DEVELOPMENTS

The Management Board's permission to disclose Due Diligence Information Before a Corporate Acquisition in consideration of the Impact of the Act to Improve the Protection of Investors (*Gesetz zur Verbesserung des Anlegerschutzes*)

By Maximilian Rittmeister[*]

A. Introduction

Prior to an acquisition of a stock corporation the purchasers often perform a due diligence at the target company. The due diligence is the examination of the company and can cover the legal, commercial, environmental, financial and fiscal matters of the company.[1] Under US law it is the purchaser's duty to examine a company accurately since the risk of any deficiencies is on him.[2] German law, in contrast, does not require the purchaser to examine the company he purchases. According to § 442 (1) sentence 2 of the German Civil Code (*Bürgerliches Gesetzbuch* - BGB) the buyer does not have rights with respect to a defect, if he is unaware of this

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[1] See hereto e.g. Hanno Merkt, *Due Diligence und Gewährleistung beim Unternehmenskauf*, Betriebs-Berater (BB) 1041 (1995); Ulrich Huber, *Die Praxis des Unternehmenskaufs im System des Kaufrechts*, 202 Civilistische Praxis (AcP) 179, 193 (2002); Rüdiger Werner, *Haftungsrisiken bei Unternehmensakquisitionen: die Pflicht des Vorstands zur Due Diligence*, Zeitschrift für Wirtschaftsrecht (ZIP) 989 (2000); Friedrich Klein-Blenkers, *Schwerpunkte und aktuelle zivilrechtliche Fragen des Unternehmenskaufs*, Deutsches Steuerrecht (DStR) 978 (1998); Holger Fleischer / Torsten Körber, *Due diligence und Gewährleistung beim Unternehmenskauf*, BB 841 (2001); Heinrich Pack, *Planung, Durchführung, Integration,* in MERGERS & ACQUISITIONS 270 (GERHARD PICOT ED., 2nd ed., 2002).

[2] The reason is the caveat emptor, a principle under US-law. See only Thomas Barnert, *Mängelhaftung beim Unternehmenskauf zwischen Sachgewährleistung und Verschulden bei Vertragsschluss im neuen Schuldrecht*, Wertpapier-Mitteilungen (WM) 416, 423 (2003); OLIVER MOOSMAYER, AUFKLÄRUNGSPFLICHTEN BEIM UNTERNEHMENSKAUF 24 (2000); Dirk Krüger / Eberhard Kalbfleisch, *Due Diligence bei Kauf und Verkauf von Unternehmen - Rechtliche und steuerlich Aspekte der Vorprüfung beim Unternehmenskauf-*, DStR 174 (1999); Gerhard Picot / Viola Russenschuck, *Legal Due Diligence*, M & A Review 426 (2002); WULF HEINRICH DÖSER, VERTRAGSGESTALTUNG IM INTERNATIONALEN WIRTSCHAFTSRECHT annotation 268 (2001).

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defect as a result of gross negligence on his part. While for some years now, the performance of due diligence prior to purchasing a company has become quite customary in Germany,[3] German law does not yet require the person wanting to purchase a company to perform a due diligence.

The purchaser's main reason for performing a due diligence is to understand the company he is willing to buy. This way risks connected with buying the company can be discovered and the result of the examination can be used for valuing the company as well as for estimating its profitability. Also the condition of the company can be documented[4] and the purchaser's representations and warranties can be prepared for the contract.[5] In order to perform a due diligence, the management board needs to provide the potential buyer with company information that is only partly public and includes confidential information. Since the confidential information is not supposed to be accessed by the public, the management board needs to make sure that it is legal to provide the potential buyer with this information for the due diligence.

B. The duty to observe secrecy under German Stock Corporation Act

Under German law, the management board of a stock corporation has the duty to observe secrecy. This duty is regulated in § 93 (1) sentence 2 of the German Stock Corporation Act (*Aktiengesetz* - AktG). In the case of the target company being organized as a stock corporation the management board's permission to transfer confidential information must be in accordance with the Stock Corporation Act. The regulations in § 93 (1) sentence 2 AktG are based on the principle that the management board has a duty of allegiance towards the company and must act in its interests.[6] From this principle follows the obligation to remain silence on confidential

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[3] But, see still for a more hesitant view: HERMANN J. KNOTT / WERNER MIELKE / THOMAS WEIDLICH, UNTERNEHMENSKAUF annotation 10 (2001); Rainer Loges, *Der Einfluss der „Due Diligence" auf die Rechtsstellung des Käufers eines Unternehmens*, Der Betrieb (DB) 965, 968 (1997); Fleischer / Körber (note 1), 847. Different KATHRIN KNÖFLER, RECHTLICHE AUSWIRKUNGEN DER DUE DILIGENCE BEI UNTERNEHMENSAKQUISITIONEN 70 (2001) for large companies.

