The Takeover bids Directive

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A. Introduction

On 27 November 2003 a political agreement has been reached in the Council on the compromise proposal for the Takeover bids Directive[1]. On 16 December, the Parliament gave its approval and the proposal has still to receive the formal voting of the Council under the Irish Presidency in March 2004. Member States are required to transpose it into national law by 2006. The Directive regulates how a company or an investor that already has control in a listed company[2] or seeks to obtain control can acquire securities in that company and applies to both voluntary and mandatory bids[3].

The provisions of the Directive that have been the subject of he heated discussions in the last years deal with *defensive mechanisms* that are available to the target management. This is where the Directive in its latest and probably final version introduces a system of optional arrangements which will in certain circumstances require choices and strategic decisions to be made by the companies themselves (*infra*, under I). The Directive also contains provisions on greater transparency in relation to the control and capital structures of all listed companies. On the one hand, such provisions lead to a higher visibility of what a potential bidder wants to ac-

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[†] The views expressed in this article are personal.

[1] The full text of the Directive is available athttp:/register.consilium.eu.int/pdf/en/03/st15/st15476.en03.pdf.

[2] The Directive is applicable according to Art 1 to takeover bids for securities admitted to trading on a regulated market within the meaning of EC Directive 93/22 of 11 June 1993, O.J. 1993 L 41/27; Directive as last amended by EC Directive 00/64 of 17 November 2000, O.J. 2000 L 290/27). These are, in short, markets that operate on a regular basis and are included in an annually updated list published in the Official Journal of the European Union. (See definition 13 in conjunction with Annex B and Art 16 of the EC Directive 00/64).

[3] In relation to mandatory bids see, *infra*, under III.

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quire. On the other hand, they create additional, and most likely burdensome, disclosure requirements (*infra*, under II).

In addition, there are a number of provisions on the protection of minority shareholders - most notable those of the equal treatment, the mandatory bid rule and the equitable price principle. The equal treatment principle prescribes the equal treatment of the target shareholders in both voluntary and mandatory bids. The mandatory bid rule requires the bidder to make an offer to all holders of securities for all their holdings once he reaches a certain percentage of the voting rights in the target company and hence obtains control. Finally the equitable price principle ensures that in the case of mandatory bids all shareholders are offered an equitable price for their shares (see, *infra*, under III). The directive also conveys squeeze and sell-out rights to the bidder and the target shareholders respectively. The bidder is able to squeeze out the remaining shareholders if he reaches a certain threshold, while the remaining minority shareholders can also require from the bidder to acquire their shares even though they didn't accept the offer initially (*infra*, under IV).

The Directive also establishes a number of procedural and information duties that secure the undistorted choice of target shareholders (*infra*, under V). Finally it includes other provisions that harmonise the market of corporate control at a European level, by providing the means for determining the applicable law and competent authority for cross border takeovers (see , *infra*, VI).

B. The new Proposal

Accordingly, the main content of the proposed Directive can be summarised as follows:

I. Defensive mechanisms

Arts 9, 11 and 11A of the proposed Directive deal with defensive measures by the offeree company. Two rules are established, the neutrality rule (Art 9) and the breakthrough rule (Art 11). The application of these rules is combined with new optional arrangements introduced by a new article (Art 11A). This article makes the application of neutrality and breakthrough rules optional by establishing a two-level system which permits at a primary level Member States to opt out from the application of the above two rules and their companies to opt in if they want, and furthermore, at a secondary level introduces the principle of reciprocity. If a Member State chooses to exercise this option, a company that has its seat in that Member State and applies articles 9 and/or 11 can be exempted from the application of those rules in cases that it receives a bid from a company that does not apply arti-

cles 9 and/or 11[4].

1. The Neutrality rule

The neutrality rule[5], if a Member State chooses to apply it or did not choose to apply it, but the company decided to opt in, requires that any defensive measures taken by the board of the offeree company, once the bid has started, must be subject to the prior authorisation of the general meeting of shareholders. To facilitate the application of this rule, the Directive demands from Member States to adopt rules requiring the general meeting to be convened at short notice. According to the Directive, actively seeking alternative bids is not considered a frustrating action. As regards to decisions taken prior to the bid and which are not yet partly or fully implemented, the general meeting of the shareholders shall approve or confirm any decisions which do not form part of the normal course of the company's business and whose implementation may result in the frustration of the bid.

