disclose to the purchaser of a business such facts about the business that may be reasonably expected to be decisive for the purchaser's decision to acquire the business. This disclosure obligation applies even if the purchaser does not conduct any due diligence and needs to be fulfilled by the seller disclosing such facts even without being specifically asked about them. If the seller knowingly does not disclose such facts the entire transaction can be avoidable under German statutory law. Also, in such a case limitations agreed with respect to the representations and warranties may cease to apply.

F. Acquisition Agreement

If the due diligence has not revealed any deal breakers, it will be followed (or coincided) by the negotiation of the specific terms and conditions of the transaction and the preparation of the contractual documents.

In general, the SPA starts with the recital, where the parties, their representatives and their functions are named. Larger documents contain an index, where the provisions are set out. Unlike U.S. or UK documents, German style SPAs may not include an exhaustive list of definitions, but those are typically embodied in the specific provisions. However, it is not unusual in larger transactions with international parties that U.S. or UK style documents (localized for purposes of German law), including a separate and extensive definition section, are used.

The SPA will often start with a preamble, giving an overview of the intentions of the parties and describing the subject matter and structure of the transaction.

(1) Subject Matter of the Agreement

It is of paramount importance that the agreement properly defines the subject matter of the purchase and sale, be it in a share or asset deal. As to the latter, the agreement must contain a detailed list of the assets to be sold and conveyed to the buyer. The same applies to liabilities, debts and other obligations. Further, the agreement has to describe exactly which contractual relationships the buyer will become a part of.

The conveyance of tangible objects can be effected under a condition precedent, most notably payment of the purchase price (Sections 158, 929 et seq. BGB). The same applies to the assignment of receivables and intellectual property rights. The conveyance of real estate, on the other hand, cannot be made subject to a condition precedent (Section 925 subpara. 2 BGB); instead, the buyer can be protected by registration of a priority notice (*Auflassungsvormerkung*) in the land register.

As mentioned before, the stepping of the buyer into existing contractual relationships between the seller and a third party requires the consent of the third party. If the third party withholds its consent, the agreement may provide for the seller to remain contracting party and to perform the contract for the account of the buyer until the first possible termination date of the contract.

As to the purchase price two models of fixing the purchase price are most common:

– Fixing a purchase price based on the last annual accounts of the company (or a similarly reliable set of numbers), with a “locked box” mechanism for the interim period from the date of the last annual accounts until the closing date. The “locked box” provisions of the purchase agreement will then set forth in detail what payments if made in the interim period are considered “leakage” and will be deducted from the purchase price.

– The parties agree on a price which is subject to adjustments based on closing accounts which will be drawn up by the company after the closing and will show the company’s net equity, net working capital or other key parameters to which the purchase price adjustment is tied, in each case as of the closing date. The parties will carefully negotiate who controls the process of drawing up these closing accounts and how disputes will be resolved, often by an expert arbitrator, often a certified auditor or auditing firm.

Variable purchase price elements tied to the future economic development of the company (“earn out”) are quite common and require attention to the detail of the relevant parameters and protection against future manipulation of those parameters. Deferred purchase price elements (vendor loans) are sometimes agreed but less common.

(2) Warranty and Liability

Scope and limitations of the representations and warranties as well as the sanctions in case of their breach are among the most important aspects of negotiating a share or asset purchase agreement.

According to German statutory law, in case of a breach of a sales contract, the buyer is primarily entitled to have the seller cure the defects (Sections 437 subpara. 1, 439 BGB). According to Sections 346, 323, 326 BGB, the buyer is entitled to rescind the agreement if the seller is either not willing or unable to cure the defects. However, these statutory provisions were designed for the sale and purchase of tangible assets, especially consumer products, but not for business entities. The seller will only rarely be able to cure a defect of the sold business, and rescission of a contractual agreement and the return of the business entity against the repayment of the purchase price is typically neither desired nor practical. For these reasons, the parties will in most cases replace the statutory provisions by a (limited and defined) right of the buyer to claim damages.