[4] Torsten Körber, *Geschäftsleitung der Zielgesellschaft und due diligence bei Paketerwerb und Unternehmenskauf*, Neue Zeitschrift für Gesellschaftsrecht (NZG) 263 (2002).

[5] Picot / Russenschuck (note 2), 427; Huber (note 1), 204; Armin Schwerdtfeger / Philipp Kreuzer, *Unternehmenskauf und „Due Diligence"- Anspruch des vorkaufsberechtigten Erwerbers?*, BB 1801 (1998); Frank Oppenländer, *Grenzen der Auskunftserteilung durch Geschäftsführer und Gesellschafter beim Verkauf von GmbH-Geschäftsanteilen*, GmbHRundschau (GmbHR) 535 (2000).

[6] Georg Wiesner, in MÜNCHNER HANDBUCH DES GESELLSCHAFTSRECHTS, vol. 4, AKTIENGESELLSCHAFT § 25 annotation 37 (MICHAEL HOFFMANN-BECKING ED. 1999); DIETRICH VON STEBUT, GEHEIMNISSCHUTZ UND VERSCHWIEGENHEITSPFLICHTEN IM AKTIENRECHT 2 (1972); KNÖFLER (note 3) 81; Wolfgang Hefermehl, in AKTIENGESETZ, vol. 2, § 93

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information to which they have access due to being members of the management board. The purpose of the duty to keep sensitive information confidential is to protect the interests of the target company.[7] Therefore the interests of the target company have to be considered as the main criteria when deciding whether the management board can provide the potential buyer with confidential company information or not. Should a member of the management board violate this duty he can be accused of a gross negligent violation of his duties as a member of the management board. Under these conditions the supervisory board has the right to dismiss him as a member of the management board (§ 84 (3) AktG) and to terminate his employment contract extraordinarily.[8] By illicitly circulating confidential company information the member of the management board also incurs a penalty (§ 404 AktG)[9] and the company may claim damages from him (§ 93 (2) sentence 1 AktG). Because of the risk of being liable and the possible sanctions involved, adhering to the duty to keep information confidential is a substantial interest of the target company's managing board members prior to an acquisition. These risks also affect their permission to perform a due diligence at the target company. The members of the management board will only support the potential buyer's due diligence with documentation and information if doing so does not violate their duty of keeping company information confidential.

In § 93 (1) sentence 2 AktG the duty to keep company information confidential is only codified for secrets (*Geheimnise*) and for confidential information (*vertrauliche Angaben*). Therefore, there is no violation of this duty if the information made available was neither secret nor confidential. In order to define the scope of protection of § 93 (1) sentence 2 AktG, one needs to determine whether information on a stock corporation is secret or confidential information. § 93 (1) sentence 2 AktG mentions company secrets (*Betriebsgeheimnisse*) and the business secrets (*Geschäftsgeheimnisse*) explicitly as secrets of a stock corporation. The legislator understood these two

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annotation 15 (ERNST GEßLER / WOLFGANG HEFERMEHL / ULRICH ECKARD / BRUNO KROPFF EDS., 1974); UWE HÜFFER, AKTIENGESETZ, § 93 annotation 6 (2004). For the members of the supervisory board see BGHZ 64, 325, 327.

[7] Andreas Dietzel, in ARBEITSHANDBUCH FÜR UNTERNEHMENSÜBERNAHMEN, vol. 1, UNTERNEHMENSÜBERNAHME § 9 annotation 75 (JOHANNES SEMLER / RÜDIGER VOLHARD / ECKHARD CORDES EDS., 2001); KAI PETERS, INFORMATIONSRECHTE UND GEHEIMHALTUNGSVERPFLICHTUNGEN IM RAHMEN EINER DUE DILIGENCE UND DARAUS RESULTIERENDE HAFTUNGSRISIKEN 46 (2002).