2. The Breakthrough rule

The proposed Directive establishes a two level breakthrough rule[6]:

The first set of rules is triggered once the bid is made public:

a) Any restrictions on the transfer of shares in the articles of association and contractual agreements (subject to certain exemptions) will be unenforceable against the offeror during the period allowed for acceptance of the bid.

b) Any restrictions on voting rights cease to have effect in the general meeting of the offeree that is deciding on defensive measures.c) Multiple voting securities will carry only one vote at the general meeting which decides on defensive measures.

The second set of rules applies once the offeror reaches the 75% threshold of the voting capital of the target company:

a) After a successful bid the offeror has the right to call a general meeting and cast his vote according to normal rules of company law in order to amend the articles of association or remove and appoint board members in the target.b) In such a meet-

[4] See infra under 4.

[5] Art 9 of the proposed Directive.

[6] Art 11 of the proposed Directive.

ing the offeror is not hindered by any:

-Voting restrictions either by the articles of association or as a result of voting agreements (in particular voting caps).

- Any extraordinary rights concerning appointment and removal of directors (for example rights awarded to a shareholder to directly appoint a director in the board).

- Any multiple voting securities (which carry only one vote for that purpose).

The Directive also provides for compensation for any loss incurred by the holders of these rights according to the law of Member States and for some exemptions in relation to so-called 'golden shares' and cooperative enterprises. As a general comment, golden shares and all special rights held by Member States in companies which are provided for in private or public national law, are excluded from the scope of the breakthrough rule if they are compatible with the Treaty[7]. However, such special rights have to be considered in the framework of free movement of capital and the relevant provisions of the Treaty[8].

3. Optional regime

The proposed Directive establishes a two-level optional system:

At a primary level Art 11A allows Member States to opt out from the application of the neutrality rule (Art 9) and the breakthrough rule (Art 11). This means that Member States are allowed:

- not to require companies established within their territory to apply the provisions limiting the powers of the board to take defensive measures during the bid (Art 9);

- not to render ineffective barriers provided for in the articles of association, like voting caps and multi-voting securities, or in specific agreements, like voting

[7] See Art 11.6 and preamble par 18(a) of the proposed Directive.

[8] There is already a substantial case law by the ECJ on this issue. See for example: Case C-98/01, Commission of the European Communities v United Kingdom; Case C-463/00, Commission of the European Communities v Kingdom of Spain; Case C-503/99, Commission of the European Communities v Kingdom of Belgium; Case C-483/99, Commission of the European Communities v French Republic; Case C-367/98, Commission of the European Communities v Portuguese Republic; for a commentary of the first decisions, see *Adolff*, 3 GERMAN LAW JOURNAL No. 8 (1 August 2002), http://www.germanlawjournal.com/article.php?id=170.

agreements or (Art 11).

At a secondary level Member States that choose to opt out must, at least, give the companies that are established within their territory an option with regard to the application of these provisions.. According to the option, companies can choose to apply articles 9 and/or 11 even though the Member State where they have their registered office chose to opt out from their application. The decision of the company must be taken by the general meeting of shareholders, based on the applicable law where the company has its seat in accordance with the rules applicable to amendments of the Article of association. Such a decision can be reversed under the same procedure. As has become clear from the policy debates preceding this hard battled-for compromise in November 2003 with regard to Germany's expected reluctance to apply neither the neutrality rule nor the breakthrough rule[9], it will fall upon the German companies to take the strategic decisions and decide whether or not to apply the above rules. One of the issues that they have to consider in taking such a decision is the reciprocity clause examined bellow.

4. Reciprocity clause

When a company which applies rules on defensive measures (Arts 9 (2) and (3)) and/or on breakthrough (Art 11), either because it is forced to[10] or because it decided to opt in,[11] becomes the target of an offer, the Member State, where the company has its seat, is provided with the option to exempt it from the application of those rules, if the bidder does not apply rules 9 and/or 11[12]. This can be the case when the offeror has its seat in a Member State that chose to opt out from the application of rules 9 and/or 11 and the target company has its seat in a Member State that chose to apply rules 9 and/or 11. The reciprocity rule could even apply if the same Member State opted out from the application of rules 9 and/or 11 and the target company made use of the option to opt in while the offeror did not.

