

Implementing the Takeover Directive in the UK

Thesis submitted for the degree of

Doctor of Philosophy

at the University of Leicester

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March 2008

Abstract

The removal of barriers to takeover activities has been the driving force behind the Directive since its initial draft appeared in 1974. The Directive was adopted in April 2004, and implemented in the UK on 20 May 2006. The main objectives of the Directive are twofold: first, to protect investors, and secondly, to harmonise takeover regulation in Europe. These objectives are fundamentally aimed at reinforcing free movement of capital. Whether and how the Directive achieves its driving force and objectives is the subject of this thesis.

At the heart of this thesis are three arguments. The first is that the Directive is unlikely to have a significant impact on how takeovers are regulated in the UK. This is because the Directive, as implemented by the Companies Act 2006, essentially maintains the regulatory status quo under the Panel and the Code. Despite changing from self-regulation to statutory regulation, the Panel remains the maker, interpreter and judge of its own takeover rules.

The second argument is that the Directive is unlikely to harmonise takeover regulations in Europe. The Directive is not detailed; it gives leeway to Member States to impose stringent rules beyond the minimum standards, and it allows Member States to opt out/into the core provisions contained therein, which in turn defeats any harmonisation effect.

The third argument is that, whereas the Directive was watered down by compromises that made its core provisions optional, and to that extent it is hardly a triumph, its strength can be revived by reading it to conform with free movement of capital under the EC Treaty. To the extent that the Directive is read to conform to the EC Treaty, it is likely to be revived to fulfil its driving force of removing barriers to takeover activities. However, a legalistic approach amid a rather politically volatile regulatory framework of takeovers, is problematic.

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Acknowledgements

It would have been difficult to complete this study without the financial help provided by my employer, Buckinghamshire New University, in paying my fees for the last two years of the study.

It was my supervisor at the University of Leicester, Professor Mads Andenas, though, whose contribution to the writing of this thesis was fundamental in achieving the end product. My self-esteem, and, as a result, my work, has benefited enormously from his advice and encouragement. My work has also benefited enormously from the constructive comments of Professor Rebecca Parry at Nottingham Trent University, who read some of my initial draft chapters – a tedious task that undoubtedly encroached on her precious time. My thanks goes to Dr. Arad Reisberg at University College London, whose comments on some parts of my work have been a source of wisdom. I also thank Professor Dr. iur. Gudula Deipenbrock at University of Applied Sciences (Berlin), with whom I discussed German law aspects during his visiting professorship at Leicester.

On a personal note, I must acknowledge that without the support of my beloved wife Rebecca I would have found researching and writing this thesis a far more arduous process.

List of Selected Abbreviations

AC	Appeal Cases
All ER	All England Law Reports
AIM	Alternative Investment Market
BCC	British Company Cases
BCLC	Butterworths Company Law Cases
CA	Companies Act 2006
Ch	Chancery (Law Reports)
DTI	Department of Trade and Industry
EC	European Community
ECR	European Court Reports
EU	European Union
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
PCC	Palmer's Company Cases
QB	Queen's Bench Law Reports
WLR	Weekly Law Reports

Introduction

Underlying problems in this thesis

The implementation of the European Community Directive on Takeover Bids (the 'Directive'),¹ poses a number of questions in relation to regulation of takeovers within and beyond the UK. Without statutory mandate, the Panel on Takeovers and Mergers (the 'Panel') has been the UK's supervisory authority for takeover bids since 1968,² supervising by means of rules contained in the City Code on Takeovers and Mergers (the 'Code').³ On 20th May 2006,⁴ the UK brought into force the law implementing the Directive, The Takeovers Directive (Interim Implementation) Regulations 2006 (the 'Regulations'),⁵ which put both the Panel and the Code on a statutory footing for the first time.⁶ The Regulations were subsequently replaced by the Companies Act 2006 on 6th April 2007; Part 28 of the CA 2006 deals with takeovers.

The fundamental issues in this thesis are:

(1) whether the Directive is likely to have any or significant impact on takeover regulation in the UK, given that much of the self-regulation characteristics seem to be retained in the process that has brought the Panel and the Code within statutory regulation;

¹ Directive 2004/25/EC [2004] OJ L142/12.

² The Panel was established under the auspices of the Bank of England, it has always discharged public functions and is subject to judicial review, a position that makes it odd to categorise as a private body.

³ The Takeover Panel Report on the year ended 31 March 2004, p 6.

⁴ Article 21 of the Directive requires Member States to bring into force laws implementing the Directive by 20 May 2006.

⁵ Statutory Instrument 1183/2006. These Regulations came into force on 20 May 2006 to coincide with the deadline required of Member States to implement the Directive.

⁶ Regulation 4(2) provides that 'the Panel shall supervise takeover bids' in the UK. These provisions 'place the activities of the Panel within a statutory framework for the first time' (Parliamentary Under-Secretary of State, Department of Trade and Industry, 'Company Law Reform Bill', *Hansard* HL, Col 186 (11 January 2006) <<http://www.publications.parliament.uk/pa/ld199900/ldhansrd/pdvn/lds06/text/60111-08.htm>> accessed 22 March 2006.

(2) whether the Directive will cause unwelcome legal scrutiny and tactical litigation;

(3) whether the Directive provides any significant changes in the protection of shareholders during takeover bids;

(4) whether the implementation of the Directive is likely to radically change directors' duties in company law by extending these duties to a class of employees and shareholders affected by takeover bids;

(5) whether the manner in which other Member States implement the Directive would negatively affect cross-border takeovers contrary to the UK interests;

(6) whether the Directive is likely to effectively achieve its objective of harmonising takeover regulations in Europe, given the discretion under Article 12 to opt out/or into the fundamental provisions of the Directive aimed at achieving this objective; and

(7) whether applying Article 12 in implementing the Directive would create a restriction to free movement of capital contrary to Article 56 of the EC Treaty.

Takeovers, as regulated by the Panel and the Code, have operated under a so-called 'self-regulation'⁷ regime since 1968. At the heart of this self-regulation lies a conflict of interest, in the sense that those engaged and interested in the takeover industry are by and large the same people who make an input into the content and operation of the rules governing their activities.⁸ Indeed, the Panel is said to be 'part legislator, part court of interpretation, part

⁷ The term is here used to 'connote a system whereby a group of people, acting in concert, use their collective power to force themselves and others to comply with a code of conduct of their own devising,' *R v The Panel on Takeovers and Mergers ex parte Datafin* (1987) 3 BCC 10, 13.

⁸ See B Pettet, *Company Law*, (Longman, Harlow 2001) 412-415.

consultant, part referee, [and] part disciplinary tribunal'⁹ in the business of takeovers it regulates.

In implementing the Directive, the Panel remains categorised as a private body as it has always been,¹⁰ and it is recognised by national law under the CA 2006 to be a competent supervisor within the meaning of the Directive.¹¹

Under FSMA 2000 section 143, the Financial Services Authority ('FSA') had power to endorse the Code and sanction any breach of the Code. That power was revoked by section 964 CA 2006, which meant that the FSA could no longer 'make endorsing rules in respect of provisions of that Code',¹² and sections 348 and 349 FSMA 2000 were amended accordingly.¹³ The effect of this amendment is to make the Panel fully independent in its functions and in applying its own sanctions for breach of the Code. There remains a duty of co-operation – the Panel 'must take such steps as it considers appropriate to co-operate with' the FSA and other agencies.¹⁴ With the independency of the Panel reinforced, the status quo maintained, and the regulatory environment likely to remain the same, it is questionable whether the Directive will have any impact.

⁹ *R v The Panel on Takeovers and Mergers ex parte Guinness* [1989] 2 WLR 863, 867 (Lord Donaldson MR).

¹⁰ The term 'private body' here refers to a body not established by statute. It is hard to categorise a body that is subject to judicial review as a private or independent body in legal terms. It may well depend on the functions it discharges – a detailed analysis of this divide can be found in D Oliver, *Common Values and the Public-Private Divide* (Cambridge University Press, Cambridge 1999).

¹¹ Article 4(1) of the Directive requires Member States to designate the authority or authorities competent to supervise bids, which authorities shall be either public authorities or private bodies recognised by national law. Section 942(1) CA 2006 confers on the Panel the regulatory functions set out in Chapter 1 of Part 28. However, the Act does not confer on the Panel the status of a statutory body; the panel remains an unincorporated body, having rights and obligations under the common law, which rights and obligations are supplemented by specific provisions set out in the Act.

¹² Section 143(1A) FSMA 2000, as amended by Statutory Instrument 2007/1183.

¹³ This amendment is designed to ensure consistency with the requirements of Article 4.4 of the Directive as regards the duties of takeover regulatory and financial services authorities within the EU to co-operate with each other.

¹⁴ Section 950 CA 2006; this section mirrors similar co-operation obligations imposed on the FSA by section 354 FSMA 2000.

The Directive requires the supervisor of takeovers to be vested with all the powers necessary for the purpose of carrying out its duties, including those of ensuring that parties to a bid comply with the rules made or introduced pursuant to the Directive.¹⁵ The approach of the Panel to compliance has always been by ‘coercion’ of its subjects.¹⁶ The City participants have always complied with the Panel’s decisions, not because of fear of legal consequences but because most companies are members of the fraternity of parties in the takeover industry to which the Panel itself belongs.¹⁷ These companies subscribe to the Panel and its rules, which they restrain themselves from challenging the Panel’s decisions, for otherwise they would risk being in trouble with their own authority.

The word used in the Directive is ‘ensuring’ rather than a word more appropriate to self-regulation such as ‘coercing’.¹⁸ Although the powers under the implementing law would enable the Panel to apply to the court to enforce its rules, if the Panel continues its stance against involving courts in its business, there are difficulties with how the Panel would comply with ‘ensuring’ compliance in implementing the Directive. It is a question of whether the approach of ‘coercing’ (or persuasion) as opposed to ‘ensuring’ (or taking legal action) will suffice to comply with the Directive.

The Directive emphasises that Member States must ensure that the directors of the offeree company give their employees sufficient information on effects of the bid on employment and conditions of employment.¹⁹ This points at radical changes in the corporate culture, which do not regard directors as

¹⁵ Article 4(5) of the Directive – the term ‘ensuring’ is used.

¹⁶ ‘Coercion’ here refers to persuasion as opposed to forceful approach or legal action. The Panel ‘... enjoys no contractual relationship with the financial market ... use their collective power to force themselves and others to comply with a code of conduct of their own devising’ *R v The Panel on Takeovers and Mergers ex parte Datafin* [1987] QB 815, 825 (Donaldson MR).

¹⁷ The Panel derives its practical authority from the backing of the Bank of England, Investment Institutions, the London Stock Exchange, Investment Banks, and recognition by professional bodies including the FSA.

¹⁸ Article 4(5) of the Directive – the term ‘ensuring’ is used.

¹⁹ Recital number 23 of the Directive; Articles 9(5) of the Directive.

owing duties to company employees nor to the shareholders but to the company.²⁰ Under company law, it is virtually impossible for employees to get any legal remedy for a breach of directors' duties.²¹ Company law further provides that directors of the offeree company have no obligation to give information to or advise its shareholders or the offeror company on the bids.²² Moreover, whereas the offeror may rely on the published accounts of the offeree company, if those accounts are seriously adrift, the offeror will have no claim against a negligent auditor or director.²³

Long before the Directive contemplated changing the corporate culture regarding the wider duties of directors, the Panel and the Code had long added to such duties by demanding a higher standard of duty than known in company law.²⁴ On their part, the UK courts have been very reluctant to intervene. This had not been much of a problem in company law considering that the Code has always been a measure of good practice between participating companies and without the full force of law. With the Code accepted as the rules laid down to implement the Directive, it is questionable whether corporate culture is likely to change and whether the courts will have to become involved.

²⁰ Section 172(1) CA 2006 requires directors to 'have regard to the interests of employees'. This leaves employees with a weak remedy given the technicalities involved in breach of directors' duties. It remains to be seen how case law will develop to bring employees directly under the protective duties of directors during takeovers rather than directors merely having regard to their interests.

²¹ B Pettet, 'Duties in Respect of Employees under the Companies Act 1980' (1981) 34 CLP 199, 200-204.

