

Corporate/Capital Markets Update

Client Letter

v. BOETTICHER HASSE LOHMANN

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Germany: Court Rulings

Time Limitations of Staggered Capital Increase

The Higher Regional Court of Munich (*OLG München Beschl. vom 22.09.2009, 31 Wx 110/09; ZIP 2009, 1954 seq.*) ruled that a shareholder resolution on the increase of the stated share capital up to a certain amount (so-called “up to capital increase”/”bis zu-Kapital-erhöhung”) in a German stock corporation cannot be implemented by issuing new shares in several tranches with no time limits. The court joined the **prevailing legal view accepting a six months time frame** for the implementation of such resolution but left open whether a staggered implementation is admissible at all (even if all tranches are issued within six months from the shareholder resolution).

From a practical point of view the resolution of so-called authorized capital (*genehmigtes Kapital*) as opposed to the standard capital increase will usually better serve the needs of flexibility of a German stock corporation. But occasionally a (staggered) standard capital increase or a combination of standard capital increase and authorized capital may fit. In any situation where a staggered capital increase shall be implemented for whatever reason, the issuer should pay attention to the following formal requirements:

- the **shareholder resolution** on the capital increase should allow for an implementation by issuing several tranches and provide for an implementation period of not more than 6 months;
- in the **filing to the commercial register** for registration of any issued tranche the issuer should reserve the right to make further use of the resolved capital increase;
- in the absence of a conclusive court ruling the issuer should get **comfort** on any contemplated staggered increase **from the competent commercial register** in advance.

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Criminal Liability of Compliance Officers

The German Federal Supreme Court (*BGH*) for the first time ruled on the **criminal liability of compliance officers** who fail to prevent representatives of their company from committing a criminal offence (fraud in the case under review). In general, criminal liability is attached to omissions under German criminal law only where the omitting person is under a specific obligation to prevent a certain outcome (*Garantenpflicht*). In its decision of 17 July 2009 (5 StR 394/08) the *BGH* ruled that such specific obligation as a matter of principle is attached to the position of a compliance officer within the scope of the duties assumed. A remarkable point is that in the case under review the convicted offender in fact was not a compliance officer but **head of the legal department** and **head of controlling**. The specific circumstances of the case lead the *BGH* to the conclusion that even such position may trigger the criminal liability attached to the position of compliance officers.

The good news is that negligence (as opposed to intentional commission) will usually not trigger criminal liability. Regularly an omission by a compliance officer will qualify as aiding and abetting the respective offence (as opposed joint perpetration). Under German criminal law aiding and abetting is subject to criminal liability only where the offender acts intentionally.

Germany: Draft IDW-Standard on Fairness Opinions (IDW ES 8)

On 4 December 2009 the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer- IDW*) has published a **draft standard addressing the preparation of fairness opinions (IDW ES 8)**. The draft standard contains principles on the assessment of the financial appropriateness of transaction prices, e.g. within business acquisitions or divestitures. Such fairness opinions often serve to provide a certain comfort to management or supervisory bodies and/or to record an adequate basis of information within business decisions (e.g. as a prerequisite for applying the Business Judgement Rule). They are typically requested in situations, in which restrictions as to time and access to information prevent a full fledge valuation pursuant to IDW Standard S 1 (Principles on Conducting Business Valuations). In the past approximately 60% of the fairness opinions have been provided by investment banks and 40% by accounting firms.

IDW ES 8 generally refers to well known valuation methods like capitalized earnings and discounted cash flow approaches on the one hand and valuations using

multiples on the other hand. According to the draft standard, the result of such valuation shall be presented in an opinion letter on the appropriateness of the transaction price, which opinion letter shall be accompanied by a valuation memorandum. Specifically with respect to the mandatory statement to be presented by the management and the supervisory board within public tender offers the draft IDW ES 8 provides a **sample opinion letter** on the appropriateness of the offer price.

Due to the ongoing consultation the draft will not be finalized earlier than mid 2010. In the meantime, it may not only serve to the accounting firms and investment banks as guidance for fairness opinions but also to management as guidance for valuation itself.

Useful link:

Draft Standard IDW ES 8:
<http://www.idw.de/idw/portal/n281334/n281114/n281116/index.jsp>

EU: New Regulation on Rating Agencies

On 17 September 2009 the European Council adopted **Regulation (EC) No 1060/2009 on credit rating agencies** which regulation entered into force on 7 December 2009.

General

Credit rating agencies play an important role in securities and banking markets, as their ratings are used by investors, borrowers, issuers and governments in taking decisions on investment and financing. They are however considered to have failed to reflect early enough in their ratings the worsening of market conditions in the run-up to the financial crisis. Credit rating agencies have only been subject to a limited extent to EU legislation and most Member States do not regulate their activities, although their ratings are used by financial institutions which themselves are subject to EU rules. The agencies, most of which currently have their headquarters outside the EU, may however apply a voluntary code of conduct issued by the International Organisation of Securities Commissions (IOSCO).