It should be noted that due to international agreements (Article II No. 1 of GATS I[13]) it is questionable whether the reciprocity clause can be used against third coun-

[9] See, for a concise account of the Directive's legislative history and the disputed issues, the introduction to the Draft Proposal of October 2003, and *Kirchner/Painter*, 50 Am. J. Comp. L. 451 (2002).

[10] This is the case when the Member State chose to apply rules 9 and/or 11.

[11] This is the case when the Member State decided not to apply rules 9 and/or 11. See supra under 3.

[12] Art 11A.3 of the proposed Directive.

[13] See http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm.

try bidders, like US companies. Contrary to the opt-in provision mentioned above[14], the reciprocity clause does not give a direct right to companies, but allows Members States to decide whether or not they want to give such discretion to their companies.

The above two-level optional system can be more explanatorily presented as follows:

- If a Member State decides to apply Arts 9 and/or 11, its companies do not have the right to opt out from the application of Arts 9 and/or 11. The same Member State can, however, allow them not to apply the above articles if they receive a bid from a company that doesn't not apply the same articles. If the Member State does not exercise such discretion, its companies cannot directly apply the reciprocity clause.

- If a Member State decides to opt out from the application of Arts 9 and/or 11 it is obliged to allow its companies to opt in and apply both or any of those articles if they wish so. Such a decision is reversible. Once a company has taken this option, it cannot differentiate among those bidders that do not apply the same provisions unless the Member State of its seat provides it with that option on the basis of the reciprocity clause. This means that the company that opts-in to Arts 9 and 11 can benefit from the reciprocity clause only if the Member State in which it is incorporated allows so. In any other case the company can withdraw its decision under the same procedures that the opt-in shareholders' resolution was obtained.

The just described optional system provides for considerable flexibility for both Member States and their companies. Especially the reciprocity clause, once chosen to be applicable in a Member State (this will be probably the case in Germany), provides an additional incentive for companies to opt in and apply Arts 9 and 11. This is especially important for companies that have an active acquisition program since the reciprocity clause can render a takeover offer by a bidder that does not apply Arts 9 and 11 more difficult.

II. Transparency (Art 10)

Transparency and disclosure is considered, beyond any doubt, as a cornerstone of the effective operation of capital markets and the market of corporate control. The Directive accommodates this principle, and in order to increase transparency and disclosure, requires from all listed companies to disclose in the annual report their

[14] See supra under 3.

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capital and control structures. Among others, there should be included in the annual report[15]:

- different classes of securities and especially securities not listed for trade (capital structure),
- significant direct and indirect shareholdings (cross shareholdings / pyramid structures),
- restrictions in the transfer of securities,
- special control rights,
- certain shareholders' side agreements known to the company,
- defensive measures like the board's power to issue buy back shares, or the 'certificat system' for example in the Netherlands,
- any agreements between the company and third parties that alter or terminate upon a change of control of the company except when their disclosure is seriously prejudicial to the company,
- golden parachutes, etc.

In addition, the proposal requires the board to submit an explanatory report on the above capital and control structures and defensive measures to the annual general meeting of shareholders. Shareholders must also be informed on the actual control and capital structures of their company.

While the benefits of such dissemination of information for the operation of the market of corporate control are obvious, compliance with the above requirements is not without its costs, since it imposes an additional burden on companies which from now on need to produce and publish that information on an annual basis.

III. Minority protection

The Directive recognizes and gold-plates at a European Level a number of minority protection principles: the equal treatment of the target shareholders, the mandatory bid rule, the equitable price principle and the cash alternative rule. While the first one applies to all bids, voluntary and mandatory, the others only apply in connection to mandatory bids.