²² See *Lynall v IRC* [1971] 3 WLR 759; *Percival v Wright* [1902] 2 Ch 421.

²³ See *Caparo v Dickman* [1990] 2 WLR 358.

²⁴ The requirements under Code rules 3(1), 19, 20, 23, 25, and 28 are not compatible with the conventional duties of directors as known under company law; for example, rule 3.1 provides: 'The board of the offeree company *must* obtain competent independent advice on any offer, and the substance of such advice *must* be made known to its shareholders'; rule 19 provides: 'Each document ... statement ... *must* be prepared with the *highest* standard of care ... This applies whether it is issued by the company direct or by an adviser on its behalf'; and rule 32 provides: 'Shareholders *must* be given sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer ...' – these Code rules clearly suggest that directors' duties are not only owed to shareholders during a takeover period but also owed to shareholders on a higher standard of care than known in company law.

On the other hand, whilst the Directive requires directors to refrain from taking measures that would frustrate the bid,²⁵ it does not define the measures that can frustrate a bid. The question then is how these measures (if defined, and the current Code laid down as takeover rules within the meaning of the Directive) fit into mainstream company law with regard to directors' obligations and liabilities and at the same time allow courts to retain the stance of not getting involved. It is also a question of whether directors' duties in takeovers are to be regarded as *sui generis* to duties under mainstream company law or whether a redefinition of directors' duties is required.

The ambitious harmonisation of takeover rules in Europe through the Directive has not been without controversy. The controversy, and indeed the problem, has been due to and still lies in the Directive's aim of introducing into Member States the corporate culture of other Member States.²⁶ For example, whilst the UK is used to the idea of a mandatory bid, Germany is not, and the Directive took the course of introducing a mandatory bid provision.²⁷

During the years of negotiations and in the run-up to the final text of the Directive, the controversy was centred on opposition to provisions contained in articles 9 and 11. Article 9 prohibits, without prior authorisation from the general meeting of the shareholders, frustrating action by the directors of the offeree company. Article 11 entitles, under the so-called 'break-through' provision, a bidder who has acquired 75 per cent of the equity in the offeree company to override multiple voting rights when taking control of the whole of the offeree company. Possibly, because of the difference in legal cultures in the Member States, the Directive had to provide a compromise allowing Member States to opt out of complying with either, or both, of the

²⁵ Article 9(2) and 9(3) of the Directive.

²⁶ M O'Neill, 'When European integration meets corporate harmonisation' (2000) 21 Co Law 173, 175.

²⁷ Germany was opposed to the inclusion of a mandatory bid provision (now Article 5), on grounds that their Stock Corporation Act [Aktiengesetz] was sufficient to protect shareholders otherwise for which a mandatory bid is sought – JA Faylor, 'Germany: A legal guide' (1998) IFLR 34, 35.

controversial articles.²⁸ The question then is whether this discretion to opt out of some of the major provisions of the Directive is a recipe for de-harmonisation.

The Directive having emerged after interminable negotiations between states for so many years, was watered down by making its core provisions optional. To that extent, 'it is hardly a triumph for harmonisation since the contentious areas remain a matter for Member States to decide for themselves'.²⁹ However, taking advantage of Article 12 of the Directive is likely to result in a restriction on free movement of capital contrary to Article 56 EC Treaty. The question is whether a Member State taking advantage of Article 12 in implementing the Directive is likely to be in breach of Article 56 of the EC Treaty.

Scope of the thesis

This thesis is primarily and broadly an examination of the legal implications of implementing the Directive in the UK. The main thrust of the thesis is to discuss the impact of the Directive, looking at the regulatory framework under the self-regulation regime compared with the statutory regime following the implementation of the Directive, and conventional duties of directors versus monitoring and disclosure duties in relation to takeovers under the Directive. The thesis also examines the wider question of the harmonisation of takeover regulation in Europe.

In general, this thesis analyses: the role of the Code and the Panel in implementing the Directive; the scope and mechanism to be applied by the Panel to ensure compliance with the Directive; the Directive's measures of

²⁸ Article 12(1) of the Directive allows Member States to opt out of articles 9(2) and 9(3) and/or article 11. If a Member State opts out of article 9(2) and (3), that would limit the use of hostile takeovers with the effect that directors apply measures frustrating the bid, and in turn fail the objective of the Directive to facilitate restructuring of companies in Europe for a wider economic competitiveness. It will also fail the objective of protecting shareholders, who may have wanted the bid to succeed. If a Member State opts out of article 11, that may render takeovers unattractive to investors where listed companies still have complicated share structures – these are gradually reducing on the UK market.

²⁹ P Scott, The Takeover Panel Report on the year ended 31 March 2004, 8.

protecting the interests of shareholders and employees of companies involved in takeovers; the Directive's provisions pertaining to defensive measures that may frustrate takeover bids; and the break-through provisions. These matters are largely examined in the context of how they affect and fit into UK company law. On a capital markets' dimension, the thesis examines whether applying Article 12 of the Directive would create restriction to the free movement of capital contrary to Article 56 EC Treaty, and, if so, then how the Directive ought to be interpreted.

There are three important limits on the scope of this thesis. First, the analysis in this thesis focuses on takeover regulation in the UK, and reference to regulation in other EU States is only a matter of illuminating on the understanding of the impact of any legal implication discussed in the context of implementing and interpreting the Directive in the UK. Thus, a limited comparative study of the approaches taken by selected Member States (Germany, France, Belgium, Netherlands and Italy) in implementing and interpreting the Directive is taken in this thesis, the emphasis of which is to analyse how those approaches would affect UK cross-border takeovers.

Secondly, although the Directive has developed through a process of political and economic negotiations and to that extent retains many political-economic characteristics, this thesis veers towards legal discussions of the merits and demerits of the Directive. Thirdly, the legal discussions in this thesis are confined to the remits of company law as the wider branch of law under which takeovers fall.³⁰ However, the emphasis is on the effect of the regulation of takeovers rather than on the substantive law of takeovers, and how that affects or fits into mainstream company law.

³⁰ Company law here refers to 'UK company law', as the analysis of varied company law doctrines in Europe is beyond the scope of this thesis. For example, in the UK company management is entrusted to a single board of directors; and in Germany it is a two-tier board management with an executive board of directors (Vorstand) and a supervisory board of directors (Aufsichtsrat) – H Fleischer, 'The Responsibility of the Management and Its Enforcement' in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 373, 407.

Sources and methodology

On a broader level, this thesis adopts an analytical method, focusing on the impact of transposing the Directive into the UK and placing the Panel and the Code within a statutory framework as envisaged by the Directive. This thesis primarily undertakes a theoretical legal analysis of regulation approaches and takeover practice in the UK, drawing from both primary and secondary legal sources: relevant EU laws, statutory provisions, case law, and existing academic literature in the light of implementing the Directive. The bulk of this thesis analyses the effect and rationale of the approach taken in the UK in the transposition of the Directive – evaluating the extent of compliance with the Directive provisions and the relevant principles of EU law, and a comparative study of the approaches taken in other EU Member States. This involves making and dealing with assumptions, conducting an analysis of the theoretical legal implications, suggesting solutions, evaluating the suggestions by way of looking at their strengths and weaknesses, and drawing conclusions.

At a more mundane level, the method of research used in this thesis is to test the defined hypotheses against reasoning in secondary sources on the regulation of takeovers in the UK. The approach includes making a descriptive account of the relevant law and then making a comparative analysis of key issues therein against either primary or secondary sources. This includes a descriptive account of the main provisions of the Directive. The main objectives of the Directive, which are to protect investors and facilitate corporate restructuring, are described. Core provisions in the CA 2006, and the regulating rules, the Code, are outlined. The descriptive account provides both the basis and framework for analysis, from which conclusions are drawn, in answering the underlying question in this thesis: namely, what is the legal impact of transposing the Directive into the UK?

Research findings are given in a conclusion at the end of each chapter. The general conclusion after the seventh chapter is a collation of all chapter conclusions albeit enhanced to reflect how this research has answered the

underlying question in this thesis. This approach is adopted here as a matter of a simple methodology to enable the research to keep track and reflection of the findings.

Structure of the thesis

This thesis comprises a general introduction, followed by seven chapters and a conclusion. Each chapter begins with an introduction and ends with a conclusion.

Chapter 1 starts with the history of the Directive, discussing the objectives and aims of the Directive, through the regulatory framework prevailing in the UK and the framework put in place to implement the Directive. The chapter examines takeover rules under the Code, and relates the rules to provisions in the Directive, as implemented by the CA 2006. The chapter concludes by looking at any likely impact of the Directive on the culture of takeover regulation after the transition from self-regulation to statutory regulation, taking into account the fact that the same regulator and the same rules apply after the transition.

Chapter 2 looks at the question of whether implementation of the Directive is likely to increase litigation, and at the question of tactical litigation in takeover bids. The chapter further looks at the provision of a prohibition to defensive measures that may frustrate the bid, and at derogatory provisions applicable to the prohibition. The chapter also examines the circumstances in which courts may become more involved than they have been in the past under self-regulation of takeovers. In particular, the chapter looks at the reluctance of the courts to become involved and whether that reluctance would be maintained in the light of the Code acquiring legal force under the CA 2006.

Chapter 3 analyses the extent to which the Directive protects the interests of shareholders, especially the interests of minority shareholders who may be squeezed out by the controlling majority who takes over the company. This includes examining the principle of decision-making by shareholders and the notion of equal treatment of shareholders. The chapter also looks at whether

the Directive adds anything that the Code would not provide, were the Directive not to be implemented.

Chapter 4 deals with the question of how directors' duties as understood in company law are affected by the relevant provisions of the Directive. The chapter looks at the disclosure obligations to shareholders and employees, and assesses whether these obligations are to be understood as extending the traditional duties of directors owed to the company. The chapter also sets out the theoretical framework for dealing with the problem of the conflict of interest in respect to directors' decision-making during takeover bids.

Chapter 5 undertakes a limited comparative study, looking at the approaches taken to Articles 9, 11 and 12 of the Directive by a selection of Member States. These selected Member States include Germany, France, Belgium, The Netherlands and Italy. The chapter also analyses how a UK bidder would succeed in taking over a company in the selected Member States in the light of how those States have implemented the Directive.

Chapter 6 looks at the wider question of how the foregoing affects the harmonisation process of takeover regulation and corporate law in Europe. The chapter looks at the effect of allowing Member States to opt out of or into major Articles 9 and 11 of the Directive, and the effect of allowing Member States to apply rules beyond the minimum standards and whether that would result in an unlevelled playing field of takeovers in Europe.

Chapter 7 looks at how the Directive relates to the free movement of capital, and whether Member States would be in breach of their Treaty obligation under Article 56 EC Treaty if they opted to restrict takeovers under Article 12 of the Directive. The chapter ends this thesis on a positive note, concluding that the seemingly failing Directive could be revived by appealing to the jurisprudence of the European Court of Justice in interpreting the Directive in order to conform to the free movement of capital under Article 56 of the EC Treaty.

Finally, the thesis concludes by reviewing, evaluating and summarising the analysis herein, and makes recommendations for implementing and interpreting the Directive in a manner consistent with EC Treaty provisions.

Chapter 1: Takeover Regulatory Framework and Rules

1.1 Introduction

Takeovers are one means of acquiring control by one company over another, the latter company being commonly referred to as the target company. The process usually involves the buying of a sufficient number of shares in the target company. The typical takeover follows a process whereby the offeree (target company) becomes the subject of a takeover bid from the offeror.³¹ Where a takeover bid is used as a technique of acquiring control of the offeree, the process involves making an offer to the shareholders, and, if a certain percentage in value of the shares accepts the offer, the offeror may compulsorily acquire the shares of the remaining shareholders in the offeree.