[8] Georg Wiesner (note 6); Franz Jürgen Säcker, *Aktuelle Probleme der Verschwiegenheitspflicht der Aufsichtsratsmitglieder*, Neue Juristische Wochenschrift (NJW) 803, 809 (1986); Picot / Russenschuck (note 2), 430.

[9] PETERS (note 7); KNÖFLER (note 3), 81; KNOTT / MIELKE / WEIDLICH (note 3), annotation 15; Dietzel (note 7).

types of secrets as merely examplary.[10] Even objective facts regarding the corporation can amount to secrets in the meaning of § 93 (1) sentence 2 AktG if they are neither public nor supposed to become public.[11] Therefore all information on a stock corporation that is supposed to be accessible only to a limited number of employees is covered by the duty of secrecy. Information can only be confidential or secret if the stock corporation itself must be seen as having an interest in not circulating it and keeping it secret. The level of a company's need for secrey must be determined by objective standards.[12] Confidential information (*vertrauliche Angaben*) in the meaning of § 93 (1) sentence 2 AktG is information obtained by a member of the management board in this function. In addition, its transfer to third parties must be clearly against the interests of the corporation.[13] Admittedly, this definition of the term is quite broad. Therefore, the information requested for a due diligence is covered by at least one of these definitions since it covers most of the important company information. § 93 (1) sentence 2 AktG could therefore lead to the stock corporations management board being detained from providing the potential buyer with information for a due diligence prior to the signing of the acquisition contract.

The management board's duty to guard the corporation's secrets (*Geheimnise*) and to protect confidential information (*vertrauliche Angaben*) (§ 93 (1) sentence 2 AktG) is only established within limits. The protection of company secrets under company law is based on the company's interest in the secrecy of the information. As § 93 (1) sentence 2 AktG aims at fleshing out the content of this duty in light of the company's interest, the management board's duty to secrecy is must be measured against the company's interest. In the case that a) it is established that a specific degree of secrecy is not in the company's interest and that b) the transfer of information is seen as benefiting the corporation, the management board's duty is being curtailed.[14] However, this discretion is given to the management board. According

[10] HÜFFER (note 6), § 93 annotation 7.

[11] Hans-Joachim Mertens, in KÖLNER KOMMENTAR ZUM AKTIENGESETZ, § 116 annotation 43 (WOLFGANG ZÖLLNER ED., 1996); HÜFFER (note 6), § 93 annotation 7; Klaus J. Müller, *Gestattung der Due Diligence durch den Vorstand der Aktiengesellschaft*, NJW 3452, 3453 (2000); Marcus Lutter, *Due Diligence des Erwerbers bei Kauf einer Beteiligung*, ZIP 613, 617 (1997).

[12] PETERS (note 7), 47; Körber (note 4), 269.

[13] Müller (note 11); Mertens (note 11), § 116 annotation 45; HÜFFER (note 6), § 93 annotation 7.

[14] Ulrich Schroeder, *Darf der Vorstand der Aktiengesellschaft dem Aktienkäufer eine Due Diligence gestatten?*, DB 2161, 2162 (1997); Klaus Hopt, in AKTG GROßKOMMENTAR, §§ 92-94, § 93 annotations 209 et seqq. (W. GADOW ED., 1999); HÜFFER (note 6), § 93 annotation 8; BARBARA GRUNEWALD, GESELLSCHAFTSRECHT 254 (2000); Wiesner (note 6), § 25 annotation 28; Hefermehl (note 6), § 93 annotation 21; Lutter (note 11); Hildegard Ziemons, *Die Weitergabe von Unternehmensinterna an Dritte durch den Vorstand einer Aktiengesellschaft*, Die Aktiengesellschaft (AG) 492, 493 (1999).

to § 76 (1) AktG, the management board manages the stock corporation at their discretion and within its power to direct the company according to their best judgment.[15] It is therefore the management board's prerogative to take or to abstain from taking action relating to the disclosure of specific information.[16] This also applies to the decision on transferring the information to the potential buyer for a due diligence prior to the acquisition. In making this decision the management board needs to determine, to weigh and to balance the company's interest in keeping the information secret or transferring it to the potential buyer. The company's interest in transferring the information to the potential buyer corresponds with its interest in the sale.[17]

It comes as no surprise that there has been, for some time now, a heated discussion as to the scope of the discretion of the management in view of the alleged benefits of the target corporation from being bought. According to Marcus Lutter, with no doubt one of the most thoughtful scholars in the field, the transfer of confidential company information during a due diligence must in most cases be considered illegitimate.[18] to The transfer of sensitive information for a due diligence must be granted only on an exceptional basis. Examples for these exceptions are the necessity of the acquisition to secure the company's existence as well as the necessity of the publication to realize an otherwise irrecoverable business opportunity for the corporation.[19]

