Legal Update
Corporate and Tax, Mergers & Acquisitions

Delisting and Downgrading in Light of the German Federal Constitutional Court's Decision dated 11th July 2012 – Recommendations for Action in Practice

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There have been some remarkable court decisions on regular delisting (complete withdrawal from the stock exchange) and downgrading (change from trading on the organized market to a qualified segment of the open market (*Freiverkehr*) on a German stock exchange) in the recent past. In its "delisting" judgment dated 11th July 2012, the German Federal Constitutional Court (*Bundesverfassungsgericht*) rejected for constitutional grounds the reasoning of the Federal Court of Justice (*Bundesgerichtshof*) in what had been up to that time the Federal Court of Justice's seminal case law on delisting. In contrast to the view taken by the Federal Court of Justice, the Federal Constitutional Court regards the transferability of a share as merely an opportunity for earnings and trade, which is not within the ambit of Article 14 of the German Constitutional Law (*Grundgesetz*). The implications of the Federal Constitutional Court's decision on delisting and downgrading are discussed below.

Introduction

The German Federal Court of Justice's "Macrotron" Case Law

The German Federal Court of Justice held in its 2002 "Macrotron" judgment (BGHZ 153, 47) that the prerequisites for a regular delisting were (i) a resolution adopted at the annual general meeting, (ii) a mandatory offer of compensation to the minority shareholders, and (iii) the possible review of the offer of compensation in valuation proceedings. The court ascertained these prerequisites through drawing an overall analogy with sections 305, 320b and 327b of the German Stock Corporation Act (*Aktiengesetz*) and sections 29 and 207 of the German Reorganization Act (*Umwandlungsgesetz*) and based its reasoning primarily on a finding that delisting affected the transferability of a share and thus the fundamental right to the guarantee of ownership (*Eigentumsgarantie*) of the shareholders (Article 14 of the German Constitutional Law). In addition, in its obiter dictum the German Federal Court of Justice held in the "Macrotron" judgment that the economic disadvantages suffered by the minority

shareholders as a result of the delisting on the organized market could not be compensated for by the inclusion of the shares in the open market on a German stock exchange. Consequently, the delisting rules that had been developed should generally be taken into account in the case of a downgrading.

Diverging Decisions on Downgrading by the Lower Courts

The Munich Higher Regional Court (*Oberlandesgericht München*) and the Berlin Higher Regional Court (*Kammergericht*) deliberately diverged from the generalized approach which had been adopted by the German Federal Court of Justice. By drawing distinctions they decided in the specific cases at hand that a downgrading from the organized market to the "m:access" segment of the Munich Stock Exchange or to the "entry standard" segment of the Frankfurt Stock Exchange, which have rules aimed at guaranteeing quality and transparency, did not require an offer of compensation to the minority shareholders or a prior resolution passed by the annual general meeting (Munich Higher Regional Court, NZG 2008, 755; Berlin Higher Regional Court, NZG 2009, 752).

The Munich Higher Regional Court and the Berlin Higher Regional Court based their decisions largely on the continued liquidity of a share in the quality segments of the respective open markets. The factors that contribute to the liquidity of a share are the number of tradable securities, the number of free-float shares, the degree to which the company is known, the sector of industry to which the company belongs, its corporate announcements and its business development. The Munich Higher Regional Court and the Berlin Higher Regional Court also justified their decisions by reference to the actual changes that had occurred in relation to over-the-counter trading, namely the increased quality and transparency requirements applicable to the partial segments "m:access" and "Entry Standard", which were established as quality segments of the open market after the "Macrotron" decision. As far as can be seen, until now only two courts have dealt with the issue of a change from the organized market to general open market trading on a German stock exchange. Both the Cologne Regional Court (*Landgericht Köln*) (AG 2009, 835) and the Frankfurt a.M. Higher Regional Court (*Oberlandesgericht Frankfurt a.M.*) (AG 2012, 330) have declared the principles in the German Federal Court of Justice's "Macrotron" decision applicable in cases involving a lack of increased transparency and consequential duties and required in each case a resolution adopted at the annual general meeting as well as a compensation offer for the relevant change from one segment to another.

The Federal Constitutional Court's Delisting Judgment dated 11th July 2012

In its judgment dated 11th July 2012, the First Senate of the German Federal Constitutional Court handed down its decisions on two constitutional complaints which both related to the German Federal Court of Justice's development of the law on delisting in its decision in the "Macrotron" case.