In the UK, the conduct of takeover bids in public companies has since 1968 been regulated by the Panel and been subject to the rules contained in the Code. The operation of the Panel and the Code has always been without statutory backing. As of 20 May 2006, the implementation of the Directive puts both the Panel and the Code and its enforcement on a statutory footing. It is in regard to the effects and impact of this change that the Directive is discussed in this thesis. The adoption of the Directive seeks to provide a regulatory framework of common principles for takeover bids throughout Europe. In the UK, the rules under the Code already provide the framework under which the Panel supervises takeover activities. The CA 2006 gives the Code the force of law to come within the Directive.³²

³¹ The Panel Statement of 21 November 2003 on *Canary Wharf Group plc* at paragraph 14 defined an offeror as a person who, alone or with others, seeks to obtain control of an offeree company and who, following the acquisition of control, can expect to exert a significant influence over the offeree company, to participate in distributions of profits and surplus capital and to benefit from any increase in the value of the offeree company, while at the same time bearing the risk of a fall in its value resulting from the poor performance of the company's business or adverse market conditions.

³² This was first implemented through interim Regulations 3 and 4, which provided that the Code or the rules of the Panel 'has effect' and 'the Panel shall supervise takeover bids'. Subsequently, the CA 2006 replaced the Regulations, providing under section 943 for the Panel to make rules, which rules are now contained in the Code.

One of the questions this research confronts is whether regulating takeovers by way of a Directive should have been deferred to national measures such as the Code. This calls for an examination of the subsidiarity principle.³³ The subsidiarity principle laid down in Article 5 of the EC Treaty, which states that:

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Did the Community have competence in regulating takeovers? Could this regulation be sufficiently achieved by individual Member States? If the answer to these questions is ‘Yes’ and ‘No’ respectively, then the subsidiarity test is met. Regulating takeovers at a European level is meant to remove takeover barriers and create level playing field that would harmonise takeover rules in Europe. Professor Hopt rightly observes that European legal harmonisation is particularly appropriate where individual Member States use their legal systems to erect or maintain barriers to market access.³⁴ He adds that, in the area of takeover bids, it was this very problem – namely, the absence of a level playing field – which led to the efforts of achieving legal harmonisation. He concludes that this is true for barriers to public takeover bids generally, and specifically for the numerous and far-reaching defence mechanisms that are permissible in many Member States.

³³ ‘Subsidiarity embraces three separate, albeit related, ideas: the Community is to take action only if the objectives of the that action cannot be sufficiently achieved by the Member States; the Community can better achieve the action, because of its scale or effects; if the Community does take action then this should not go beyond what is necessary to achieve the Treaty objectives’ – Paul Craig and Grainne De Burca, *EU Law: Text, Cases, and Materials* (4th edn OUP, Oxford 2008) 103.

³⁴ Klaus Hopt, ‘Takeover regulation in Europe – The battle for the 13 directive on takeovers’ (2002) 15 Aust JCL 1, 2.

Notwithstanding the removal of national barriers as a justification for not leaving the regulation of takeovers to Member States pursuant to Article 5 of the EC Treaty, the Directive, as will be seen, fails to remove these legal barriers. On this basis, and especially from the UK point of view, it could be argued that the subsidiarity principle should have been applied and regulation deferred to national measures. The Code, as will be seen, suffices to regulate takeovers, at least to the extent that the Directive adds nothing that the Code does not already provide.

One of the objectives of the Directive is to facilitate restructuring of companies throughout the EU. This is achieved in two ways: first, by requiring that once the offeror has gained a certain level of control of the offeree company, then the offeror must make a mandatory bid as a means of protecting the remaining minority shareholders of that company,³⁵ and second, by requiring that the board of the offeree company refrain from taking actions that may frustrate the takeover bid unless such actions are authorised by the general meeting of shareholders.³⁶

Thus, whilst protecting shareholders, the Directive seeks to remove barriers that would frustrate free movement of capital and company restructuring by way of takeover activities. As such, the right of establishment and the free movement of capital have a great potential impact on the regulatory framework for companies,³⁷ and indeed for takeover activities in those companies. However, much as the Directive is now transposed into the UK, its merits, as an appropriate regulatory framework, is still much a matter of academic debate given the questionable aspect of its impact.

On the other hand, the transposition of the Directive requires taking into account the need for the alignment of the Community market (hereinafter referred to as the 'internal market') perspective and the national market

³⁵ Article 5 of the Directive.

³⁶ Article 9(2) and (3) of the Directive.

³⁷ M Andenas, 'European company law, the Court of Justice and the Directives' (2005) 26 Co Law 1.

perspective. In transposing the Directive to national market, Community law principles have to be followed. Where national market interests conflict with internal market interests, the latter should take precedence in transposing a Community measure, unless a derogation under Community law applies. Whether and to what extent the implementing law, particularly the national market regulation of other Member States other than the UK, adhere to Community law principles governing the internal market remains to be seen.³⁸

To remove barriers to free movement of capital and establishment in takeovers, the Directive prohibits the use of defensive measures that may frustrate the bid,³⁹ but at the same time gives Member States the leeway of opting out of the very prohibition.⁴⁰ The effect of this option is twofold. First, where Article 9 is disapplied, it creates the barriers the Directive aims at removing, the result of which is unlevelled implementation of the Directive throughout Europe. Second, the non-application of Article 9 would mean that hostile takeovers are not facilitated. Hostile takeovers are seen as a measure of disciplining the board of the offeree company, thereby compelling the managers to make better use of the assets of the company for the interests of the shareholders.⁴¹

That this sceptical view of the optional prohibition is worth the analysis, one only need to consider the safeguards in the Directive, where a Member State opts out of the prohibition. As a safeguard to the effect of opting out of applying the prohibition, the Directive allows for companies to have a reversible option of being subject to the prohibition,⁴² – that is, opting to restrict their defensive actions to a prior approval of the general meeting of the shareholders. According to Murley, given that ‘article 9 is very similar in its

³⁸ See further discussion in this thesis at 3.2 under ‘Community versus national interests’.

³⁹ Article 9 of the Directive.

⁴⁰ Article 12(1) of the Directive.

⁴¹ M Mandelbaum, ‘Economic Aspects of Takeover Regulation with Particular Reference to New Zealand’ in J Farrar (ed), *Takeovers, Institutional Investors and the Modernisation of Corporate Laws* (OUP, Oxford 1993) 203, 206.

⁴² Article 12(2) of the Directive.

effect to General Principle 7 and Rule 21.1 of the Code, the Panel believes that it is essential that the UK opts in to this provision',⁴³ so that directors are prohibited from taking action that may frustrate the bid unless authorised by the shareholders.

However, if the application of the prohibition from defensive measures is subject to an offer launched by a company, which does not apply the same prohibition, then the Directive gives room for the prohibition to be inapplicable.⁴⁴ The compromise in Article 12, which allows Article 9 to be optional, may have the effect of putting the UK at a disadvantage, as the UK may not achieve any good by opting in where the offeror has opted out. In that respect and to that extent, the Directive will add very little of benefit to the UK system.⁴⁵ This puts a gloss of doubt onto the Directive's impact as a regulatory framework.

1.2 The Directive and its background

On 21 April 2004 the Directive was formally adopted into European law, with the aim of promoting a framework of common principles and general requirements to govern takeovers throughout Europe and to be implemented by Member States by 20 May 2006.⁴⁶ The Directive is a product of over thirty years of negotiations,⁴⁷ characterised by drawbacks, frustration, opposition and compromises. The difficulties over the years have been the result of the tension between the wider aim of achieving an integrated internal market for Europe and satisfying the unity of Member States with diverse corporate governance structures and cultures. After a history of disappointments, the

⁴³ See The Takeover Panel Report on the year ended 31 March 2004, 13.

⁴⁴ Article 12(3) of the Directive.

⁴⁵ See The Takeover Panel Report on the year ended 31 March 2004, 13.

⁴⁶ Article 21 of the Directive.

⁴⁷ A draft of the Directive first appeared in 1974, annexed to the report by Professor Robert Pennington, but this draft was not pursued; years passed with subsequent drafts and changes until April 2004 when the current Directive was adopted.

final draft of the Directive emerged as a compromise, the result of which cannot be claimed as a triumph. Broadly, the Directive fails to meet the objectives set out by the European Commission (the 'Commission') in its Financial Services Action Plan of 11 May 1999,⁴⁸ that is to achieve an integrated and harmonised market for financial services in Europe.

The initial attempts to integrate and harmonise takeover rules in Europe, and to issue a Takeover Directive for that purpose, were started over thirty years ago when Professor Pennington was appointed by the Commission to write a report on takeovers in Europe. In November 1974, Professor Pennington produced a report on Takeover Offers, and presented the report to the Commission.⁴⁹ The Pennington Report had a draft directive attached, which had been modelled on the Code, with a heavy UK influence. Years passed by with no progress and the Pennington recommendations were abandoned, as the Member States showed no interest. The Commission modified the Pennington recommendations and issued guidelines in 1977, which were contained in the Recommendations on Securities Transactions.⁵⁰ These were based on Article 100 of the EEC Treaty. However, the recommendations came under heavy criticism,⁵¹ and were abandoned.

With still less agreement on the measures for regulating takeovers in Europe, the Commission introduced the first formal draft of the proposed Directive and published it on 19 January 1989 and revised it in 1990, which

⁴⁸ European Commission, 'Commission Outlines Action Plan for Single Financial Market' (Press Release IP/99/327, Brussels 11 May 1999).

⁴⁹ European Commission, 'Report on Takeover Offers and Other Offers', Document XI/56/74; see also KJ Hopt, 'Takeover regulation in Europe – The battle of the 13th directive on takeovers' (2002) 15 Aust JCL 1, 8.

⁵⁰ European Commission, 'Recommendation of the European Community Commission of 25 July 1977 concerning a European Code of Conduct relating to Transactions in Transferable Securities', OJEC No L212/37 of 20 August 1977; OJEC No L294/28 of 18 November 1977.

⁵¹ House of Lords, Select Committee on the European Communities, 'Approximation of Laws under Article 100 of the EEC Treaty' (House of Lords, Session 1977/78, 22nd Report, London 18 April 1978).

was also abandoned and again reintroduced in 1996 as second draft.⁵² The controversial provisions of the proposed Directive were the mandatory public takeover bid and the restriction of defences available to the board of directors of the target company. These provisions were mainly influenced by the UK and were designed to break down the laws of Germany, the Netherlands, and other continental European countries that were hostile to takeovers.⁵³ After 12 years of formal negotiation, a second draft was amended and proposed as a framework Directive but it was rejected in July 2001, much to the disappointment of the Commission.⁵⁴

Following the failure of the second draft Directive, the Commission engaged a group of company law experts (the 'High Level Group of Experts'), chaired by Professor Jaap Winter, to report and give advice on the proposals.⁵⁵ The recommendations contained in the Report of the High Level Group of Company Law Experts (the 'Winter Report'), published on 10 January 2002,⁵⁶ were broadly interpreted by the Commission in preparing the third draft Directive published on 2 October 2002.⁵⁷

⁵² European Commission, 'Proposed Takeovers Directive – Question and Answers' (Press Release Memo/01/255, Brussels 03 July 2001).

⁵³ KJ Hopt, 'Takeover regulation in Europe – The battle for the 13th directive on takeovers' (2002) 15 Aust JCL 1, 9.

⁵⁴ European Commission, 'Commission regrets rejection of Takeovers Directive by the European Parliament' (Press Release IP/01/943, Brussels 4th July 2001). In this Press Release, the Internal Market Commissioner Frits Bolkestein said: 'I am very disappointed that the European Parliament has not been able to ratify the agreement approved by its delegation last month, despite the tremendous efforts made by the Commission and the Council to meet the Parliament's concerns. Twelve years of work have been wasted by today's decision. This vote represents an important setback for achieving the targets agreed by the EU's Heads of State and Government in Lisbon of realising an integrated European capital market by 2005 and making Europe the most competitive economy in the world by 2010. Financial markets, investors and European companies have been waiting eagerly for this Directive. Fourteen out of fifteen Member States clearly wanted the Directive. It is tragic to see how Europe's broader interests can be frustrated by certain narrow interests.'

⁵⁵ European Commission, 'Commission Creates High Level Group of Experts' (Press Release IP/01/1237, Brussels 4 September 2001).

⁵⁶ European Commission, 'Report of The High Level Group of Company Law Experts on Issues Related to Takeover Bids' (Brussels 10 January 2002).