Yet, one can argue that the duty to keep information confidential in § 93 (1) sentence 2 AktG finds its limits in the company's interest. Indeed, § 93 (1) sentence 2 AktG aims at keeping company information secret in order to protect the company's interests. If it were true that only in exceptional cases the transfer of information were allowed, then it would depend on whether one wanted to recognize cases in which a due diligence is performed as an exceptional case. This would certainly impose serious limits on the effectiveness and the hoped for benefits of a thorough due diligence process. Applying the exceptionality test,

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[15] HÜFFER (note 6), § 93 annotations 13 et seq.; BGH, NJW 1926, 1927 et seq (1997).

[16] BGH, ZIP 883, 886 (1997); Werner (note 1), 991; Wolfgang Hefermehl / Gerald Spindler, in MÜNCHNER KOMMENTAR ZUM AKTIENGESETZ, vol. 3, § 93 annotation 24 (BRUNO KROPFF / JOHANNES SEMLER EDS., 2004); Eberhard Schwark, in KAPITALMARKTRECHTS-KOMMENTAR § 14 WpHG annotation 41 (EBERHARD SCHWARK ED., 2004).

[17] Mertens (note 11), § 93 annotation 82, § 76 annotations 16 et seqq.; Müller (note 11); Lutter (note 11); Hefermehl (note 6), § 93 annotations 21 et seq., § 76 annotation 10.

[18] Lutter (note 11).

[19] *Id.*, 617.

the buyer would be forced to purchase a company of which he has no more than vague ideas.

Furthermore, it might not only be in the buyer's interest to have the opportunity to perform a due diligence. The absence of an effective due diligence can also harm the company. If the management board of the target company were not in a position to allow the buyer a due diligence, this this would clearly have detrimental effects on the company's attempts of finding an investor, e.g. in case of a company crisis. Purchasing a stock corporation would be less attractive for potential buyers since they purchasing a stock corporation would inevitably entail enormous risks without there being effective hedging possibilities. Likewise, this would certainly drive the price down. A lower price , however, will be harmful both to shareholders of the target company and the company itself.[20] It sends out clear signals to the market of potential buyers and investors as regards the value of the company – being a source for conclusions and speculations on its solvency and its economic prospects. Speculations over an allegedly low value of a listed stock corporation will reach out to an even wider range of possibly discouraged investors. This is especially true in view of the important signaling effect of a firm's value being associated with the share price.[21] This has important consequences for the issue here at stake – the disclosure of information in the context of a pre-acquisition due diligence. If the management board were engaging in illegal conduct when it releases information supporting a due diligence this would likely cause serious disadvantages for German stock corporations on the international market for mergers and acquisitions.[22] It can be argued that the negative effects of this restrictive understanding of § 93 (1) sentence 2 AktG would result in the impairments to the companies interests being more extensive than their protection.

According to many authors, it can clearly lie in the interests of the company will to have its shares sold. It would hence be just as desirable that an effective transfer of information for a due diligence is guaranteed.[23] This follows from the allegation

[20] Müller (note 11), 3454; KNÖFLER (note 3), 88.

[21] KNÖFLER (note 3), 88.

[22] Kurt Kiethe, *Vorstandshaftung aufgrund fehlerhafter Due Diligence beim Unternehmenskauf*, NZG 976, 979 (1999); Ole Ziegler, *„Due Diligence" im Spannungsfeld zur Geheimhaltungspflicht von Geschäftsführern und Gesellschaftern*, DStR 249, 252 (2000).