Under German law a claim for damages requires either negligence on the part of the seller (with a presumption of fault according to Section 280 subpara. 1 clause 2 BGB) or the breach of a specific warranty given by the seller. This presumption of fault is rather disadvantageous for the seller because, after the closing of the deal, it usually no longer has access to evidence which could prove that it was not at fault. In this context, it has to be pointed out that the German civil procedure rules do not provide any kind of pre-trial discovery, which would enable a party in a lawsuit to obtain the relevant information from the other side.

As the statutory provisions do not fit very well into the concept of the sale of a business, the parties usually stipulate that the buyer has no legal rights against the seller except those specifically set out in the agreement, most notably the representations and warranties and related remedies.

In this respect, the seller usually gives specific warranties, with legal effect either as of the day of the signing or the closing date, or both. These warranties are not subject to any fault of the seller (therefore are technically referred to as “guarantees”) and do apply only to specifically described circumstances with specifically tailored remedies. In general, the scope and the limitations of the contractual guarantees are influenced by the due diligence findings and the bargaining powers of the respective contractual parties. Typical warranties refer to the subjects such as:

- corporate law issues of the seller and the target company (e.g. proper incorporation of the company, contribution and possible repayments of capital, correct chain of title and company title ownership of the shareholders, claims of the shareholders against the company and vice versa; profit transfer and control agreements, specific agreements with shareholders);

- the assets, liabilities and earnings of the company, financial statements;

- intellectual property rights;

- employment regulations, especially retirement plans and social security contributions;

- pending or threatened claims or disputes;

- compliance with laws, specific compliance issues (no corrupt practices), data protection, environmental issues, etc.;

- public permits.

In addition to negotiating the scope of the individual warranties there are a few typical points of a general nature which may be the subject matter of tough negotiations. Buyers will ask for a blanket warranty on the correctness and completeness of the data room or even all pre-transaction disclosures, which sellers will reject in view of the broadness of such a warranty. Sellers will try to limit their liability to actual or constructive knowledge of the incorrectness of warranties given, with a specification whose knowledge will be attributed to the selling entity. Particular attention should be paid to the burden of proof applicable to the prerequisites of a claim or the defense against it, which may be determined by the grammatical details of wording. As the German civil procedure system does not know the concept of pre-trial discovery, the proper setting of the burden of proof may be decisive in determining the likelihood of success of a claim or a defense.

As for the consequences of the breach of a warranty, the agreement usually provides that the buyer shall notify the seller of a breach of a warranty and shall give it the possibility to cure the defect within a reasonable time. If an effective cure is either not possible or has not taken place within the agreed time, the buyer will usually have the right to claim damages. Under German law, any disadvantage suffered as a result of the breach must be balanced by way of damages, as long as there exists an “adequate causal link” between the breach and the disadvantage suffered. As this can present an unforeseeably broad liability of the seller, the parties in an M&A transaction may agree that lost profits (and possibly other indirect damages) are excluded. Furthermore, the parties may agree on certain monetary limitations for the amount of damages such as thresholds or deductibles, caps and the like, which may result in a fairly detailed system of limitations applicable to individual warranties or potential claims or groups of them or the overall aggregate, be it by setting Euro amounts or percentages of the purchase price or other appropriate parameters.

It has to be noted, that these limitations will not apply if the seller acts intentionally (Section 276 subpara. 3 BGB). Therefore and as noted above, it is of paramount importance that the seller discloses any facts of which he is aware which would constitute a breach of warranty.

Another element of negotiation will be the limitation period. In the absence of a contractual provision this will be two years (Section 238 subpara. 1 clause 3 BGB) or in some cases three years (Section 195 BGB). However, these periods can be shortened or extended by contractual provision and there will often be a staged approach with a period running for a few months after the finalization of the first annual accounts after the closing for more routine claims and longer periods for such items as customer claims or environmental warranties (unless covered by specific examination and indemnification provisions). Warranties regarding existence of the company sold and ownership of title in the sold shares (share deal) and warranties relating to other fundamental legal properties of the company and the sold shares (“title warranties”) are often subject to longer limitation periods agreed by the parties.

To ensure proper fulfillment of a claim in case of a breach, buyers will often suggest to place some of the purchase price in escrow (to be released in stages or in one sum when the agreed limitation period for guarantee claims ends) or to obtain a parent company guarantee or other surety from the seller.