The new regulation introduces a **common regulatory approach** in order to enhance the integrity, transparency, responsibility, good governance and reliability of credit rating activities, contributing to the quality of credit ratings issued in the European Community. It lays down conditions for the issuing of credit ratings and rules on the organisation and conduct of credit rating agencies to promote their independence and the avoidance of conflicts of interest. It is aimed at:

- ensuring that credit rating agencies **avoid conflicts of interest** in the rating process, or at least manage them adequately;
- **improving the quality** of methodologies used by credit rating agencies and the quality of their ratings;
- increasing transparency by **setting disclosure obligations** for credit rating agencies;
- ensuring an **efficient registration and surveillance** framework, avoiding 'forum shopping' and regulatory arbitrage between EU jurisdictions.

Registration, Organisation and Conduct

The regulation introduces a **registration procedure** for credit rating agencies to enable European supervisors to control the activities of rating agencies whose ratings are used by credit institutions, investment firms, insurance, assurance and reinsurance undertakings, collective investment schemes and pension funds within the Community. **CESR will receive applications** for registration and effectively inform the competent authorities in all Member States. The examination of applications for registration will be carried out at **national level** by the relevant competent authority.

Furthermore, credit rating agencies will need to comply with the following rules on the organisation and conduct:

- credit rating agencies **may not provide advisory services**;
- they will not be allowed to rate financial instruments if they do not have **sufficient quality information** to base their ratings on;
- they must **disclose the models, methodologies and key assumptions** on which they base their ratings;
- they will be obliged to publish an **annual transparency report**;
- they will have to create an internal function to **review the quality** of their ratings;
- in order to ensure the independence of the credit rating process from the business interest of the credit rating agency as a company, credit rating agencies should ensure that at least one third, but no less than two, of the members of the **administrative or supervisory board** are independent.

Use of Credit Ratings for Regulatory Purposes

Credit institutions, investment firms, insurance undertakings, assurance undertakings, reinsurance undertakings, undertakings for collective investment in transferable

securities (UCITS) and institutions for occupational retirement provision may use credit ratings for regulatory purposes only if they are issued by credit rating agencies **established in the Community and registered in accordance with this regulation**.

The Regulation provides for the use of **credit ratings issued in third countries** for regulatory purposes in the Community provided that they comply with requirements which are as stringent as the requirements provided for in the regulation. The regulation introduces an endorsement regime allowing credit rating agencies established in the Community and registered in accordance with its provisions to endorse credit ratings issued in third countries. When endorsing a credit rating issued in a third country, credit rating agencies must determine and monitor, on an ongoing basis, whether credit rating activities resulting in the issuing of such a credit rating comply with requirements for the issuing of credit ratings which are as stringent as those provided for in this regulation, achieving the same objective and effects in practice. Further provisions address the use of credit ratings related to entities established or financial instruments issued in third countries which ratings are issued by credit rating agencies situated in a third country.

Transitional Provisions

Credit rating agencies operating in the Community before 7 June 2010, shall submit their application for registration by 7 September 2010 and shall adopt all necessary measures to comply with the provisions of the regulation by that date. Other credit rating agencies may file their application for registration from 7 June 2010.

Useful links:

Regulation (EC) 1060/2009 (English):

<http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2009:302:SOM:EN:HTML>

Regulation (EC) 1060/2009 (German):

<http://eur-lex.europa.eu/JOHtml.do?uri=OJ%3AL%3A2009%3A302%3ASOM%3ADE%3AHTML>

EU: 9th Update of CESR Q&A re Prospectuses

On 16 September 2009 the Committee of European Securities Regulators (CESR) issued the 9th updated version of common positions agreed by the CESR members regarding prospectuses under the Prospectus Directive 2003/71/EC in the form of a Q&A paper (Ref. CESR/09-798). This paper adds new Q&A to those

included in the previous Q&A document published in February 2009 (Ref. CESR/09-103).

In the new Q&A document the following additional common positions have been included:

- no **right of withdrawal** after completion of the purchase of securities but prior to their listing;
- no **right of withdrawal** where the prospectus relates to the admission of securities to trading while such securities have issued without a prospectus;
- required statements to accompany **profit estimates** in prospectuses for debt and derivative securities;

- **display of documents** referred to in the prospectus whether or not they are prepared by an expert;
- only summary but no display of **material contracts**;
- no offer to the public by displaying **secondary market prices** on issuers website.

Useful link:

9th Update of CESR Q&A (CESR/09-798):
<http://www.cesr-eu.org/index.php?page=groups&mac=0&id=40>

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This Client Letter is intended to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact the person named under "Key Contact", or your usual contact at v. Boetticher Hasse Lohmann.

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