[23] Christian Roschmann / Johannes Frey, *Geheimhaltungsverpflichtungen der Vorstandsmitglieder von Aktiengesellschaften bei Unternehmenskäufen*, AG 449, 451 (1996); Kai Mertens, *Die Information des Erwerbers einer wesentlichen Unternehmensbeteiligung an einer Aktiengesellschaft durch den Vorstand*, AG 541, 546 (1997); Schroeder (note 14), 2161; Kiethe (note 22); Schwark (note 16); Ziegler (note 22); Dietrich Bihr, *Due Diligence: Geschäftsführungsorgane im Spannungsfeld zwischen Gesellschafts- und Gesellschafterinteressen*, BB 1198, 1199 (1998); Müller (note 11); PETERS (note 7), 48; Hefermehl / Spindler (note 16), § 93 annotation

that the sale of a company bears many advantages for the sold company. A company may clearly benefit from a change of shareholders. In addition, the sale might unpack an unprecedented and possibly much needed set of synergies with other firms connected with the buyer company. Possible synergies include the improvement of the purchasing conditions and the access to favourable financing conditions.[24]

Besides the constellations mentioned by *Lutter*[25] one might think of various other constellations where the company has an interest in being sold. In that case, it must be assumed that even the transfer of sensitive company information lies in the company's interest.. The detrimental effects on the company where no prior due diligence was possible, raise serious doubts as to the convincing power of Professor Lutter's propositions. Other continuing controversial issues relate to the scope of permission for the transfer of company information in the context of a due diligence.

In general the management board of a stock corporation has a broad scope in deciding whether an action is in the company's interest.[26] Nevertheless some authors propose particularly strict criteria to answer the question when the transfer of company information for a due diligence is in the company interest and therefore legal.[27] These authors recognize the necessity of excluding the buyer from performing the due diligence. Only in the case of the buyer being excluded from performing the due diligence can the company's interest in transferring the information be reconciled with the management board's duty to keep it confidential. In this line of argument the due diligence ought to be performed by an independent auditor and the buyer should only be allowed to receive an abstract report of the auditor's results.[28] This kind of due diligence is called the vendor due diligence and the potential buyer does not get access to the company information itself.

63; Wiesner (note 6), § 19 annotation 21; HÜFFER (note 6), § 93 annotation 8; Hopt (note 14), § 93 annotation 213.

[24] Thomas Koch, *Post-Merger Management*, in MERGERS & ACQUISITIONS 383 et seqq, (GERHARD PICOT ED., 2002); Schroeder (note 14); Körber (note 4), 269.

[25] Lutter (note 11).

[26] BGH, NJW 1926, 1927 et seq. (1997); HÜFFER (note 6), § 93 annotations 13 et seq.

[27] Bihr (note 23); Ziemons (note 14), 495.

[28] Ziemons (note 14), 497; Bihr (note 23). Hefermehl / Spindler (note 16), § 93 annotation 63, consider this as necessary „as the case may be *(gegebenenfalls)*".

Other authors do not consider the vendor due diligence as the management board's only possibility to admit a due diligence while complying with the Law's established duty to secrecy. In these authors' opinion the duty to keep information confidential is preserved, provided that, except where the sale is seen as being in the interest of the target company, a non-disclosure agreement be concluded with the potential buyer prior to the due diligence and the transfer of the information being necessary for closing the deal.[29] Under this premise the company's secrets and confidential information can be transferred to the potential buyer since the company's interest in transferring the sensitive information prevails over its interest in keeping it secret. The necessity of transferring the information in order to close the deal can be assumed if the potential buyer strongly intends to purchase the corporation[30] and the purchase of the company is not evidently impossible, e.g. for antitrust violation.[31]

The afore-mentioned opinion, which has been endorsed in several cases as well, lays particular emphasis on the corporation's interests. Even though the management board's permission to transfer information for a due diligence prior to an acquisition was not yet the subject of a judgement by the *Bundesgerichtshof* (Federal Court of Justice), a lower court did rule that it was in the management board's duty to diligently audit a company's financial circumstances prior to its acquisition.[32] Accordingly, in case of a pending acquisition the court considered the performance of a due diligence as a duty of the management board in light of its duty to act prudently (§ 93 (1) sentence 1 AktG).[33] At any rate, however, the transfer of confidential company information needs to be legal. If this were not the case the management board could not prepare its decision to buy a stock corporation diligently without the management board of the target company violating its duty to observe secrecy.

In principle, one may assume a general admissibility of the transferr of information for a due diligence. The duty to secrecy under the German Stock Corporation Act only prohibits the information transfer in case of the target company not having an interest in being sold, no non-disclosure agreement being concluded with the potential buyer prior to the due diligence or the acquisition being evidently impossi-

[29] KNOTT / MIELKE / WEIDLICH (note 3), annotation 15; Mertens (note 23), 546; PETERS (note 7), 72; KNÖFLER (note 3), 93; Hefermehl / Spindler (note 16), § 93 annotation 63; Schroeder (note 14), 2163; Roschmann / Frey (note 23), 452; Ziegler (note 22).