In recent years, it has become more common in German M&A practice to use warranty & indemnity insurance to bridge a gap between the purchaser’s need to receive adequate protection for possible unknown problems in the company and the seller’s desire to protect the purchase price against subsequent claims by the purchaser by obtaining insurance covering possible breaches of the warranties negotiated by the parties. The insurer’s fees are usually paid by the buyer (so called “buy-side-insurance” in contrast to a “sell-side-insurance” where the seller pays the insurer’s fees) and the purchaser has a direct claim against the insurer in case a warranty under the SPA is breached. Describing the mechanics and details of such warranty & indemnity insurance would go beyond the limits of this article but in should be noted that several large international insurance brokers and their legal advisers by now have a sufficient knowledge of the German M&A practice and market to provide information regarding the process and details for such coverage.

(3) Agreements on Applicable Law

In cross-border transactions, it is essential for the parties to specifically agree on the law to govern the contracts. If the parties come from different jurisdictions, either side will try to select the law of its home country.

However, according to German international private law, the parties are only free to choose the law governing the sale and purchase agreement and have no choice regarding the law applicable to the transfer of shares or assets, since these legal acts are mandatorily governed by the law of the country where the assets are located or, as to shares, where the company is incorporated. Thus, a share or asset purchase agreement in relation to German assets or shares but executed under foreign law will typically need some implementation under German law. Therefore, the parties will often agree on German law to be applied if the transaction has a strong connection to Germany. Sometimes a “neutral jurisdiction”, such as Swiss law, is chosen although this may make matters unnecessarily complicated, including the need to involve additional advisors familiar with the law of the neutral jurisdiction.

Besides the choice of law, the choice of language is an important issue – even from a psychological perspective. If the parties do not ordinarily communicate in the same language, each party will try to ensure that the negotiations are conducted and contracts drafted in its own language. Thus, a German seller not experienced in international transactions may insist on German as the only operative language. On the other hand, most larger German businesses will have no problem entering into an English language contract but may insist on terms whose meaning is critical under German law concepts to be added in their German original. To some extent it may be necessary to provide for official translations (typically only of excerpts) for German authorities such as tax, the land register or the commercial register.

Bilingual contracts are sometimes used in cross-border transactions but this usually makes negotiations particularly burdensome and, in the interest of clarity, the parties nevertheless should stipulate which version shall be decisive. Therefore not much is gained thereby.

(4) Signing and Closing

Although German deals used to be signed and closed at the same time whenever possible, it has become increasingly accepted to have a two step process. This would mostly be a function of private or government approvals being required or other conditions precedent, if it is impractical to obtain them prior to signing. Examples may be:

– Regulatory approvals, be it in relation to merger control (see Chapter G below) or industry specific regulations;

– Approvals by other shareholders or partners, as required by the relevant articles or incorporation documents;

– Company or group internal board approvals;

– Third party approvals (in an asset deal where contracts cannot be transferred without their consent or to comply with change-of-control provisions in contracts that are material for the business);

– Client consents in the medical or legal advisory fields or elsewhere to comply with data protection rules;

– Probate court approvals in case of minors being involved or spousal consents under specific circumstances;

– Other contractually agreed conditions precedent.

In these cases, the sale and purchase agreement is signed when the parties have agreed on all terms and conditions, while closing occurs at a later point in time, after all approvals or other conditions precedent have been obtained or fulfilled. In the German market it is very unusual to provide for a confirmatory due diligence by the buyer to be agreed as a closing condition.

In transactions subject to notarization a two tier structure may increase the notarial fees, and therefore the parties will attempt to have the completion acts (such as the agreement on the transfer and assignment itself) included in the deed containing the sale and purchase but made subject to conditions precedent which do not require a separate legal act to be notarized. However, depending upon the closing conditions, this is not always feasible.

Between the signing and the closing, the seller remains responsible for the target company. The buyer, however, has an interest to ensure that during the transition period the seller will not make any long term business decision which might have a negative impact on the target or the buyer or are incompatible with the buyer’s strategy. For this reason, the SPA may subject certain business measures to the consent of the buyer. However, in transactions subject to pre-merger clearance the parties must be careful that the influence of the buyer during the transition period does not amount to a premature consummation of the transaction for merger control purposes.