⁵⁷ European Commission, 'Commission Proposes a Transparent Framework for takeover Bids' (Press Release IP/02/1402, Brussels 2 October 2002).

The Winter Report recommendations revolved around two guiding principles: shareholder decision-making; and proportionality between risk-bearing capital and control. The former meant that, in the event of a takeover bid, the ultimate decision must be with the shareholders.⁵⁸ The latter meant that the holder of the majority of risk-bearing capital should be able to exercise control and break through any company constitutional entrenched voting rights that would frustrate the bid.⁵⁹ After intense bargaining and as a result of deadlock in the European Parliament when voting on the proposal, the two Winter Report principles were compromised and made optional under Article 12, a compromise text reached for the contents of the third draft Directive and subsequently approved by the European Parliament on 16 December 2003 and formally adopted as the Directive on 21 April 2004.

It should be noted that, since the Pennington Report, subsequent draft Directives have also been heavily influenced by the Code in respect of their contents. Ironically, whereas the Directive was essentially modelled on the UK's regulatory system, it was, in its original text, likely to have legal implications that would have threatened the very existence of the UK takeover system. The main threat in the original text is claimed to have been the lack of provisions preventing tactical litigation and protecting the supervisory authority from frivolous litigation.⁶⁰ Article 4(6) of the Directive is now worded in a manner that deals squarely with any threat of litigation during the bids, including the right of courts to decline becoming involved in the decisions of the Panel. However, due to disagreements and compromises, subsequent draft Directives, up to the final text, have paid less attention to details and only produced a minimum standards and framework Directive, for which the UK system already provides more than minimum standards. Also, the split jurisdiction provision under Article 4(2), and the reciprocity provision

⁵⁸ This is now contained in Article 9 and implemented by rule 21 of the Code.

⁵⁹ This is now provided in Article 11 and the UK has opted out under Article 12.

⁶⁰ Whether the original text posed a threat of tactical litigation is questioned by academics and discussed further in chapter 2 below.

under Article 12(3), are both features of the Directive that are not very favourable to the UK system.

To achieve the company restructuring objectives, the Directive had to contain provisions that made it possible for a majority shareholder to successfully launch a takeover. This required a suspension of voting restrictions so that bids operated under a one-share-one-vote principle, and that any deviation was outlawed. The ‘breakthrough’ provision under Article 11 was designed to facilitate this company-restructuring process. However, to accommodate Member States that use multiple voting rights or dual shareholding structures – a system widely used in Nordic countries and France⁶¹ – the ‘breakthrough’ provisions were made optional by including in Article 12(1) a provision allowing Member States to exempt companies from applying such provisions.

Further, to achieve the company-restructuring objective, the management of target companies needed to remain neutral, leaving the shareholders to decide on the merits of the bid. Article 9(2) and (3) had been designed to achieve this neutrality by requiring that the target board refrain from actions that would frustrate the bid unless they sought the approval of the shareholders first. Again, due to much controversy, this provision was also compromised in Article 12(1) so that Member States now reserve the right not to require companies, which have their registered offices within their territories, to apply Articles 9(2) and (3). In addition, Article 12(2) allows Member States to grant companies that have disapplied Article 9 and 11, a reversible option of applying Article 9(2) and (3) and/or Article 11. The likely result of these compromises is for the varied corporate cultures to remain intact throughout Europe. As such, harmonisation of takeover regulation is likely to fail, and so is the corporate restructuring, much of which depends on the former.

The final text of the Directive adopted in April 2004 fell short of the recommendations of the report of Company Law Experts, in the Winter

⁶¹ F Guerrero and B Jennen, ‘UK in deal with Germany over takeover code’ *Financial Times* (London 3 February 2003) Sport 10.

Report, especially as regards neutralisation of defensive measures following a successful takeover bid. The Winter Report recommendations were watered down, and then made optional. This is because the recommendations met with opposition from virtually all Member States and interested parties, notably because of the legal problems to which they might give rise (application threshold, concept of risk-bearing capital, compensation for rights forgone, etc).⁶² As a result of disregarding and compromising the legal scholarly recommendations from Company Law Experts, the Directive is largely a political instrument, the success of which may lie in continued political will of the Member States rather than in legal responsibility.

The final version of the Directive was not what had been anticipated by the Commission. Rather than a mere ‘legal framework’ and ‘minimum standards’ Directive, the Commission had envisaged a Directive with the general objectives of integrating European markets in line with the Financial Services Action Plan and undertaking harmonisation conducive to corporate restructuring, and a Directive that was set to strengthen the legal certainty of cross-border takeover bids in the interests of all concerned and to ensure protection for minority shareholders in the course of such transactions.⁶³ Whereas the Directive is likely to ensure protection for minority shareholders, it can hardly be seen as strengthening legal certainty of cross-border takeovers when Member States are left to apply their varied legal cultures and to opt out of the Directive’s provisions which were designed for the very purpose of strengthening legal certainty.

Whereas the minimum standards set by the Directive are certainly a step forward in the majority of the Members States, it may not be so with regard to the UK. This is because the UK takeover regulatory system surpasses the Directive’s requirements in many aspects and the Directive itself does not

⁶² European Commission, ‘Proposal for a Directive of the European Parliament and of the Council on takeover bids’ (COM [2002] 534 final, Brussels 2 October 2002).

⁶³ European Commission, ‘Communication on the proposal for a Directive of the European Parliament and of the Council on Takeover Bids’ (COM 2002[534], Brussels 2 October

preclude the UK from applying a wider range of standards. For instance, the Code has a wider scope than the Directive; the Directive will not prevent the Panel from continuing to regulate the wider range of companies and types of mergers covered by the Code.⁶⁴

1.3 *Fundamental principles of the Directive*

1.3.1 Objectives of the Directive

The principles set out in the Directive are based on two main objectives: (a) harmonisation: ‘making takeover safeguards equivalent throughout the Community’;⁶⁵ and (b) protection of shareholders: ‘protecting the interests of holders of the securities of companies governed by the law of Member States’.⁶⁶ To achieve these objectives it is necessary ‘to prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures’,⁶⁷ and the Commission is to ‘facilitate movement towards the fair and balanced harmonisation of rules on takeovers in the European Union’.⁶⁸

The Directive was doomed *ab initio* to fail in achieving its first objective, as the Directive is simply a ‘procedure for the establishment of a framework consisting of certain common principles and a limited number of general requirements which Member States are to implement through more detailed rules in accordance with their national systems and their cultural contexts’.⁶⁹ Ironically, whereas the Directive aims at preventing ‘patterns of corporate

2002); European Commission, ‘Commission proposes a transparent framework for takeover bids’ (Press Release IP/02/1402, Brussels 2 October 2002).

⁶⁴ J Francis, ‘The Takeover Directive’ in M Button (ed) *Practitioner’s Guide to The City Takeover Code on Takeovers and Mergers* (City & Financial Publishing, London 2004) 249, 250.

⁶⁵ Recital number 1.

⁶⁶ Recital number 2.

⁶⁷ Recital number 3.

⁶⁸ Recital number 29.

⁶⁹ Recital number 26.

restructuring within the Community from being distorted by arbitrary differences in governance and management cultures',⁷⁰ it leaves fundamental principles to the discretion of Member States to make detailed rules in accordance with their varied national systems and cultures – a recipe for de-harmonisation.

As to the second objective (namely the protection of shareholders), the Directive is more likely to achieve it. The Directive sets out minimum guidelines regarding the conduct of takeover bids for all listed companies throughout the Community, aimed at protecting investors. This is achieved partly through provisions in the Directive for a mandatory bid to be made to the remaining minority shareholders following a successful takeover bid, and provisions for a basic level of disclosure of information in respect of takeover offers, thereby ensuring that there is transparency during takeover bids to enable investors to make informed choices.

However, the disclosure under the Directive is confined to 'takeover offers', and unless such disclosure were to extend to other company law matters, takeover activities remain inadequately facilitated in Europe. The problem according to Sealy is that:

... some jurisdictions require much less disclosure from companies than others, and this lack of transparency may put a bidder, especially a foreign bidder, at a disadvantage in deciding whether to bid for a company and what price to offer. Differing accounting standards and differing approaches to the requirements for the filing of accounts may add to the problem.⁷¹

⁷⁰ Recital number 3.

⁷¹ LS Sealy 'The Draft Thirteenth E.C. Directive on Take-overs' in M Andenas and S Kenyon-Slade (eds) *EC Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 135, 141-145.

1.3.2 Scope and definitions

The scope of the Directive is given under Article 1, which applies only to takeover bids by companies listed on a trading market – in the UK this is the London Stock Exchange; these being public companies with securities wholly or partly traded on the market. Article 2 gives definitions, and defines ‘securities’ as ‘those securities carrying voting rights in all circumstances at general meetings’. This means that securities with limited voting rights, such as preference shares, are excluded; which makes the scope of the Directive narrower than that under the Code.

The definition of ‘takeover bid’ and ‘takeover offer’ is confusing in the Directive and in UK laws. Article 2 defines ‘takeover bid’ as a public offer (other than by the offeree company itself) made to the holders of the securities of a company to acquire all or some of those securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance with national law. It is unhelpful that section 971 of the CA 2006 simply refers back to the Directive for the meaning of ‘takeover bid’. It is confusing for section 971 to state that ‘takeover bid’ and ‘takeover offer’ have the same meaning under the Directive, and yet section 974 defines ‘takeover offer’ as ‘an offer to acquire all the shares in a company or all shares of one or more classes’ without making it clear whether ‘takeover offer’ is the same as ‘takeover bid’ under the CA 2006.⁷²

1.3.3 General principles

The general principles in Article 3 are at the core of the objectives of the Directive, as they require:

(a) equal treatment of all shareholders, and protection of the remaining shareholders where one has acquired control;

⁷² This is similar to the first statutory definition of ‘takeover offer’ previously contained in s 428 CA 1985 – ‘an offer to acquire all the shares, or all the shares of any classes or classes, in a company’.

(b) offeree shareholders must have sufficient time and information to decide on the bid, and the offeree board must give sufficient information on the effect of the bid on employment and conditions of employment;

(c) the offeree board must act in the interest of the company as a whole and must not deny the shareholders the opportunity to decide on the bid;

(d) a false market must not be created in the shares of the offeree;

(e) an offeror must announce the bid only if he can fulfil a cash consideration in full and meet other considerations; and

(f) an offeror must not hinder the business of the offeree for an unreasonable length of time.

In implementing the Directive, these general principles are imported verbatim into the Code from Article 3 of the Directive.⁷³ This is not to say that these form new concepts, but in order to comply with the Directive, it was convenient and easy to import into rather than to rewrite the existing Code. While Article 3 requires Member States to ensure minimum standards are in place, Member States may provide for more stringent conditions than in the Directive. It is possibly the latter provision that may sabotage the achievement of the first objective (equivalent safeguards), while the second objective (shareholder protection) is achieved in each Member State implementing the Directive. These are not novel in the UK; they existed under self-regulation, now restated in the Code.

1.3.4 Jurisdictional rules

Article 4 deals with matters concerning the supervisory authority and the applicable law. It requires Member States to designate a regulator. This could be a private body recognised by national law, and ought to be seen to be independent and impartial of all the parties to the bid. In the UK, the government settled for the Panel to continue supervising takeovers. Although placing the Panel on a statutory basis as the UK's supervisory body can be

⁷³ See Code, Introduction, para 2(a) – these principles are the same as in the Directive.

viewed as a compliment to the City, the truth is that in electing to designate the Panel, the UK government simply took the obvious, simplest, cheapest, and most convenient course.⁷⁴

Article 4(2) deals with jurisdictional issues. Where a target company trades in a Member State, other than where it has its registered office, the competent regulator is that of the Member State where the offeree is registered if trading on the market in that Member State. If the offeree is not trading in that Member State where it is registered, then the competent supervisor is that of the Member State where the securities of the offeree are traded. Article 4(2) is detailed, but whether this split jurisdiction will work to achieve either of the Directive's objectives may well depend on the cooperation of other supervisors.