[30] Müller (note 11), 3455.

[31] Körber (note 4), 270.

[32] LG Hannover, AG 198, 200 et seq (1977).

[33] *Id.*

ble. Nevertheless, the management board should resolve about whether or not it wishes to support the potential buyer's due diligence.[34] The resolution is advisable since the management board needs to prove in case of a claim that it abided by the standard of care expected from a diligent and fair manager (§ 93 (2) sentence 2 AktG). By issuing a written resolution that specifies the main criteria of the process, it will be easier for the management board to substantiate this level of care in case of a claim.[35]

C. The duty to observe secrecy under the German Securities Trade Act

If the target company is a listed stock corporation the management board's duties are not only regulated by the German Stock Corporation Act but also by the German Securities Act (*Wertpapierhandelsgesetz* - WpHG). The German Securities Act has recently been changed by the Act Improving the Protection of Investors (*Gesetz zur Verbesserung des Anlegerschutzes*).[36] This legislative initiative changed, *inter alia*, the provisions regarding insider trading. To determine whether or not the management board of a listed stock corporation was allowed to transfer confidential company information, the company's duty not to transfer insider information need to be considered in light of the German Securities Act and. The amended § 14 (1) No. 2 WpHG prohibits all insider information. The purpose of this rule is to keep the number of insiders as small as possible in order to lower the risk of insider trading and to protect investors as well as the function of the capital market.[37] The equalization of primary and secondary insiders in § 14 WpHG was necessary due to the market abuse directive[38] and was changed by the Act to improve the protection of investors (*Gesetz zur Verbesserung des Anlegerschutzes*)[39]. By allowing due diligence and with it the transfer ofsecret company information, the target company's management board may not violate the prohibition of insider dealing. The members of the target company's management board commit a criminal offence (§ 38 (1) No. 2 WpHG) if they violate the prohibition of insider trading and can therefore cause damage to the company's image.

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[34] Eberhard Meincke, *Geheimhaltungspflichten im Wirtschaftsrecht*, WM 749, 751 (1998); Schroeder (note 14), 2163; Müller (note 11), 3455; Roschmann / Frey (note 23), 452.

[35] Schroeder (note 14), 2163; Müller (note 11), 3455; Roschmann / Frey (note 23), 452.

[36] BGBl I 2004 No. 56, 29 October 2004, 2630 et seqq.

[37] Uwe H. Schneider / Bernd Singhof, *Die Weitergabe von Insidertatsachen in der konzernfreien Aktiengesellschaft, insbesondere im Rahmen der Hauptversammlung und an einzelne Aktionäre - Ein Beitrag zum Verhältnis von Gesellschaftsrecht und Kapitalmarktrecht* -, in FESTSCHRIFT FÜR ALFONS KRAFT, 585, 589 (1998).

[38] Art. 9 of the EC Directive 2003/6 of 28 January 2003, O.J. 2003 L 96/23.

[39] BGBl I 2004 No. 56, 29 October 2004, 2630 et seqq.

§ 14 (1) No. 2 WpHG prohibits the disclosure or other release of inside information. Inside information is precise information on non-public circumstances regarding the issuers of insider securities or the insider securities themselves which –if it became public - might effect the market or stock exchange price of the insider securities significantly (§ 13 (1) sentence 1 WpHG). A precise definition of a significant (*erheblicher*) effect on the market price is still missing. It is however assumed that the threshold is reached when the security's market price is fluctuating by five or more percent.[40] It can be expected that only very important company information can affect a security's market price that much if it becomes public. Whether the information is positive or negative does not matter. Performing a due diligence aims to investigate the risks in buying a company as well as assessing the company's value. In order to determine these risks and assets of the target company comprehensive information needs to be transferred to the potential buyer. This information is likely to extend to strengths or weaknesses of the company that were hitherto not known to the public. For this reason some doubt remains as to whether the information provided for the due diligence could affect the security's market price by more than five percent either way in case of becoming public.[41] The information provided for the due diligence can therefore significantly affect the security's market price if it becomes public.