Buyers will often ask for MAC (Material Adverse Change) provisions in order to protect themselves against a deterioration of the target during the transition period, be it by reduction of the purchase price or even being granted a rescission right. Such a request will in particular be driven by financing sources of the buyer, whereas the seller will be very reluctant to agree on such a clause. Note that MAC clauses are much more common in other markets such as the United States than in Germany. German M&A practice generally still proceeds on the assumption that once the transaction is signed, the closing should be a mere matter of mechanics and none of the parties will be allowed to reconsider the deal between signing and closing, even if circumstances change in the meantime. If a MAC clause is agreed it is very important to specifically define the trigger events and how they are determined, as well as the consequences of a material adverse event occurring. Otherwise there is a high risk that a buyer may use such provision as a pretext to renegotiate or even walk away from the deal.

G. Merger Control

(1) Introduction

Any M&A and similar transactions, such as entering into a joint venture, should be carefully reviewed in terms of merger control and other antitrust considerations as, due to an intention or effect of restraining competition, they may either be prohibited or subject to clearance proceedings. In this context, one should think not only of the jurisdiction where the transaction is taking place, but also of any other jurisdiction where the transaction may have an impact upon competition. Thus, an acquisition or disposal in Germany may be subject to regulations in several other countries outside of Germany and, vice versa, a transaction taking place outside of Germany may be subject to German or European merger control regulations (e.g. an M&A transaction in a third country with participating entities that have operations or sales in Germany).

This area of law could be the subject matter of an extensive separate paper and therefore this Guide only sets out some basic information in relation to German and European merger control.

(2) Merger Control in Germany

The relevant legal regulations are set forth in the Act against Restraints of Competition ("**GWB**") which is administered and enforced by the Federal Cartel Office in Bonn (*Bundeskartellamt*).

Any M&A transaction qualifying as a merger (as defined in Section 37 GWB, see below) is subject to a premerger filing requirement if all undertakings involved, during the last completed business year before the transaction, commanded worldwide revenues of more than EUR 500 million and at least one of the undertakings involved commanded domestic revenues in Germany of more than EUR 25 million and another of the undertakings involved commanded domestic revenues in Germany of more than EUR 5 million (Section 35 subpara. 1 GWB). An exception from this applies if an independent company which until then did not form part of another group and during the last business year commanded worldwide revenues of less than EUR 10 million merges with another undertaking. (Section 35 subpara. 2 GWB).

With effect from 9 June 2017 (closing date), a transaction is also subject to a premerger filing requirement if only the first and second revenue thresholds are met (more than EUR 500 million worldwide revenues of all undertakings involved, more than EUR 25 million domestic revenues in Germany of at least one but (1) the value of the consideration (e.g. purchase price plus assumed liabilities) amounts to more than EUR 400 million *and* (2) the undertaking to be acquired (target) has substantial business activities in Germany (Section 35 subpara. 1a GWB). This new transaction-value based threshold is intended to cover deals which may have a significant impact on competition in the future, even though monetary revenues of the target or even the market volume of the markets concerned are still low at present. Transactions in the high-tech and digital economy and innovation-driven industries such as pharmaceuticals are in the focus. The revenues mentioned above are calculated in a different way in relation to banks, insurance companies, publishers and trading companies (Section 38 GWB). Section 35 subpara. 2 GWB contains some rare exemptions for banking groups, central banks, and certain public undertakings. Undertakings participating in the transaction and therefore to be considered in the above described calculations always include the buyer and the target. In the case of a sale of 100% the seller would not be included. However, the disposing entity would be included if at least 25% of the shares or votes are retained or if several companies jointly control the target as a result of the transaction.

The definition of a merger includes the acquisition of 25% and 50% of the shares or votes of the target company (Section 37 subpara. 1 clause 3 GWB), e.g. even an existing shareholder acquiring further shares and thus reaching either of these thresholds will be subject to merger control. In the same context, any acquisition by means of an asset deal may qualify as a merger, even if the assets and liabilities are not comprehensive enough to constitute an independent business enterprise. Similarly, any other combination by which one or several entities may acquire a direct or indirect influence over another undertaking relevant upon competition may fall within the definition of merger. There is wide ranging case law available which cannot be discussed here in detail.