Article 4(5) of the Directive gives Member States the power to designate to judicial or other authorities responsibility for dealing with disputes and for deciding on irregularities committed in the course of bids. With particular favouritism to the UK, the Directive does not affect the power which courts may have in Member States to decline to hear legal proceedings and to decide whether or not such proceedings affect the outcome of a bid, and the Directive does not affect the power of the Member States to determine the legal position concerning the liability of supervisory authorities or concerning litigation between the parties to a bid.

Article 4 of the Directive is largely implemented by the rules, which the Panel makes, contained in the Code, as empowered to make such rules under section 943 of the CA 2006. Further, sections 948 to 950 of the CA 2006 implement part of Article 4 of the Directive. In laying down conditions under which information received by the Panel can be released to third parties, section 948 implements the requirement under Article 4(3) of the Directive that Member States shall ensure that information provided to those employed or formerly employed by takeover supervisory authorities shall not be further

⁷⁴ A Steinfeld, *Blackstone's Guide to The Companies Act 2006* (OUP, Oxford 2007) 127, para. 17.14.

divulged ‘to any person or authority except under provisions laid down by law’. It is unclear whether the discretion bestowed upon the Panel under section 950 is sufficient to implement the requirement under Article 4(4) of the Directive for the supervisory authorities and financial services regulators to provide reasonable assistance to other such authorities within the EEA – this remains to be seen. Section 950 seems to suggest that it is up to the Panel to elect the form and manner of co-operation, as the Panel considers ‘appropriate’. This is not a novel approach in the UK, as the discretion given to the Panel in the duty of co-operation is similar to that given to the FSA under section 354 of the FSMA 2000. The above provisions are largely designed to maintain the Panel’s status quo.

1.3.5 Protection of shareholders and the mandatory bid rule

In seeking to achieve its objective of protecting shareholders, especially the minority, the Directive provides for a mandatory bid. The provisions for a mandatory bid to protect minority shareholders are contained in Article 5 of the Directive. This requires that a mandatory bid be made where an offeror, as the result of an acquisition of shares by that person or persons acting in concert with him, holds securities which directly or indirectly gives him a specified percentage of voting rights in that company giving him control of that company.

However, as a shortfall, the Directive does not define the acquisition percentage that constitutes control of the target company. By virtue of Article 5(3), the determination of such percentage of voting rights and method of calculation is left to the Member State where the company has its registered office. The problem with the undefined and unlevelled threshold is that, if domestic rules provide for a lower threshold than its counterpart abroad, that of itself would create a situation whereby domestic companies are more vulnerable to foreign takeovers. The failure to prescribe a uniform threshold of shareholding triggering the mandatory bid will also, as Edwards says, ‘limit its

harmonising effect’.⁷⁵ On the other hand, it could be an opportunity to launch cross-border bids, if the foreign threshold is lower.

Whatever the threshold provided under national rules, the Directive provides standard protection for minority shareholders. In particular, Article 5(1) requires that mandatory bids be made to all shareholders at an ‘equitable price’. By virtue of Article 5(4), ‘equitable price’ is defined to be ‘the highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by Member States, of not less than six months and not more than twelve months before the bid’. Further, if the offeror or any concert party purchases securities at above the offer price, the Article requires that the offeror must increase his offer so that it is not less than that price. Moreover, any decision to adjust the equitable price must be substantiated and made public, so that the shareholders not only receive a fair price but also a justified price. Rule 9 of the Code is only vindicated in this regard, which implements Article 5 of the Directive.

1.3.6 Information on bids and timetable

Article 6 (1) requires that the decision to make a bid be made public without delay, and that company boards inform employees or their representatives of the bids. By virtue of Article 6(2) and (3), the offeror is required to draw up and make public an offer document with information enabling shareholders to reach a decision on the bid, and once the document is approved, if subject to approval before being made public, it should be communicated to shareholders and to employees. The document drawn by the offeror company must contain sufficient information to enable the shareholders to make an informed decision on the bid.

Article 6 is largely implemented by the rules contained in the Code, as made pursuant to the power given to the Panel to make such rules under section 943 of the CA 2006. In addition to the Code, section 947 of the CA 2006 specifically requires parties to takeover bids to provide the Panel with

⁷⁵ Vanessa Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’

information requested in order for the Panel to carry out its functions. Further, in implementing Article 6(3), section 953 of the CA 2006 creates new offences that can be committed by either the offeror or the offeree if any of these does not comply with rules contained in the Code. Persons guilty of this new offence of requiring information are liable to a fine under section 953.

To prevent hindering the affairs of the offeree, the Code stipulates a tight timetable. The timetable helps to keep disruption of a target company's business to a minimum. Unless the Panel agrees, especially in case of intervention by the Competition Commission,⁷⁶ no offer is allowed within the next 12 months after an offer elapses.⁷⁷ If a new offer timetable is allowed under rule 12.1, there is the potential for disruption of business in the target company. It is incumbent upon directors to remain competent to foster value in the company for the benefit of the company and in turn for the benefit of shareholders, amid all these possible disruptions. It may seem burdensome to directors, but it is a competitive market and only competent directors survive.

1.3.7 Rule against defensive measures

In respect of restructuring companies through takeovers, it is important that takeover bids are not frustrated. To this extent, Article 9 prohibits the offeree board from adopting, without shareholder approval, defensive measures that would frustrate the bid. Where a company has a two-tier board structure,⁷⁸ 'board' means both management and supervisory board. The prohibition on defensive measures by the board of a target company requires that no action be taken by the board, other than an action seeking alternative bids, which may result in the frustration of a takeover bid. Authorisation by shareholders is mandatory from the time the offeree board receives information concerning a

(2004) ECFLR 416, 439.

⁷⁶ Rule 31.6 of the Code, 8th edition 2005.

⁷⁷ Rule 35.1 of the Code, 8th edition 2005.

⁷⁸ A two-tier board structure (supervisory board and management board) is prevalent in Germany – see generally, H Fleischer, 'The Responsibility of the Management and Its Enforcement' in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 373.

bid until the result of the bid is made public or lapses. This prohibition on defensive measures has always been and remains the centrepiece of the Code, and the UK system would find it usual to apply it.

In the UK, contrary to the European perspective of directors being the agents of the shareholders,⁷⁹ they are generally the agents of the company. Traditionally, directors act in the interest of the company as a legal entity and not *per se* in the interests of shareholders. Management interests are often not aligned to the interests of shareholders. To remedy this misalignment, the Code obliges directors to seek shareholders' approval before taking any action that may frustrate a takeover bid.⁸⁰ Examples set out in the Code include: issuing new shares, and granting options over unissued shares; creating securities carrying rights to convert into target shares; and entering into contracts other than in the ordinary course of business. The effect of some of these examples prohibited by the rule is to make bidding for shares less attractive to investors, often serving the interests of directors at the expense of the interests of shareholders. It is for this lack of aligned interests that Article 9 of the Directive, as implemented by rule 21 of the Code, protects the interests of shareholders. Arguably, this has the effect of allowing companies, through shareholders, to defend themselves against coercive takeover bids, which would not be in the interest of shareholders.

However, Article 9 is compromised by Article 12 and rendered optional, so that Member States may choose not to apply Article 9. This compromise is not favourable to cross-border takeovers. As a result of this compromise, Simpson is of the opinion that 'regulatory arbitrage and national protectionism could continue to be a characteristic of cross-border takeovers in Europe in the post-takeover Directive environment'.⁸¹ Since its introduction, the Code has always contained a provision requiring the offeree board to seek approval of

⁷⁹ Report of The High Level Group of Company Law Experts on Issues Related to Takeover Bids (the "Winter Report"), Brussels, 10 January 2002, 19.

⁸⁰ Rule 21 of the Code, 8th edition 2005.

⁸¹ Scott V Simpson, 'EU Directive fails to harmonise takeovers' (2005) A Special IFLR Supplement 15 <<http://www.iflr.com>> accessed 03 July 2007.

the shareholders before taking any action that may frustrate a bid. Although the UK has opted in to apply Article 9, it is unhelpful on cross-border takeovers if other Member States have not opted to apply it.

1.3.8 Disclosure of information on companies

Article 10 requires companies involved, both offeror and offeree, to disclose by publishing detailed information on: the structure of their share capital; any restrictions on the transfer of securities; significant direct and indirect shareholdings; any securities with special control rights; system of control of any employee share schemes; any restriction on voting rights; any agreements between shareholders, the rules governing the appointment and replacement of board members and the amendment of the Articles of Association; any powers of board members to issue or buy back shares, any significant agreements to which the company is a party; and any agreements between the company and its board members or employees. All this information must be made public once the offer bid process is triggered, and must also be published in the company's annual report.

In the UK, this public scrutiny of public companies is the norm. Section 992 of the CA 2006 implements Article 10 of the Directive. This is implemented by amending Part 7 of the CA 1985, requiring that the required information under Article 10 of the Directive must be set out in the directors' report and in the summary of financial statement accompanying such report. Further, failure to comply with this requirement attracts existing criminal sanctions under section 415(5) of the Act. It should be noted that these requirements go beyond the implementation of the Directive, and are meant to increase transparency in all companies' dealings whether or not such companies are involved in a takeover bid.

1.3.9 Removal of takeover barriers

The wider objective of the Directive, facilitating the restructuring of companies, is further achieved through the removal of barriers – including barriers contained in the company's constitution. Takeovers are essentially about acquiring control. This requires total or substantial control. As such, it

is vital that, if a person has acquired a certain level of control, he should be enabled to break through barriers contained in the target company's constitution; this requires a so-called 'breakthrough rule'.

Article 11 deals with break-through: removing or rendering restrictions on voting or transfer of shares entrenched in the articles or any contractual arrangements inapplicable to the offeror during the period of acceptance of the offer, if the restrictions in the Articles of Association were adopted after the Directive. Where the restrictions in the Articles of Association were adopted before the Directive, such restrictions do not apply where the offeror holds 75 per cent or more of the capital with voting rights. Further, if the offeree board wish to take defensive measures against the bid, Article 11(3) provides that multiple-vote securities shall carry only one vote each at the general meeting of shareholders which decides on any defensive measures under Article 9.

By way of protecting shareholders affected by the break-through rule, those whose rights under the Articles of Association are made inapplicable must be compensated in accordance with rules set by Member States. Because the compensation provision could be onerous to impose on companies, many Member States, including the UK, have opted out of Article 11.

1.3.10 Optional use of defensive measures and takeover barriers

It is important to note that Articles 9 and 11 are the cornerstone provisions of the Directive as far as the wider objective of the Directive is concerned. These Articles ensure that takeover bids are not frustrated, and that barriers contained in the company's Articles of Association, or in any other agreements, do not defeat the process of acquiring control of the target company. The problem is Article 12 makes Articles 9 and 11 optional. Professor Clarke rightly observes that the ensuing optionalisation of Article 9, one of the core elements of the Directive, must raise serious doubts about its ability to achieve its objective of co-ordinating the national measures designed to protect offeree shareholders.⁸² She rightly questions how this optionalisation might be reconciled with the

acknowledged necessity to prevent patterns of corporate restructuring within the European Union from being distorted by arbitrary differences in governance and management cultures.

Article 12 gives Member States the option not to apply Article 9(2) and (3) and/or Article 11; and to allow companies registered in their territory to apply or not to apply Article 9(2) and (3) and/or Article 11. In giving parties to a takeover bid the benefit of Article 12 of the Directive, while Article 11 will not generally apply in the UK, sections 966 to 972 of the CA 2006 outline provisions for companies with voting shares traded on a regulated market to opt in to Article 11 of the Directive, should they choose to do so. As discussed below, it is unlikely that any UK company will seek to opt in to Article 11.

1.3.11 Squeeze-out and sell-out rights

To further strengthen the rights of the offeror who acquires control, Article 15 makes further provisions. It provides for a procedure for the right of squeeze out, based on recommendations contained in the Winter Report. Following a bid made to all shareholders, Member States must ensure that an offeror is able to require that the holders of the remaining securities sell him those securities at a fair price. Article 15(5) provides that the fair price shall take the same form as the consideration offered in the bid or shall be in cash.