1. The Equal treatment principle

A key principle of the Directive is that all target shareholders of the same class must

[15] Art 10 of the proposed Directive.

be afforded equivalent treatment[16]. Although the word "equivalent" used in the English version of the Directive doesn't necessarily mean "equal" and may leave some room for interpretations that could allow the bidder to differentiate among shareholders and still offer an 'equivalent' offer, (for example by using a different form of consideration), the purpose of the Directive is to ensure that all shareholders of the same class can tender their shares under the same terms.[17] This principle applies irrespectively of whether the bidder initiates a takeover offer on free will, through a voluntary bid, or is required to abide to the mandatory bid rule. In the latter case the principle is further strengthened by the application of a number of rules that determine the price and the form of consideration offered.

2. The Mandatory bid rule

The mandatory bid rule[18] ensures that the acquirer shall make an offer at an equitable price to all holders of securities for all their holdings once he reaches a certain percentage of the voting rights in the target company which gives him control of the company. Such percentage and the method of calculation are left to be determined by the Member States. In Germany and the UK this percentage is currently fixed at 30%[19].

However, the Directive doesn't prohibit partial offers in voluntary bids. Consequently, the bidder can make an offer for less than 100% of the voting rights of the target company provided that it doesn't exceed through extra-offer dealings the threshold determined by each Member State that triggers the application of the mandatory bid rule. That does not mean however that Member States are not free to prohibit partial offers even in cases of voluntary bids. This is, for example, the case in the UK where the Takeover Code prohibits any partial offers unless with consent of the Takeover Panel and only in exceptional circumstances.

3. The Equitable price principle

The equitable price principle[20] works at two levels:

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[16] 3.1.(a).

[17] the word used in the German version of the Directive is "*gleich*" (equal).

[18] Art 5.1-3 of the proposed Directive.

[19] For Germany see §§ 29, 35 Wertpapiererwerbs- und Übernahmegesetz (WpÜG). For the UK see Rule 9.1 of the City Code on Takeovers and Mergers.

[20] Art 5.4.

- First, in cases where a mandatory bid is required, the bid must be made at an equitable price which according to the Directive is the highest price paid for the same securities by the offeror, over a period determined by the Member States[21]. Such a period, however, cannot be less than six months and not more than twelve months prior to the launch of the bid[22].

- Second, the bidder must match the highest price paid for any securities acquired after the launch of the bid and before that lapses if it is higher than the initial offer[23].

At both levels Member States are free to allow deviations from the highest price rule as long as the price is adjusted by the competent regulatory authorities, for special reasons, and provided that the price adjustment does not defeat the purpose of the mandatory bid rule.

4. Consideration: Cash alternative

The Directive prescribes[24] that in an offer the consideration must include either liquid securities or cash. However, it provides for cash to be mandatory offered at least in form of a cash alternative in three cases:

a) first, when the consideration offered consists of illiquid securities not traded on a regulated market;
b) second, when the bidder while the bid is still open, acquires securities carrying 5% or more of the voting rights of the offeree company in cash;
c) third, when Member States decide to require a cash alternative in every case.

IV. Squeeze out – Sell out rights

Once a bidder holds a large majority of a company's securities as a result of a takeover bid, it can "squeeze out" the remaining minority by compelling them to sell their securities at a *fair* price. In order to take account of different national traditions[25], Member States can set the threshold for triggering the squeeze-out right by

[21] idem.

[22] In Germany, there exists a three months period, see §§ 39, 31 WpÜG, 3, 4 AngebVO.

[23] Idem.

[24] Art 5.5.

[25] For example in the UK, the threshold is set to 90% of the share capital or a class of shares (see sections 429 to 430B of Companies Act). In Germany, the threshold is set to 95 % of the share capital.

reference to capital (between 90% and 95%) or, alternatively, by reference to the number of acceptances in the offer (at 90%). The offeror must exercise the squeeze out right within a period of three months after the end of the bid and is required to offer a fair price and the same form of consideration offered in the bid, or cash. Following a mandatory bid, the consideration offered in the bid is presumed to be fair, while in voluntary bids the consideration offered in the bid is presumed to be fair where the offeror has acquired, through acceptance of the bid, securities representing not less than 90% of the capital carrying voting rights comprised in the bid.[26]

The "sell-out" right is "the other side of the coin". Minority shareholders will have the right to compel an offeror who has obtained 90% (or 95%, depending on the Member State's choice) or more of the capital to purchase their securities at a fair price.[27]

V. Protection of shareholders undistorted choice

One of the principles that the Directive seeks to protect is that shareholders of the target company will not be forced to accept an offer that they wouldn't consider optimal with regard to severe time pressure and/or inadequate or misleading information.

