The revival of delisting

Practical issues after German Federal Court of Justice dropped cumbersome restrictions

By Dr. Philip Martinius

In November 2013, the German Federal Court of Justice *(Bundesgerichtshof)* issued a landmark ruling concerning the requirements for a delisting of a public company from the regulated stock market in Germany. In this decision, known as the Frosta ruling, Germany's supreme court in criminal and private law reversed its 11-year-old ruling in the Macrotron case that had made delistings in Germany complex and costly. As a result of the Frosta ruling, issuers and large shareholders will face fewer hurdles and have more certainty when they weigh the possibility of removing their company from trading on the stock exchange and—as a consequence—delistings will likely become more frequent. This article analyzes the practical consequences of the new case law.

The Macrotron ruling in 2002

In 1998, German securities law first introduced a rule whereby public companies could ask the stock exchange to withdraw the authorization to have their shares listed on the regulated market (delisting). As corporate law was silent on shareholder protection in the context of such a delisting, the question arose whether (a) a company's board would need shareholder approval before filing the request and (b) the company or its majority shareholder would be obliged—like in a merger or a similar corporate restructuring—to submit a purchase offer at a certain minimum price to minority shareholders.

In the Macrotron case, the court held that a delisting was allowed only if it had been previously approved by a majority resolution of the shareholders' meeting, arguing that without such a shareholder vote, the shareholders' constitutional right would be infringed. Secondly, it held that in order for the delisting to be permitted, the company or the majority shareholder would also need to submit a mandatory offer to the minority shareholders to purchase their stock at an adequate price and that such price could be verified by a judge in a special court proceeding *(Spruchverfahren)*. Thus, the court established a whole new set of rules based on its interpretation of constitutional law. It was no surprise that following Macrotron, delistings became much more complex and occurred less frequently.

No more bull and bear: A landmark ruling from the German Federal Court of Justice will make delistings easier.

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The reversal of Macrotron in 2013

After the Macrotron principles had been applied for more than 10 years, in 2012 a separate delisting case reached the German Constitutional Court, which serves as Germany's supreme court in constitutional matters. This court ruled that a delisting from the regulated market would—contrary to the Federal Court of Justice's view in Macrotron—not infringe on the shareholders' constitutional right to property because they could still keep their shares and their rights as shareholders would remain the same. As the Constitutional Court has the ultimate authority on the interpretation of the Constitution, the Macrotron principles could only →

be upheld if a different reasoning was found to support them.

In 2013, the Federal Court of Justice took up the Frosta case and had the opportunity to reconsider the Macrotron principles in light of the Constitutional Court's ruling. In Frosta, the issuer had applied for a delisting from the regulated market in Berlin and simultaneously sought to be listed on the—less regulated—open market in Frankfurt (a so-called downgrading). As the company did not solicit shareholder approval or make a purchase offer, the minority shareholders decided to challenge the company's action in court. Given that this was a mere downgrading, it would have been possible for the Federal Court of Justice to merely consider the downgrading situation and exclude this particular set of facts from the scope of Macrotron.

The Federal judges, however, decided to review Macrotron in its entirety. Following the constitutional judges' ruling of summer 2012, the original reasoning (based on the premise that the shareholders' constitutional rights were affected by the delisting) was no longer available. The Federal Court of Justice did review other theories that could possibly uphold Macrotron but found that a delisting neither interfered with the structure of the corporation nor with the shareholder's individual rights and that therefore the shareholders did not require the same protection as in, for example, a merger, squeeze-out or change of legal form. Therefore, the court held that neither shareholder approval nor a purchase offer was required by corporate law. Instead, it acknowledged that the securities laws regulating the delisting afford sufficient protection to the investors. As a result, the requirements for a delisting are now mostly regulated in the securities laws and relevant stock exchange regulations.

Protection of investors in a delisting under securities law

Under German securities law, the issuer may file an application to delist its securities with the relevant stock exchange. The stock exchange will then make a decision on the application by applying reasonable discretion and considering the issue of investor protection, in particular. To implement this principle, most German stock exchange rules will allow a delisting from the regulated market to be approved only if a purchase offer (which, however, is not subject to court review) –>

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has been made or a sufficient time period has been set before the delisting becomes effective so that investors have a chance to sell their shares on a regulated public market. For example, the rules of the Frankfurt Stock Exchange require a six-month waiting period (if the stock is not listed on another regulated market). If the issuer or a shareholder makes a purchase offer, the waiting period may be shortened.