Similar to the rights further accorded to the offeror, shareholders are given similar rights under Article 16. These are referred to herein as sell-out rights. Article 16 contains provisions regarding the right of sell-out, which are also derived from the recommendations contained in the Winter Report. Article 16 requires Member States to ensure that, following a bid made to all shareholders, a holder of the remaining securities is able to require the offeror to buy his/her securities at a fair price in the same circumstances as provided for by Article 15(2).

⁸² B Clarke, 'Articles 9 and 11 of the Takeover Directive (2004/25) and the market for corporate control' (2006) JBL 355, 374.

Squeeze-out and sell-out concepts are not novel to the UK takeover regulations. These have always been concepts provided for under UK company law, under Part 13A (Takeover Offers) of the CA 1985. Sections 974 to 991 of the CA 2006 have now restated Part 13A of the 1985 in order to ensure clear implementation of the requirements under Articles 15 and 16 of the Takeovers Directive. However, the restatement of Part 13A is mainly designed to give effect to recommendations that were already in place in the UK from the Company Law Review.⁸³ For example, some of the changes in the restatement of Part 13A include the dual test of calculating the squeeze-out threshold. The first limb of the test is that the bidder must have acquired both 90 per cent of the shares to which the offer relates, and 90 per cent of the voting rights carried by those shares. The second limb is that, where the offer relates to shares of different classes, then, in order to acquire the remaining shares in a class, the bidder must have acquired 90 per cent of the shares of that class to which the offer relates, and 90 per cent of the voting rights carried by those shares. The second limb was not part of the test under Part 13A, and is added pursuant to the recommendations of the Company Law Review.

1.3.12 Administration and revision

Article 21 required implementation of the Directive in Member States by 20 May 2006. In the UK, the Directive was implemented by a statutory instrument,⁸⁴ the Takeovers Directive (Interim Implementation) Regulations 2006, which came in force on 20th May 2006, and which were subsequently replaced by the CA 2006, for which the relevant takeover provisions came into force on 6 April 2007. Article 20 empowers the Commission to revise the Directive after five years from 20 May 2006 when the Directive is implemented in Member States. It is submitted that it would be desirable for the Commission in the revision phase to also examine the effect of Article 12 of the Directive on the free movement of capital under Article 56 EC Treaty.

⁸³ Modern Company Law for a Competitive Economy – Final Report, July 2001, 282-300.

1.4 Self-regulation and the takeover Panel

The regulation of takeovers in the UK can be traced from the 1960s, and its history is well documented.⁸⁵ Since 1968, takeovers have been regulated by the Panel, a regulatory body set up in response to mounting concern about unfair practices in the conduct of takeover offers.⁸⁶ These unfair practices were mainly characterised by defensive measures adopted by offeree boards and aimed at frustrating takeover bids. The real losers in these practices were the shareholders, as often shareholders were not consulted or given the opportunity to decide on the bids. The traditional approach in company law made it difficult for aggrieved shareholders to challenge company directors who frustrated the bids, as the board was not answerable to shareholders individually but to the company. As long as, or at least purportedly, the offeree board acted in the interest of the company as a whole, they were entitled to resist any attempts of takeover.

By 1959, a solution to these unfair practices was found through the requirements of the Notes on Amalgamation of British Businesses, a measure introduced by the Governor of the Bank of England. The rules in these Notes, established in 1959, were revised in 1963 to cater for equal treatment in requiring the offeror to make equivalent offers to other classes of shareholders whose shares had not been purchased after a certain controlling stake had been obtained. When these measures under the Notes were still inadequate to protect shareholders, the Panel was set up in March 1968, and a Code on takeovers thereafter drawn up in 1985. From its creation until 20 May 2006 when it was put on a statutory footing, the Panel has had ‘neither statutory,

⁸⁴ Statutory Instrument 2006 number 1183.

⁸⁵ See R Falkner, ‘Judicial review of the takeover Panel and self-regulatory organisations’ (1987) 2 JIBL 103, 104-105.

⁸⁶ The history of takeover regulation in the UK is briefly documented in various publications of the Panel on their website <<http://www.thetakeoverpanel.org.uk>> accessed 20 April 2006).

prerogative nor common law powers, nor is it in contractual relationship with the commercial community who are expected to obey the code'.⁸⁷

The Panel is concerned with most transactions that involve a change in the control of companies whose shares are held by the public, which transactions are in turn subject to the Code. The Panel's function is to ensure the fair conduct of a takeover bid from the point of view of the shareholders. The principal objective of the Code is to give shareholders a fair opportunity of considering an offer on its merits. The structure of the Panel and the Code is designed to allow the necessary degree of flexibility of application and interpretation of takeover rules. Flexibility of approach to regulation of takeovers, and speed and certainty of decision-making of the Panel are said to have 'been the hallmark of the Panel's takeover regulation',⁸⁸ which the Panel has been keen to retain in the transition to statutory regulation as envisaged by the implementation of the Directive as of 20 May 2006.

One of the main drawbacks of self-regulation has been the lack of legal force on the part of the Code. The only legal force associated with the Code has been the endorsing and sanctioning powers of the FSA under section 143 FSMA 2000, submitted here as not giving full legal effect to the Code.⁸⁹ From a general point of view, all so-called advantages of self-regulation were but desperate measures developed to ensure compliance of participants to keep up with the objectives of takeovers, given that the regulator and the rules were not backed by law and legal sanctions. These desperate measures have now been rendered obsolete under statutory regulation where the regulator and the rules are fully backed up by the force of law. Nevertheless the CA 2006 has been designed in a way that retains the current system with the Panel having

⁸⁷ H W R W [Initials of unknown author], 'New vistas of judicial review' (1987) 103 LQR 323, 323.

⁸⁸ The Takeover Panel, The European Directive on Takeover Bids, Explanatory Paper (The Panel on Takeovers and Mergers, London 20 January 2005).

⁸⁹ Under the Regulations, regulation 18, section 143 FSMA 2000 is no longer applicable. Subsequently, s 964 CA 2006 has repealed s 143 FSMA 2000; the rationale of this repeal seem to be that given that the Code now have legal force as a consequence of the CA 2006, it is considered that there is no longer a need to maintain s 143 FSMA 2000.

responsibility for takeover regulation. However, implementing the Directive has placed takeover regulation and the Panel on a statutory footing for the first time.

The change from self-regulation to statutory regulation is hardly noticeable, given that the CA 2006 has replicated, to the greatest extent possible, the Panel's current jurisdiction, practices and procedures within a statutory framework, including giving the Panel the power to make statutory rules. Further, particular care has been taken to ensure that new legal rights or opportunities for tactical litigation are not inadvertently created as a consequence of the process of putting takeover regulation on statutory footing. The CA 2006 provides for the Panel to act as the competent authority to supervise bids with statutory power to make and amend rules in relation to takeover regulation – effectively on the basis of the existing Code and the current mechanisms for amending the Code. A number of specific statutory powers designed to ensure that parties to a bid comply with the rulings of the Panel and to facilitate the Panel in the exercise of its supervisory functions have been included in the CA 2006. Given that no noticeable change has been created since the Panel and the Code was put on statutory footing, a further discussion of self-regulation in comparison with statutory regulation would be misplaced.

1.5 Statutory regulation, the Takeover Panel and the Government

The Department of Trade and Industry (DTI) issued a consultative document in January 2005 seeking comments on its proposals for the implementation of the Directive.⁹⁰ The Government largely proposed to retain the current system with the Panel having responsibility for takeover regulation. However, implementing the Directive involves placing takeover regulation and the Panel

⁹⁰ DTI, *Company Law Implementation of the European Directive on Takeover Bids: A Consultative Document* (DTI, London 20 January 2005).

within a statutory framework for the first time. The intention, therefore, has been to replicate to the greatest extent possible the Panel's current jurisdiction, practices and procedures within a statutory framework, including giving the Panel the power to make statutory rules. The document notes that particular care will have to be taken to ensure that new legal rights or opportunities for tactical litigation are not inadvertently created as a consequence of this process. As to the impact of the Directive on the regulation of takeovers in the UK, the Government accepted throughout the negotiations that the minimum standards approach adopted by the Directive would not enhance the effectiveness of the domestic takeover regime overseen by the Panel since 1968, essentially on a non-statutory basis.⁹¹

At the same time the Panel also issued a statement welcoming the Government's proposals for implementing the Directive.⁹² In that statement the Panel also published an initial explanatory paper setting out in broad terms how it intended to proceed under the proposals set out by the Government. The statement clearly showed the Panel being confident that the way in which it operates would be largely unaffected by the required changes under the Directive.

Following the consultation period, which ended in April 2005, the Government proceeded in October 2005 to table a legislative Bill to Parliament. From the Company Law Reform Bill 2005, through the Regulations, to the CA 2006 (hereinafter also referred to as the 'Act'), the Panel has been designated as the competent supervisory authority for takeovers in the UK.⁹³ This is in keeping with the requirements of Article 4.1 of the Directive, which requires Member States to designate a supervisory authority for takeovers. Under the Act the Panel has virtually all its former glory in the form of the powers conferred on it by or under the Act. The Panel may do

⁹¹ DTI, Consultative Document (London 20 January 2005) 3.

⁹² The Takeover Panel, The European Directive on Takeover Bids, Explanatory Paper (The Panel on Takeovers and Mergers, London 20 January 2005).

⁹³ From clause 642(1) of the Company Law Reform Bill 2005; through para 4(2) of the Regulations 2006, to s 924(1) CA 2006.

anything that it considers necessary or expedient for the purposes of, or in connection with, its functions.⁹⁴ In carrying out its functions, the Panel may delegate or make arrangements for any of its functions to be discharged by a committee or sub-committee of the Panel, or an officer or member of staff of the Panel, or a person acting as such.⁹⁵

The Panel remains the rule-making body in takeovers with the mandate of the Act to make rules giving effect to Articles 3.1, 4.2, 5, 6.1 to 6.3, 7 to 9 and 13 of the Directive.⁹⁶ The Panel has an easy task in making rules to comply with these Articles, for the Code already provides more than adequate rules in these matters. The approach taken by the Act is to adopt the Code in its amended form, the eighth edition, which contains more than adequate provisions to cover relevant Articles of the Directive.⁹⁷ For example, the Code already provides rules relating to giving information on the bid;⁹⁸ Article 9 is reflected in Rule 21 of the Code; and Article 13 is covered in Rules 30-36 of the Code.

The Panel then is armed with all the powers to make its own rules. The CA 2006 not only give the Panel power to make rules but also power to make other provisions or to incorporate the Code as it had effect immediately before the passing of the CA 2006.⁹⁹ The rules so made by the Panel must be made by an instrument in writing,¹⁰⁰ and immediately after an instrument containing rules is made, the text must be made available to the public, with or without

⁹⁴ CA 2006, s 942(2); formerly para 4(3) of the Regulations.

⁹⁵ CA 2006, s 942(3); formerly para 4(4) of the Regulations.

⁹⁶ CA 2006, s 943; formerly para 3 of the Regulations provided that the 'rules' contained in the Code prevailing as of 20 May 2006, 'has effect'. However, there was no equivalent power in the Regulations for the Panel to make rules, as the Regulations were issued under delegated powers contained in s 2(2) European Communities Act 1972, which did not confer power on the Secretary of State to re-delegate further to the Panel the power to make further rules but to apply the Code in its amended form prevailing on 20 May 2006.

⁹⁷ CA 2006, s 943(3) provides that the rules that the Panel makes may include provisions within or similar to provisions contained in the 'City Code on Takeovers and Mergers as it had effect immediately before the passing of this Act.'

⁹⁸ Includes provisions under Rules 3, 19, 20 and 23 of the Code.

