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» update

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Germany: Unanimous Shareholder Resolution Required for Due Diligence Review by Competitor

While it is common practice to conduct a due diligence review in the course of a corporate transaction, be it in a domestic or cross-border scenario, the vast disclosure of sensitive information can turn out to be hazardous if it is misappropriated by a competitor. Therefore, under recent German case law, the target company / the selling shareholder should secure the due diligence process by obtaining a unanimous shareholder resolution

A due diligence review is standard procedure in almost any M&A setting. In a typical scenario, due diligence means that a potential purchaser evaluates the circumstances of a target company as early step of the acquisition process, i. e. after having concluded a letter of intent (LOI). The examination typically comprises commercial and legal aspects of the target company (i. e. legal due diligence, financial due diligence, tax due diligence, commercial due diligence, environmental due diligence, IT due diligence, etc.). The review is mostly carried out by professional advisers (e. g. lawyers, tax advisers, environmental surveyors) and/or by staff of the purchasing entity (mainly commercial due diligence, IT due diligence, technical aspects). The due diligence regularly concludes with management interviews, a Q&A process and results in a summary of findings, the so-called due diligence report.

Due diligence as part of the acquisition process

The purpose of the due diligence exercise is mostly for the potential purchaser to assess chances and risks of the deal. Based on the due diligence information, he will decide whether to engage in the further acquisition process (absence of any deal breakers) and, if so, to determine a reasonable purchase price (taking into account any risks that may diminish the value of the company). Also, the purchaser will use the findings from the due diligence process in the negotiations of the Share Purchase Agreement (SPA) in order to limit the detrimental consequences of any potential risks resulting from the acquisition.

At the same time, the seller of the company also uses the due diligence to control chances and risks resulting

from the potential transaction. He will aim to limit his own liability resulting from the potential breach of any representations and warranties given to the purchaser in the SPA and argue that all circumstances disclosed to the purchaser in the course of the due diligence process are thereby known to the purchaser and not subject to any liability of the Seller. Thereby, the due diligence process also serves to reduce any potential for post-M&A disputes.

Obvious risk of disclosing confidential information

It is the nature of almost any due diligence process that the potential purchaser obtains insight to business secrets and decisive know-how going to the heart of the target company. Furthermore, the potential purchaser is not seldom a direct competitor of the target company. Therefore, a vast disclosure of information during the due diligence process is of specific sensitivity, particularly if the potential purchaser-competitor walks away from the deal after having concluded the due diligence process.

The seller and the target company should therefore make sure to balance the interest of the potential purchaser to be informed about the circumstances of the target company against the target company's interest in maintaining confidentiality. This regularly includes the conclusion of a non-disclosure agreement (NDA), a letter of intent (LOI) providing for a break-up fee, or several rounds of due diligence with increasing standard of disclosure (in particular in case of a bidding process with several potential purchasers).

Legal framework in Germany: recent case-law

Also, the individuals acting on behalf of the seller or the target company, i. e. its managing director or the senior employee in charge for the due diligence process, should obtain support from the shareholders. This was confirmed by a recent court decision: in that case, the majority shareholder holding 74,9 % of the target company permitted a potential purchaser, competitor of the target company, to carry out a due diligence review. He gave the competitor access to confidential business documents without informing the minority shareholder about this step. The court held that the disclosure of confidential information without consent of all shareholders violated the duty of loyalty among shareholders. In fact, the court prohibited any further disclosures by expedited summary proceedings (Higher Regional Court of Cologne, decision dated 31 October 2013, file no. 18 W 66/13).

Key aspects

- Any shareholder of a German company wishing to sell its shares should secure a due diligence process by obtaining a shareholder resolution approving the due diligence process.

- Any managing director / senior employee of a target company entrusted with the due diligence process should disclose confidential business information to a potential purchaser only after having obtained a prior shareholder resolution approving the due diligence process.

- Unless the articles of association of the target company provide otherwise, the shareholder resolution approving the due diligence process should be passed by unanimous vote of all shareholders.

About our M&A practice

We provide advice on all legal aspects of the sale and purchase of enterprises and shareholdings. We provide support on questions of structuring prior to the transaction, in processing and conducting the due diligence and during the contract negotiations to follow. As member of 'The Law Firm Network' we are capable of acting in all major jurisdictions globally.

Our M&A practice is ranked Band 1 for "Corporate/M&A: Mid-Market" by Chambers & Partners Europe 2014 and Tier II for "M&A: Mid-Sized Domestic Deals (under €500m)" by Legal500 2014.

Contact

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