Some stock exchanges have developed questionnaires that they use to determine the relevant facts in these cases. The questionnaires address issues such as the free float, trading volumes, the possibility that a listing on another regulated market will remain in effect and the reasons for the delisting.

Practical consequences

The delisting has no doubt become simpler, quicker and cheaper without the corporate law requirements that have now been abandoned. In practice, issuers will need to consider the following steps:

Decision-making process

A German public company can now file for a delisting without shareholder approval. Shareholder meetings of public companies in Germany are not only expensive and time-consuming, but also create an opportunity for minority shareholders to challenge the approved resolutions by citing small procedural or formal errors and thereby block or delay the whole process. Now, the decision to apply for a delisting can be made by the management board. Depending on the details of the relevant board procedures of the issuer, the board's decision will usually require the approval of the supervisory board.

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When considering a delisting, the Management Board should duly consider the pros and cons of the delisting (these might include cost and management attention, free float, trading volumes, etc.) and should document its reasoning to demonstrate that it is acting in the company's best interest. As a delisting is usually price-sensitive information, the issuer will also need to take →

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such steps as issuing an ad hoc release at an early stage or preparing an exemption.

Majority requirement

Under Macrotron, one of the key issues was shareholder approval of the delisting, be it by a simple majority or a special majority of 75 percent. With this issue now eliminated, the focus shifts to stock exchanges and their consideration of such issues as the free float and trading volumes. They will likely not require a fixed threshold (e.g., 25 percent free float), but rather consider all circumstances of the case. But it is hard to imagine that the stock exchanges will not approve a filing if the protection of investors is ensured.

Purchase offer

Unless the stock exchange rules provide otherwise, the requirement of a mandatory purchase offer that can be reviewed in court no longer applies. This eliminates the possibility that a majority shareholder would make a purchase offer and then would be forced to increase it retroactively after a judge ruled that it was too low. Rather, the amount of the offer will be determined in advance, approved by the stock exchange and cannot be increased retroactively by a third party.

Stock exchange process

The issuer will usually approve the delisting and submit its filing to the stock exchange at the same time. The stock exchange will review the filing, potentially request additional information and then make a quick decision within weeks. Once the delisting is granted (whether applying a waiting period or not), the issuer will normally have to issue another ad hoc release. The delisting will become effective as stated in the stock exchange's decision.

Once the delisting is effective, the listing on the regulated market will stop. As a consequence, various rules will cease to apply. These include the German takeover act *(Wertpapiererwerbs- und Übernahmegesetz)* as well as the laws on the disclosure of large shareholdings, on ad hoc disclosures and on director's dealings. Further, some cumbersome corporate law rules (including the necessity to announce deviations from the corporate governance code and certain reporting requirements and formalities) will also no longer be applicable.

Court review

Unlike in the past, shareholders will most likely be unable to file a court challenge against a company over a delisting for lack of a shareholder resolution. On the other hand, questions have emerged about whether and to what extent shareholders may challenge a stock exchange's approval of a delisting before an administrative court. But given the stock exchanges' discretion, such an action will rarely succeed, and the issuer will be only indirectly involved.

Summary

In summary, we expect delistings will occur more frequently in the future, especially if the listing has lost most of its purpose in light of a small free float and limited trading volume. Recent months have shown that in Frankfurt, many smaller companies with low trading activity have successfully been delisted, usually by using the six-month waiting period.
The new situation may also facilitate public takeovers in Germany because when the majority of shares is sold to a new shareholder, a squeeze-out of the minority is only possible if the controlling shareholder owns at least 95 percent (sometimes 90 percent) of the stock. Below this threshold, a delisting may now allow the buyer and the company to reduce costs and to persuade minorities to tender their shares. In addition, the public stock price is usually the minimum payable in a squeeze-out. Hence, a delisting may be a good step to prepare for a squeeze-out at a later stage. <–

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