⁹⁹ CA 2006, s 943(3).

payment, in whatever way the Panel thinks appropriate.¹⁰¹ Further, the CA 2006 provides that the Panel may give rulings on the interpretation, application or effect of the rules.¹⁰² To the extent and in the circumstances specified in the rules made by the Panel, a ruling of the Panel has binding effect, subject to any review or appeal.¹⁰³ The rules the Panel make may contain provision conferring power on the Panel to give any direction that appears to the Panel to be necessary in order to restrain a person from acting (or continuing to act) in breach of the rules; to restrain a person from doing (or continuing to do) a particular thing, pending determination of whether that or any other conduct of his is or would be a breach of the rules; otherwise to secure compliance with the rules.¹⁰⁴

The CA 2006 maintains the status quo of the Panel and the Code – the Panel remains the lawmaker, the interpreter of that law, and the court of its own law. The status quo does not affect the law, as access to the courts still remains albeit in a limited form as it was before the Directive came into force; the Directive itself gives this liberty.¹⁰⁵ With the CA 2006 replicating the structure and practice of the Panel under the Code, the Panel will continue its business as it has always done under self-regulation system, albeit with legal force. Arguably, although the Directive has now put the Code on a statutory footing, the Code should still be regarded as ‘a self-regulatory instrument’, as Johnston states ‘implementation [has] merely had the effect of freezing some of the Code’s most important provisions’, which the Panel ‘would have been least

¹⁰⁰ CA 2006, s 944(2).

¹⁰¹ CA 2006, s 944(3); note that para 5(1) of the Regulations also required that the Code must be made public and accessible to the public with or without payment – although the Regulations had simply adopted the Code already published – this should have been worded differently but for the speed at which this was enacted and the wording extracted from the Company Bill in order to meet the deadline of 20 May 2006 to implement the Directive.

¹⁰² CA 2006, s 945(1).

¹⁰³ CA 2006, s 945(2).

¹⁰⁴ CA 2006, s 946.

¹⁰⁵ Article 4.5 of the Directive.

likely to alter'.¹⁰⁶ To that extent, the Directive will have very little impact as to how takeovers are regulated in the UK.

1.6 The Code, the Regulations and the Directive

Until the Regulations came into force, awaiting provisions of the Act to come into force, takeovers have not been regulated by any specific law but rather by the rules contained in the Code administered without force of law. The Code, in its eighth edition that came in force on 20 May 2006, was given force of law under the Regulations, and the scope of its application goes beyond that of the Directive as provided in Article 1 of the Directive. The Directive only applies to offers for companies whose shares are traded on a regulated market. The Code applies to both companies whose shares are traded on a regulated market (primarily fully listed companies) and companies whose shares are not traded on a regulated market (primarily AIM companies and other unquoted companies).

The Code contains certain definitions analogous to those in Article 2 of the Directive. Of particular interest is the definition of 'persons acting in concert'. The Code definition is more detailed and wider than that of the Directive. This more detailed and wider definition is designed to overcome the majority of problem that arises in parties avoiding the scourge of Rule 9 (mandatory bid rule). It is incumbent on advisers to take extra care that a concert party is not created unintentionally, otherwise it may trigger a Rule 9 requirement and failing to comply could result in compensation being ordered.

The Code, as given the force of law under the CA 2006, in effect forms the UK's implementing law for the purpose of transposing the Directive. The Panel, as designated by the CA 2006, is a private or independent body recognised by national law and is the designated authority competent to supervise bids for the purposes of the rules contained in the Code and

¹⁰⁶ A Johnston, 'Takeover regulation: historical and theoretical perspectives on the City Code' (2007) 66 CLJ 422, 447-448.

introduced pursuant to Article 4(1) of the Directive. The Panel is vested with all the powers necessary for the purpose of carrying out its duties as required by Article 4(5) of the Directive. The CA 2006 allows the Panel to order compensation where there has been a breach of certain specific rules of the Code, being any of Rules 6, 9, 11, 14, 15, 16 or 35.3.¹⁰⁷

The majority of the rules in the Code are designed to protect all shareholders. Rule 9 of the Code is specifically designed to protect minority shareholders by way of a mandatory bid requirement, as contained in Article 5 of the Directive. Under the Code, two main circumstances will trigger a mandatory bid requirement; these are where: (a) any person acquires, whether by a series of transactions over a period of time or not, an interest in shares which (taken together with shares in which persons acting in concert with him are interested) carry 30 per cent or more of the voting rights of a company; or (b) any person, together with persons acting in concert with him, is interested in shares which in the aggregate carry not less than 30 per cent of the voting rights of a company but does not hold shares carrying more than 50 per cent of such voting rights and such person, or any person acting in concert with him, acquires an interest in any other shares which increases the percentage of shares carrying voting rights in which he is interested.

The Directive does not define what constitutes ‘control’ for the purpose of a mandatory bid requirement. The Code provides a 30 per cent threshold, which can be held by a single shareholder, a group of shareholders, offerors, or persons acting in concert. Article 5(3) provides that ‘the percentage of voting rights which confers control and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office.’ If the threshold in a Member State where the bidder has its registered office is say, 33 per cent such bidder will not be subject to rule 9 of the Code notwithstanding reaching a 30 per cent threshold. This remains a problem in cross-border takeovers.

¹⁰⁷ CA 2006, s 954; Section 10 of the Code, Eighth Edition of 20 May 2006.

The Code contains provisions designed to implement Articles 6-8 of the Directive, announcing offers, making public the offers, drawing documentation concerning the offer, having plenty of time for acceptance, and making relevant disclosures – all designed to enable the holders of the offeree company's securities to reach a properly informed decision on the bid. Rules 20, 23, 24 and 25 of the Code are examples of rules requiring information to be made public to both shareholders and employees, and further requirements as to the detailed contents of documentation is contained in Appendix 6 of the Code. To ensure compliance with the Directive, the provisions in the CA 2006 which introduce criminal liability for non-compliant offer documents or defence documents, reinforce the Code. The potential penalties under the CA 2006 for breach of these statutory requirements include fines and/or imprisonment.¹⁰⁸ The effect of the Act is to require extra care on the part of advisers of the parties to a bid.

One of the main obligation imposed on the offeree company by the Code is the obligation to consult shareholders before acting in a manner that would frustrate a bid contrary to Article 9 of the Directive. Rule 21 of the Code deals with this, which in essence is an acknowledgement that the interests of the board of the offeree and its shareholders may not be aligned. In keeping with the principle of fair treatment for shareholders, a further obligation is imposed on the board of the offeree not to take any action that could frustrate the offer.

As the UK has not opted in to Article 11 of the Directive, there is no direct rule in the Code dealing with the so-called break-through rules. The essence of a break-through is to provide for the unenforceability of restrictions on transfers of securities and other corporate devices that serve as pre-bid defensive structures, such as preferential shares or voting structures. Although the UK has opted out of this provision in accordance with Article 12 of the Directive, nevertheless in implementing the Directive the CA 2006 includes a right for any company to opt into the break-through provisions of Article 11 pursuant to Article 12 of the Directive. Whether the UK will lose out for

¹⁰⁸ CA 2006, s 949(2).

opting out of Article 11, or whether companies will gain anything for opting in, is questionable. In the UK, the dictates of the market for securities on a regulated market have reduced the number of companies with preferential share and voting structures that would be subject to a break-through rule, as such, and so whether or not a company should opt in to Article 11 of the Directive is unlikely to be relevant in most cases.

1.7 Conclusion

The regulatory framework for takeovers in the UK has now been redefined, from so-called self-regulation to statutory regulation. Until 20 May 2006, takeover regulation in the UK had since 1968 been regulated by the Panel and had been subject to the rules contained in the Code. With the implementation of the Directive, the operation of the Panel and the Code has been put on statutory footing for the first time. Statutory provisions in Part 28 of the CA 2006 which implements the Directive, though reflecting the wording of the Directive, are but a reincarnation of the Code. As stated by Johnston, ‘in terms of content, nothing has changed since the Directive was implemented, although some of the Code’s provisions now have Parliamentary approval’.¹⁰⁹ The Panel remain the competent supervisor of takeover bids for the purpose of implementing the Directive, and the Code, as amended prior to 20 May 2006, provides the framework under which the Panel supervises takeover activities, both of which have been given the force of law through the Act to come within the Directive.¹¹⁰

The Directive implemented in the UK and other EC Member States is a product of an historical political process that can be traced back to 1974, when the Commission first commissioned Professor Robert Pennington to assess the merits and demerits of a European wide regulatory framework of takeover

¹⁰⁹ A Johnson, ‘Takeover regulation: historical and theoretical perspectives on the City Code’ (2007) 66 CLJ 422, 448.

¹¹⁰ The CA 2006 confers to the Panel the powers to regulate takeover activities, and powers to make rules, which such rules may provide for matters that are or similar to the City Code.

activities. The UK joined the process, as it was hoped that an EC regulatory framework would enhance the UK's business interests in cross-border takeovers. The Directive passed through several stages of drafts, with much political disagreement over certain suggested provisions, until it was adopted on 21 April 2004. The UK has since responded by passing legislation that implements the Directive. This was first contained in the interim provisions in the Regulations, and was subsequently replaced by the CA 2006.

The main benefit for the UK under the Directive has always been the facilitation of takeovers across borders. The Directive is meant to facilitate restructuring of companies throughout the European Union. This is achieved through the provisions that seek to protect shareholders and those that seek to remove barriers that would frustrate free movement of capital and company restructuring by way of takeover activities. The UK regulatory system prior to the Directive had provided protection to shareholders, at a level that surpassed the Directive's minimum standard requirements. When it came to the removal of barriers that would hinder cross-border takeovers, the Directive was much needed. However, much as the Directive is now in place as from April 2004 when it was adopted, its merits as an appropriate regulatory framework in the UK is still a matter of much academic debate, given the questionable aspect of its impact in terms of barriers that hinder cross-border takeovers.

The main obstacle not solved by the Directive is the retention of the varied legal and cultural approaches across Europe. To remove barriers to free movement of capital and establishment in the takeovers field, the Directive prohibits the use of defensive measures that may frustrate the bid,¹¹¹ but at the same time gives Member States the leeway of opting out of the very prohibition.¹¹² The effect of this option is twofold. First, where Article 9 is disapplied, it creates the barriers the Directive aims at removing, the result of which is variable implementation of the Directive throughout Europe. Secondly, the non-application of Article 9 would mean that hostile takeovers

¹¹¹ Article 9 of the Directive.

¹¹² Article 12(1) of the Directive.

are not facilitated. Takeover barriers and lack of measures facilitating hostile takeovers are foreign to the customs of UK takeovers and may not be in the UK's business interests. In that respect, and to that extent, the Directive will 'add very little of benefit to the UK system'.¹¹³

¹¹³ R Murley, The Takeover Panel Report on the year ended 31 March 2004, 13.

Chapter 2: Tactical Litigation and Defences in Takeovers

2.1 *Introduction*

The implementation of the Takeover Directive in the UK has resulted in ending the so-called self-regulation of takeovers. This change of regulatory framework was always feared for having the potential to create a culture of tactical litigation that would be detrimental to takeovers. In this chapter, these fears are assessed against the measures in the Directive and in UK laws designed to limit tactical litigation.

This chapter is concerned with the regulation of takeovers in the UK under the Directive, as implemented by the CA 2006. In particular, the chapter examines the question of whether implementation of the Directive creates the potential for tactical litigation in takeover bids. Tactical litigation may broadly be described as legal proceedings taken by parties to a bid with a view to frustrating or hampering the bid or the defence of a bid.¹¹⁴ The chapter further looks at the provision that prohibits the use of defensive measures to frustrate bids and derogative provisions in the Directive.

This chapter begins with an examination of the basis of the perceived fear of litigation and puts both self-regulation and statutory-regulation in their historical context. The chapter then examines a few technical aspects of takeover regulations, paying particular analysis to provisions in the Directive designed to prevent tactical litigation, and implementation of those provisions under the CA 2006. The chapter then highlights a few examples showing the extent to which the Takeover Panel is able to maintain its self-regulation qualities even after the change to statutory-regulation. This chapter does not attempt to examine any possible causes of potential for tactical litigation, but rather whether there is any basis for the perceived fear of litigation. In assessing the perceived fear of tactical litigation, this chapter concludes that it

¹¹⁴ DTI, Consultative Document (London, January 2005) 15 para 2.32.

is very unlikely that the implementation of the Directive in the UK will cause a litigation culture in takeovers.