The prohibition in § 14 (1) No. 2 WpHG does, however, not include each kind of information transfer. Only unauthorized information transfer is prohibited. The definitional element "unauthorized" (*unbefugt*) in § 14 (1) No. 2 WpHG is based on Art. 3 (a) of the EU-Insider-Directive[42] that prohibits the transfer of insider information unless the transfer is carried out within the scope of the management board's duties. As mentioned before, this rule is supposed to ensure the equality of information opportunities and to limit the number of insiders preventive down to a minimum. Obtaining non-public information which provides the market participant with advantages because of one's status, function or by chance is supposed to be eliminated.[43] While discussing the permission to transfer information, has to take

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[40] Schroeder (note 14), 2164; Heinz-Dieter Assmann, in WERTPAPIERHANDELSGESETZ § 13 WpHG annotation 69 (HEINZ-DIETER ASSMANN / UWE SCHNEIDER EDS., 1995); PETERS (note 7), 51; Christoph F. Vaupel, *Zum Tatbestandsmerkmal der erheblichen Kursbeeinflussung bei der Ad hoc Publizität*, WM 521, 530 (1999); SIEGFRIED KÜMPEL, BANK- UND KAPITALMARKTRECHT annotation 16.120 (2000); Friedrich-Carl zur Megede, in Handbuch des Kapitalanlagerechts, § 14 annotation 26 (HEINZ-DIETER ASSMANN / ROLF A. SCHÜTZE EDS., 1998); Kiethe (note 22), 980; Müller (note 11), 3456.

[41] Schroeder (note 14), 2164, Kiethe (note 22), 980; KNÖFLER (note 3), 98.

[42] EEC Directive 89/592 of 13 November 1989, O.J. 1989 L 334/30.

[43] Karl-Burkhard Caspari, *Die geplante Insiderregelung in der Praxis*, Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 530, 542 et seqq. (1994); KÜMPEL (note 40), annotation 16.184; Heinz-Dieter

into account that the prohibition to transfer insider information will interfere with the information flow as such. Yet, information flows are sometimes necessary while – in some cases – even being required by law. The latter includes the duty to disclose price-sensitive information *ad hoc* (§ 15 WpHG) as well as the duty to publish under commercial law (§§ 242, 264 German Commercial Code (*Handelsgesetzbuch* – HGB)). In determining the extent of the permission to transfer insider information it is necessary to pay attention to these flows of information too. Therefore the permission of a stock corporation's management board to transfer insider information has to be determined taking into account the goals of the insider law on the one hand and the functional requirements of legal and economic institutions on the other hand.[44]

The consideration regarding the transfer of insider information for due diligence is often the subject of the discussion regarding block trading. A block trade is a privately negotiated transaction executed separately from the public auction market either on or off the exchange trading floor.[45] The prevailing view in the legal literature considers the transfer of insider information prior to a block trade to be legal[46] since the information transfer is necessary for maintaining the block trade as a transaction form.[47] There is a common interest in the function of the market for acquisitions and block trades. Without performing a due diligence prior to the block trade the buyer would not be willing to pay as much for the shares. The restriction of the permission to transfer the insider information would therefore affect the value of the shares that are the subject of the block trade as well as the value of the whole stock corporation.[48]

Assmann, *Das künftige deutsche Insiderrecht (II)*, AG 237, 247 (1994); Heinz-Dieter Assmann / Peter Cramer, in WERTPAPIERHANDELSGESETZ § 14 WpHG annotation 48 (HEINZ-DIETER ASSMANN / UWE SCHNEIDER EDS., 1995).

[44] Heinz-Dieter Assmann, *Rechtsanwendungsprobleme des Insiderrechts*, AG 50, 55 (1997); Assmann / Cramer (note 43); similar Frank Schäfer, in WERTPAPIERHANDELSGESETZ § 14 WpHG annotation 23 (FRANK SCHÄFER ED., 1999); Schneider / Singhof (note 37), 590.

[45] KÜMPEL (note 40), annotation 16.169; Rolf Schmidt-Diemitz, *Pakethandel und das Weitergabeverbot von Insiderwissen*, DB 1809 (1996).

[46] Ziegler (note 22), 253; Müller (note 11), 3456; Schroeder (note 14), 2165; Roschmann / Frey (note 23), 454; Kiethe (note 22), 980; Assmann / Cramer (note 43), § 14 WpHG annotation 88e; Schäfer (note 44), § 14 WpHG annotation 64. Different opinion Stephan Weimann, *Insiderrechtliche Aspekte des Anteilserwerbs*, DStR 1556, 1560 (1998).

[47] Ziemons (note 14), 498; Assmann / Cramer (note 43), § 14 WpHG annotation 88e; Rainer Süßmann, *Die befugte Weitergabe von Insidertatsachen*, AG 162, 169 (1999).