A merger project must be pre-notified to the Federal Cartel Office by all entities involved, which obligation in the case of an asset deal and the acquisition of 25% or 50% of the shares or the votes of the target company also extends to the seller (Section 39 subpara. 2 GWB). The filing requires the submission of extensive documentation to the Federal Cartel Office which may ask for further information (Section 39 subparas. 3 and 5 GWB), details of which are not described here.

Basically, the Federal Cartel Office must prohibit a merger which would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant market position (Section 36 subpara. 1 sentence 1 GWB). An exemption from that rule applies if the companies can prove that the merger also results in improvements of competitive conditions and that those outweigh the disadvantages of the market domination (Section 36 subpara. 1 no. 1). A further exemption applies if only a "minor" market is concerned, i. e. a market in which goods or services have been offered at least for the last five years, but in the last calendar year before the transaction the market volume was less than EUR 15 million (Section 36 subpara. 1 no. 2 GWB). This second exemption is not applicable in cases of the new transaction-value based threshold, Section 35 subpara. 1a GWB – see above –, and for markets in which services are rendered free of charge, Section 18 subpara. 2a GWB. A special failing firm defense exists for "rescue mergers" of press companies (Section 36 subpara. 1 no. 3 GWB).

The transaction must not be consummated before the clearance process has been completed (Section 41 GWB). In practical terms, this is sometimes relevant where in relation to the period between signing and closing measures are taken in order to protect the buyer (e.g. appointments to management or supervisory positions, consent requirements in relation to significant contracts or business transactions). Those should be closely reviewed to make sure that they do not go as far as running the risk of being qualified as premature consummation of the transaction for merger control purposes.

The transaction will be considered approved and thus may be consummated if, within a month from receipt of the complete filing, the Federal Cartel Office has not notified the parties that it is commencing an in-depth review (so called main examination proceedings). If the Federal Cartel Office has notified the parties that it has initiated the main examination proceedings but has not issued a prohibition order within four months from the initial filing, unless the parties have agreed on an extension of the Principal Examination, the merger is equally considered approved and may be consummated (Section 40 GWB). However, it is rare for a transaction to be considered approved simply by virtue of expiration of the described deadlines. The Federal Cartel Office typically issues a written notification that the conditions for prohibition of the transaction are not satisfied.

Consummation of a transaction in violation of the above described requirements renders the legal consummation acts void (Section 41 subpara. 1 clause 2 GWB) and may make the participants subject to substantial fines (Section 81 subpara. 2 clause 1 GWB). The participants in the transaction and to some degree also third parties (e.g. competitors) may play an active role in the administrative proceedings and may also challenge the decisions by the Federal Cartel Office. Upon special application the Federal Minister of Economic Affairs and Energy may grant relief from a prohibition order issued by the Federal Cartel Office in the interest of the public good, taking into account considerations beyond the competition rules (Section 42 GWB). This is subject to special procedural rules and extremely rare (only nine applications have been granted so far, the last one in 2016 – Edeka/Tengelmann).

(3) European Merger Control

The most important legal source in this area is the Council Regulation no. 139/2004 of 20 January 2004 (European Merger Control Regulation, "**EMCR**") which, together with other legal sources in relation to European merger control, can be found at http://ec.europa.eu/competition/mergers/legislation/legislation.html. In general, the national German merger control regulations (Sections 35-43 GWB, see above) do not apply where the European Commission has exclusive jurisdiction pursuant to the EMCR (Section 35 subpara. 3 GWB).

According to Article 1 subpara. 2 EMCR, all "concentrations" with a "Community dimension" are subject to European merger control conducted by the European Commission in Brussels. A concentration has a Community dimension, if

– all undertakings concerned command aggregate worldwide turnover exceeding EUR 5 billion, and

– each of at least two of the undertakings concerned command an aggregate Community wide turnover of more than EUR 250 million,

– unless each of the undertakings concerned achieves more than two thirds of its aggregate Community wide turnover with one and the same Member State.