1. Sufficient time in relation to the bid

According to the Directive holders of securities of an offeree company must be afforded sufficient time to enable them to reach a properly informed decision on the bid[28]. This principle is expressed and quantified in Art 7 where the Directive prescribes that the minimum period that the offer must remain open to acceptances, can be no less than two weeks and no more than ten weeks from the date of publication of the offer document.

2. Information Provision in relation to the bid

The Directive[29] provides for increased transparency and disclosure in relation to the announced bid. Among others it requires:

[26] Art 14.5.

[27] See above under squeeze out right.

[28] Art 3(b).

[29] For more details see Arts 6, 8 and 9 of the proposed Directive.

- prior communication of the offer document to the supervisory authority before the offer document is made public;
- notification of the employees' representatives once the bid is made public;
- prompt dissemination of information in all Member States that the securities of the target company are listed so as to ensure market transparency and integrity for all securities of the offeree company;
- a minimum content of the offer document, so as for the holders of securities to reach a properly informed decision on the bid.

3. Employees

Contrary to what the Directive introduces with respect to target shareholders (Art…), the proposed Directive does not introduce new information or consultation rights for employees. It does, however, specifically refer to the need to apply the various existing Community measures in this area, for example, Directive 94/45 EC on European works councils (IP/95/744), Directive 98/59 EC on collective redundancies and Directive 2002/14 on informing and consulting employees (IP/01/1840).

VI. Harmonisation of the market of corporate control: Competent authority and applicable law

The proposed Directive provides for a means of determining which is the competent authority for the supervision of a takeover and which national law is applicable in the case of cross-border takeovers[30]. In particular, the proposed Directive provides a legal framework for takeovers in cases where the target company is not listed in its country of origin. For this purpose, some distinctions are made:

- first, between the law of the Member State where the target company is listed (so-called "market" rules) and the law of the Member State where that company has its registered office (so-called "home" rules);
- second, between matters relating to the procedure on the one hand and matters relating to the information of employees and company law on the other hand.

Based on these distinctions, the proposed Directive provides that:
- matters relating to the procedure and price should be dealt with in accordance with the market rules and supervised by the authority of the Member State where the target company is listed, or if it is listed in several places, of the Member State where it has been first listed;
- matters relating to the information of employees and company law should be

[30] Art 4 of the proposed Directive.

dealt with in accordance with the home rules and supervised by the authority of the Member State where the target company has its registered office.

C. Conclusion

The provisions of the Directive about enhanced transparency, competent authority and applicable law, as well as the recognition at a European level of principles like the equal treatment of target shareholders, the mandatory bid, the equitable price and the target shareholders' right for undistorted choice, provide a substantial level of harmonisation of the European market of corporate control.

It is true that the Commission attempted to achieve the same harmonisation in respect of defensive measures by requiring the neutrality and breakthrough rules to be compulsory in all Member States. However, different traditions and shareholding structures in various Member States have prevented this attempt from materialising[31].

The adoption of the Takeover Directive does not, by all means, signal the end of the special interest that it attracted from press, the academic community and various market participants. Member States still have to transpose the Directive by 2006 and the Commission, five years after the transposition of the Directive by the Member States, shall submit proposals for a timely revision, after examining its application and also the control structures and barriers to takeover bids at a European level. As a result, it is safe to assume that this is not the last we heard from the Takeover bids Directive.

[31] With regards to article 9 (neutrality rule), many Member States (e.g. UK, France, Italy, Spain) have that rule in their national law, while others like Germany and Netherlands do not have such a rule. Regarding art 11 (breakthrough rule) Sweden, Finland and Denmark for example have multiple voting shares, while others do not, many Member States have voting caps and some of them have ownership caps, such as Italy and the Netherlands. Germany has none of them. With the original proposal, the Commission wanted to introduce the neutrality rule on a mandatory basis and to have a breakthrough rule to eliminate barriers. However, the original proposal did not include multiple voting rights.