[48] Kiethe (note 22), 980 et seq.; KNÖFLER (note 3), 102; Schmidt-Diemitz (note 45), 1811; Süßmann (note 47); Ziemons (note 14), 498.

The legislative intent of § 14 (1) No. 2 WpHG also needs to be understood in the way that transferring insider information and allowing a due diligence prior to a block trade is in compliance with the insider law. According to the legislator's intent[49] a block trade does not violate the insider law since the block trade creates an insider information itself. A person using this knowledge of the block trade which he created himself does not violate the insider law. In general, the purchase of a block of shares is permitted according to the legislator since it is not used for getting an unfair advantage condemning the equality of all investors. This is not the case even if the confidential information on the target company is submitted to the potential buyer during the contract negotiations. This situation changes if the person that bought the shares in the block trade purchases further stocks on a stock exchange or off-market using this knowledge. In using the insider information for these trades, according to the legislator's intent, he violates the insider law according to the legislator.[50]

In the case of a block trade, the legislator considers receiving insider information to be legal. If receiving insider information by the potential buyer is lawful, the target company's management board providing this insider information has to be lawful.[51] Differential treatment on each side would prove to be unsuitable. Therefore, in the case of an acquisition in the form of a block trade, the target company's management board is authorized to provide the potential buyer with insider information, (§ 14 (1) No. 2 WpHG). In case the buyer is willing to purchase the whole company the authorization remains the same. By transferring the information prior to selling the whole company the function of the capital market is not more affected than prior to selling a smaller amount of the company's stocks. Also, the protection of investors is not more affected by a transfer of information prior to selling a whole company compared to the sale of smaller block of shares.

The duty to make an ad hoc announcement, if the issuer or a person acting for the issuer transfers insider information to a third person and is authorized to do so (§ 15 (1) sentence 3 WpHG)[52] does not affect the information transfer prior to an acquisition. Transferring insider information to the potential purchaser does not

[49] BT - Drucksache 12 / 6679, 47.

[50] *Id*.

[51] Müller (note 11), 3456; Körber (note 4), 267; Assmann (note 44), 56; Schroeder (note 14), 2165; Schmidt-Diemitz (note 45), 1810. Different opinion Weimann (note 46).

[52] Added to the German Securities Trade Act by the Act to Improve the Protection of Investors, BGBl I 2004 No. 56, 29 October 2004, 2630 et seqq.

lead to this duty to make an ad hoc announcement, if the potential purchaser is committed to keeping the company information secret. According to § 15 (1) sentence 3 WpHG an ad hoc announcement does not have to be made, if the person receiving the information is legally required to keep the information confidential. Being legally required to keep information confidential does not only mean the requirement by law like in § 42 a (2) sentence 1 Federal Lawyers' Act (*Bundesrechtsanwaltsordnung* – BRAO) for lawyers and in § 43 (1) sentence 1 Federal Auditors' Act (*Wirtschaftsprüferordnung* – WPO) for auditors. It also means the duty of confidentiality based on contract.[53] Therefore no ad hoc announcement needs to be made if transferring insider information to the potential purchaser unless no confidentiality agreement was made.

D. Conclusions

The management board of a stock corporation is legally allowed to provide the company's potential buyer with sensitive information for a due diligence. The rules and regulations of the German Stock Corporation Act are not opposed to providing the potential buyer with secrets and confidential information for a due diligence prior to an acquisition. This does not change if the company is listed on a stock exchange. When faced with the decision to transfer confidential company information, the management board needs to assess the company's interests. Through balancing the interests between the disclosure and protection of information for the interest of the company, the adequate resolution should consist of recognizing the company's interest in transferring the information over its secrecy interests. In this case the management board should issue a written resolution declaring the single interests and their weightings. In addition and prior to the transfer of information, the management board needs to ensure that the potential buyer is committed to keeping the company information secret and acts with the intent to buy the company and that the purchase of the company is not evidently impossible. Providing sensitive information does not impose on the management board of a listed stock corporation a duty to make an *ad hoc* announcement in the meaning of § 15 (1) sentence 3 WpHG, if a confidentiality agreement had been made with the potential purchaser.

[53] Art. 6 (3) of the EC Directive 2003/6 of 28 January 2003, O.J. 2003 L 96/22 explicitly mentions the duty of confidentiality agreed by contract.