– In case these thresholds are not met, a concentration has nevertheless Community dimension, if

– the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2.5 billion, and

– in each of at least three Member States the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million, and

– in each of at least three Member States included for the purpose of the second point above, the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million, and

– the aggregate Community wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million,

– unless each of the undertakes concerned achieves more than two thirds of its aggregate Community wide turnover within one and the same Member State.

The definition of "Concentration" focuses on obtaining control, i.e. contrary to the German national rules the acquisition of 25% or 50% without gaining control would not constitute a concentration within this meaning.

A concentration without Community dimension may be referred to the Commission if otherwise it would have to be filed in at least three Member States (Article 4 subpara. 5 EMCR), or one or several Member States may refer a case to the Commission (Article 22 EMCR).

The notification and conduct of the proceedings by the Commission exclude any parallel merger control proceedings in a Member State.

In exceptional cases the parties or a Member State may ask the Commission, under certain conditions, to refer a case with Community dimension to a Member State if the market impact is restricted to the territory of such Member State (Article 4 subpara. 4, Article 9 EMCR).

As is the case under German merger control legislation, a concentration with Community dimension must be filed with the Commission and must not be consummated before it has either been cleared or the relevant periods of time have expired without a prohibition order having been issued. In special cases the Commission may grant a waiver from the prohibition of consummation (Article 7 subpara. 3 EMCR). From the time of filing the Commission has 25 working days to decide whether the transaction is subject to the EMCR and whether it raises serious concerns. In that case it will commence a second phase review, under which it shall issue its decision within 90 working days. However, this period can be extended (e.g. upon application of the parties or as a result of information requests issued by the Commission). Further details go beyond the scope of this Guide and should be discussed with merger control experts.

H. Prohibition of Acquisition for National Security Reasons

Under the Foreign Trade Regulation (**AWV**) introduced in the German Federal Ministry of Economic Affairs and Energy may prohibit any direct or indirect acquisition of assets or of shares granting at least 25% of the votes of a German company by a buyer not resident within the European Union or EFTA (Iceland, Liechtenstein, Switzerland, Norway) if it determines that the transaction threatens the public order or security of Germany (Section 59 AWV). It is not a requirement that the seller is a German or EU resident. In principle, this may relate to any industry sector and businesses of any size, but realistically the main application will be key military, technology, IT and infrastructure businesses.

There is no mandatory pre-filing requirement and no prohibition on consummation, but the ministry may unwind the transaction if it decides to prohibit it (Section 59 subpara. 2 AWV). If the ministry learns of a critical transaction it has three months to commence a formal review process (Section 55 subpara. 3 AWV) and, upon receiving complete information requested, has further two months to issue a prohibition order or conditions to the transaction, in both cases requiring cabinet level approval (Section 59 subpara. 1 AWV). It seems that this process is only used in rare and exceptional circumstances.

If the parties wish to avoid the uncertainties resulting from the possibility of such a post-transaction review they may apply for a pre-clearance. Upon receipt of such an application the Ministry has one month to commence a formal review, otherwise the transaction is considered cleared (Section 58 AWV).

I. Dispute Resolution

German parties (as seller) typically will not accept the jurisdiction of a foreign court. German court proceedings are generally reliable, of high quality and relatively efficient, with manageable costs. A disadvantage, however, is the fact that the proceedings will need to be held entirely in German and the essential documents must be provided in German. In case such documents were drafted in English this requirement will lead to substantial difficulties. If a German court is not practical or for other reasons is not accepted by the other side, a German seller will typically propose arbitration in Germany (notably under the auspices of *D.I.S. – Deutsche Institution für Schiedsgerichtsbarkeit*) but may also agree to foreign arbitration organizations such as the International Chamber of Commerce (*ICC*).

J. After the Transaction

The success of an acquisition is especially dependent on the successful integration of the acquired business into the existing operations of the buyer. Such integration is often less complex in a share deal than in an asset deal.

With respect to representations and warranties as well as indemnities, the buyer should set up a process to monitor any claims so that proper evidence can be submitted and deadlines are not missed. Depending on the purchase price mechanism, a closing balance sheet or other financial accounts may need to be prepared after the acquisition.

There may also be other post-transaction changes such as replacement of officers or other key employees, a change of corporate name and the like, which may require filing and registration in the commercial register of the target company.

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