In the case of one of the constitutional complaints, the majority shareholder had objected to being required to make an offer of compensation to the minority shareholders and to the review of the offer in valuation proceedings on the grounds that there was no statutory foundation for such requirements and that therefore the development of the law by the courts was to this extent illegal (1 BvR 3142/07).

In the second constitutional complaint, a minority shareholder asserted that it was absolutely necessary in the case of downgrading in the form of a change from the organized market to a quality segment of over-the-counter trading for this to be preceded by (i) a corresponding

resolution passed at the annual general meeting, (ii) a compensation offer, and (iii) for such compensation offer to be reviewable in valuation proceedings (1 BvR 1569/08).

The German Federal Constitutional Court rejected both constitutional complaints and clearly stated in the course of its judgment that neither ordinary delisting nor downgrading affects shareholders' property rights (Article 14 of the German Constitutional Law). In the German Federal Constitutional Court's view, the increased transferability of the shares had to be viewed as merely an opportunity for earnings and trade, which was not relevant for the allocation of share ownership within the meaning of Article 14 of the German Constitutional Law. It therefore found that the "Macrotron" case law's requiring a compulsory offer and its review in valuation proceedings was unnecessary under constitutional law. However, at the same time, the German Federal Constitutional Court emphasized that the development of the law on delisting by the German Federal Court of Justice – for which there had been no constitutional necessity – was not impermissible and therefore did not constitute a violation of the principle that binds the judiciary to the law (Article 20(3) of the German Constitutional Law).

Practical Implications and Recommendations for Action

Delisting
As a result of the Federal Constitutional Court's judgment, the reasoning expounded in what had been the leading case up to such time, the German Federal Court of Justice's "Macrotron" decision on delisting, ceased to have effect. Since the German Federal Constitutional Court did not place the increased transferability of a share under the protection of the constitutional guarantee of ownership, it is unclear whether the German Federal Court of Justice will continue to uphold its "Macrotron" case law and, if so, how it will justify this in the future. If one takes the grounds on which the German Federal Constitutional Court's decision is based seriously (a delisting does not affect minority shareholders' legal rights and titles in a legally relevant way), then there are strong reasons for reconsidering the "Macrotron" principles and for abandoning them in part or in whole.

However, just a few months prior to the German Federal Constitutional Court's judgment, the German Federal Court of Justice expressly confirmed the necessity for an offer of compensation in the case of a delisting (German Federal Court of Justice, ZIP 2011, 1708 – "*Kässbohrer*"). As far as upholding the "Macrotron" principles is concerned, it would also be possible for the German Federal Court of Justice to rely on a value-based decision by the legislature which, in connection with the enactment of the revised version of section 29(1) of the German Reorganization Act, expressly referred to the development of the law by the German Federal Court of Justice.

As long as the German Federal Court of Justice does not expressly renounce the prerequisites for a delisting which it established through its judicial development of the law, it would be advisable for reasons of legal certainty not to delist a company without (i) a resolution adopted by the annual general meeting and (ii) an offer of compensation.

Downgrading
No offer of compensation has to be made to the minority shareholders where a company changes from trading on the organized market to a qualified segment of the open market on a German stock exchange and as to that consequently no reviewability in valuation proceedings is required. However, it still remains unclear after the German Federal Constitutional Court's decision whether the consent of the annual general meeting is mandatory for a downgrading. Until this legal issue is decided by the

German Federal Court of Justice, the question whether it is necessary for the annual general meeting to pass a respective resolution will remain open. According to our interpretation of the law, it would be reasonable not to require a resolution to be passed by the annual general meeting for a downgrading from the organized market to a quality segment of the open market; this would be in line with the decisions and arguments of the Munich Higher Regional Court and the Berlin Higher Regional Court.

If, however, the existence of the necessary majority at the annual general meeting is certain, we would recommend that it be asked for its consent to a downgrading prior to the execution of the downgrading since there is still – in our opinion – a small degree of legal uncertainty.

Note

This overview is solely intended for general information purposes and may not replace legal advice on individual cases. Please contact the respective person in charge with GÖRG or respectively the authors themselves: Dr. Christian Becker on +49 89 3090 667-39 or by email to cbecker@goerg.de or Lutz Pospiech on +49 89 3090 667-39 or by email to lpospiech@goerg.de. For further information about the authors visit our website www.goerg.com.

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