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What co-investors in public takeovers need to consider for contracts

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The trend in the M&A market continues to be that companies and private equity firms are demonstrating a high level of free liquidity, and that activist shareholders are pushing structural changes in companies with high dynamics. In fact, the market for public takeovers was particularly active in 2019, with a total of 29 proceedings (vs. 15 proceedings in 2018).

Syndicates of bidders are increasingly forming in order to submit an offer for the target company. Prominent examples from last year are the unsuccessful takeover attempts of Scout24 by Hellman & Friedman and Blackstone, and of Osram by Bain and Carlyle. Furthermore, in the case of large-volume takeovers by financial investors, other parties regularly participate in the financing without themselves appearing as bidders. For example, such a model was chosen for Canadian investor CPPIB in connection with KKR's acquisition of Axel Springer, as well as for the participation of OMERS in the public offer in connection with Morgan Stanley Infrastructure's delisting of VTG.

The scope of the participation rights granted to the co-investor differs in such co-investments. In some cases, co-investors receive a legal status comparable to that of a limited partner, so that they lack a voice in management measures and at most have a right to information (passive co-investment). In other cases, however, co-investors jointly control the respective bidding company, and thus — in case of a successful bid — they control the target company (active co-investment). An active co-investment regularly requires a comprehensive vote on the execution of voting rights, as well as the selection of management and financing of the offer.

In terms of takeover law, whether or not a co-investor qualifies as active or passive makes a considerable impact. Only active co-investors are assigned the full amount of shares in the target company. On the one hand, the attribution triggers reporting obligations under securities trading law. On the other hand, the attribution has the effect that no new matter has to be made in the case of a later exit of the remaining co-investors and the related transfer from joint to single control of the target company. Furthermore, purchases of shares in the target company by active co-investors and persons acting in common with them or their subsidiaries have to be taken into account to determine the "minimum price" that the target company's shareholders will receive. In order to enable BaFin to verify compliance with the minimum price requirements, the offer document must list the chains of participation of the active co-investors up to their respective ultimate controlling shareholder, as well as all subsidiaries within this group. In practice, this represents a considerable effort, which often takes up a substantial part of the preparation time for the offer document.

None of these requirements apply to passive co-investments, making them attractive from a bidder's perspective as they have minimal influence on the process of preparing and executing a public offer. Co-investors, however, may prefer to have co-decision rights, depending on their financing share. In the case of offers submitted for the purpose of delisting, this conflict of interests can be resolved by granting the co-investor control rights subject to the condition that the delisting becomes valid. In this way, a mandatory offer by the co-investor is prevented, since the takeover law no longer applies after delisting. Depending on the concrete form of the delisting offer, however, the co-investor's share purchases may be taken into account to determine the minimum price in the delisting offer.

All of these implications demonstrate that the contractual design of co-investments under takeover law requires careful consideration.