Since 1968, takeovers in the UK have been supervised by means of a body of rules contained in the Code, as administered by the Panel. The Code has always operated in a non-legal context, and been hailed as providing ‘a quicker, cheaper and more flexible method of regulation, which could not be matched by a system based on legal rulings’.¹¹⁵ Indeed, a system of self-regulation has been hailed for having advantages ranging from commanding a greater degree of expertise and technical knowledge in the relevant area to offering low regulatory costs.¹¹⁶ The fear has always been that a change from self-regulation to statutory-regulation of takeovers, whereby the Code and its enforcement are put on a statutory footing, was likely to create ‘a litigation culture and [cause] delays in the takeover process’.¹¹⁷

To the Panel, a statutory framework of takeover regulation was likely to result in ‘opportunities for legal challenges and a risk that litigation, tactical or otherwise, would increase, thereby causing regulatory difficulties – delays, expenses, and a loss of certainty that the Panel’s rulings were final’.¹¹⁸ Broadly, there is little case law to suggest that litigation culture is likely to increase. An empirical study by Deakin and Others taken over a five-year period found that ‘shareholder litigation is very rare in the UK’, mainly due to ‘procedural bars including the rule in *Foss v Harbottle* (1843) 2 Hare 461’, and that the use of poison pills and other defences in takeovers ‘have not been adopted to anything approaching the levels seen in the USA’.¹¹⁹

¹¹⁵ M O’Neill, ‘When European integration meets corporate harmonisation’ (2000) 21 Co Law 173, 176.

¹¹⁶ A Ogus, ‘Rethinking Self-Regulation’ (1995) 15 OJLS 87, 97.

¹¹⁷ G Stedman, *Takeovers* (Longman, Harlow 1993) 55.

¹¹⁸ Panel on Takeovers and Mergers, Report on the Year ended 31 March 1989, 10.

¹¹⁹ S Deakin and Others, ‘Implicit contracts, takeovers, and corporate governance: in the shadow of the City Code’ (2002) Centre for Business Research, University of Cambridge, Working Paper 254, 7-14 <<http://www.cbr.cam.ac.uk/pdf/WP254.pdf>> accessed 28 December 2007.

The lack of case law on defensive tactics in takeover bids can be explained by the fact that the decision on the legality of the technique used and its permissibility is taken, as a matter of utmost urgency, by the bodies supervising the takeover battle; such that, once the battle is over, parties do not maintain a sufficient interest to have the matter litigated.¹²⁰ The UK's position following the Court of Appeal's decision in *R v Panel on Takeovers and Mergers, ex parte Datafin plc*¹²¹ has been to discourage such litigation. Further, the courts have been very restrictive in allowing references to the European Court of Justice in case they lead to delay with detrimental effects.¹²² Cognisant of the effects of tactical litigation, Lord Bingham MR stated that given 'the highly sensitive and potentially fluid financial market, the courts will not second-guess the informed judgment of responsible regulators steeped in knowledge of their particular market'.¹²³ Thus, the courts preferred confining takeovers to the jurisdiction of the Panel.

Ordinarily, as long as the Panel and the Code remains involved, albeit with minor modifications, there is no reason why the courts would not apply its restrictive role in judicial intervention.¹²⁴ Moreover, Article 4(6) of the Directive has been specifically designed to allow individual Member States to prevent tactical litigation, which might frustrate or delay a takeover bid. In implementing the Directive, Part 28 of the CA 2006 in part aims at preventing tactical litigation. Introducing the Bill (that led to the CA 2006) in Parliament, Lord Sainsbury of Turville said that 'the Bill's provisions aim to ensure that tactical litigation seeking to delay or frustrate a takeover bid will not become a

¹²⁰ E Wymeersch, 'The Effects of the Regulation of Securities Markets on Company Law within the EEC' in RR Drury and PG Xuereb (eds), *European Company Laws* (Dartmouth, Aldershot 1993) 61, 72-73.

¹²¹ *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815.

¹²² See *R v Stock Exchange ex parte Else* [1993] QB 534; All ER 420.

¹²³ *R v Stock Exchange ex parte Else* [1993] QB 534, 552 (*obiter* by Lord Bingham MR).

¹²⁴ M Andenas, 'European take-over regulation and the City Code' (1996) 17 Co Law 150, 151.

feature of our takeover markets’.¹²⁵ Indeed, the CA 2006 contains clear provisions that are intended to limit litigation and make recourse to the courts a matter of last resort.

2.2 Statutory regulation and perceived litigation

2.2.1 The Panel’s resistance to statutory regulation

As early as 1987, the idea of statutory regulation by way of a Directive did not find favour with the Panel. The Panel argued that ‘if we had a legislative system, the rules would have to be less strict, so giving less protection to shareholders, or they would be wide-ranging as at present but without the ability to mitigate their potential harshness in appropriate cases’.¹²⁶ The Panel’s resistance to the Directive has always been due to the fear that ‘the directive may inadvertently create a system which increases the risk of litigation during a takeover and lacks the general flexibility that the Panel finds essential in its day to day operations’.¹²⁷ With this attitude, and given that the majority of takeover activities have historically taken place in the UK compared to any other European state, it was vital to the success of the Directive that the UK was persuaded to go along with the need for a Directive.

As such, the way forward was to allow the first official proposal, the draft Directive of 1989, to reflect the UK aspirations and in particular, to have provisions that mirrored the Code. Indeed, as Johnston says, ‘those early discussions, with their insistence that the Directive should be based on the City Code, exercised a strong influence over all subsequent proposals, a policy choice that has been one of the impediments to the Directive’s adoption’.¹²⁸

¹²⁵ The Parliamentary Under-Secretary of State, Department of Trade and Industry, ‘Company Law Reform Bill’, HL Col 186 11 January 2006
<<http://www.publications.parliament.uk/pa/ld199900/ldhansrd/pdvn/lds06/text/60111-08.htm>> accessed 22 March 2006.

¹²⁶ Panel on Takeovers and Mergers, Report on the Year ended 31 March 1987.

¹²⁷ Panel on Takeovers and Mergers, Report on the Year ended 31 March 1989, 10.

¹²⁸ A Johnston, ‘The European Takeover Directive: Ruined by protectionism or respecting diversity’ (2004) 25 Co Law 270, 270.

However, once the 1989 draft Directive was subjected to the wide and varied corporate culture in Europe, the grapes soon become sour and the UK sought to abandon the whole idea of the Directive altogether, but to no avail.

The Commission revised the draft Directive and produced a second draft in 1996. The Panel feared that the wording of the 1996 draft Directive was still bound to result in litigation, with shareholders seeking the intervention of the courts to obtain adequate remedies and compensation, which would frustrate takeover bids. The House of Lords Select Committee on the European Communities agreed with the Panel and rejected the 1996 proposal by recommending that it should not be adopted.¹²⁹ But the Commission needed the UK's involvement for any European measure to work, and the UK also needed some kind of European rules in place to facilitate cross-border takeovers. The way forward was to make compromises, which also had to take account of the interests of other states. The basis for the process of compromises was explained by Edwards as an acceptance that 'any gain by way of harmonisation and improvement in the regulatory systems of other Member States would be outweighed by the risk of damage to United Kingdom system'.¹³⁰ Notwithstanding the revised 1996 draft Directive, which was designed to minimise tactical litigation feared by the Panel, the Panel was of the view that 'the risk of increased litigation [could] only be eliminated by having no Directive at all'.¹³¹

The wider question here is whether the Panel's fears and concerns were justified. It has been observed by Andenas that the Panel's opposition to the draft Directive '[seemed] to be based on an ill-defined opposition to European regulation, which is particularly directed against any meddling with City regulation in an area where it is perceived to be successful.'¹³² These fears were unfounded and Andenas said that there were 'no reason to fear that a

¹²⁹ The 13th Report of the House of Lords 1995-1996 (Paper 100).

¹³⁰ V Edwards, *EC Company Law* (OUP, Oxford 1999) 397.

¹³¹ Panel on Takeovers and Mergers, Report on the Year ended 31 March 1999.

take-over directive [would] lead to more litigation and undermine the City Code and the Takeover Panel', as the 'English case law is clear in this respect'.¹³³ Indeed, English 'courts have not supplied a forum for resolving takeover battles'; and courts and the Panel have worked together on a 'consistent policy of preventing parties from resorting to obstructive litigation, especially as this would undermine the basis of the City Code'.¹³⁴ Arguably, there has never been a substantial risk of litigation, and the Panel's perceived fears of tactical litigation were unfounded.

The softening of the Panel's hostility to the idea of the Directive began in 2000, when for the first time in its annual reports the Panel acknowledged that the Directive contained 'damage-limitation provisions which should, subject to the manner of implementation of the Directive by the UK Government, help to maintain the benefits of the Panel's non-statutory system of regulation' and 'minimise the scope for litigation'.¹³⁵ By 2003, the Panel felt that many of its concerns had been resolved, which to the Panel's credit was due to the 'persistent efforts of the Executive working closely and constructively with the Department of Trade and Industry and the Commission'.¹³⁶ By 2005, the Panel was satisfied that the law implementing the Directive would be favourable to the extent that it contained 'measures to ensure that the orderly conduct of bids will not be disrupted by tactical Litigation'.¹³⁷

Throughout the resistance period, the Panel had the UK Government on board. A central plank in the negotiating position taken by the Government on the Directive was to minimise the risks associated with the possible increase in

¹³² M Andenas, 'European Take-over Regulation and the City Code' (1996) 17 Co Law 150, 150.

¹³³ M Andenas, 'European Take-over Regulation and the City Code' (1996) 17 Co Law 150, 152.

¹³⁴ S Kenyon-Slade, *Mergers and Takeovers in the US and UK: Law and Practice* (OUP, Oxford 2004) 704 para.10.27.

¹³⁵ Panel on Takeovers and Mergers, Report on the Year ended 31 March 2000, 8.

¹³⁶ Panel on Takeovers and Mergers, Report on the Year ended 31 March 2003, 8.

¹³⁷ Panel on Takeovers and Mergers, Report on the Year ended 31 March 2005, 13.

tactical litigation.¹³⁸ The Directive was finally adopted in 2004 by Member States, and implemented in the UK by the CA 2006. As stated by Morse, ‘many of the substantive provisions of the Directive, which are minimum standards only, are derived from the Code and the impact of the Directive on the actual rules will, on the whole, be fairly minimal’.¹³⁹ Indeed, both the Directive and the CA 2006 are worded carefully to minimise or limit any tactical litigation.¹⁴⁰ With the CA 2006 replicating the Panel’s rules in the Code, tactical litigation is unlikely to increase.

2.2.2 Fears of litigation and restriction by the courts

It is difficult to understand the basis of fears of litigation in takeovers, as the UK courts have been at the forefront of discouraging tactical litigation, and have always accepted the Panel’s interpretation of the Code and have only been prepared to intervene in exceptional circumstances, leaving the Panel to be the judge and the jury in takeover matters. In some cases, the courts have resisted intervening in takeovers, to the extent that even ‘the very moving for an injunction’ has been seen as ‘an action designed to frustrate the making of the bid’.¹⁴¹ In other cases, the courts, in the words of Millett J, have been dismayed at the ‘regrettable tendency for the contestants in modern takeover battles to try to enlist the aid of the court’.¹⁴²

¹³⁸ Company Law Implementation of The European Directive on Takeover Bids Jan 2005: A Consultative Document (DTI, London January 2005) 15 para.2.34.

¹³⁹ G Morse, *Charlesworth’s Company Law* (17th edn Sweet & Maxwell, London 2005) 676.

¹⁴⁰ Article 4.6 provides that the ‘Directive shall not affect the power which courts may have in a Member State to decline to hear legal proceedings and to decide whether or not such proceedings affect the outcome of a bid. This Directive shall not affect the power of the Member States to determine the legal position concerning the liability of supervisory authorities or concerning litigation between the parties to a bid’. S 961 CA 2006 exempts the Panel and its individual members from liability in damages for anything done (or omitted to be done) in, or in connection with, the discharge or purported discharge of the regulatory functions of the Panel.

¹⁴¹ *Dunford & Elliot Ltd v Johnson & Firth Brown Ltd* [1977] Lloyd’s L Rep 505, 510 (Lord Denning MR).

¹⁴² *Re Piccadilly Radio plc* (1989) 5 BCC 692, 706 where Millett J refused an injunction to a rival bidder who alleged that target shares had been transferred in breach of articles of association.

In his judgment in *Datafin*,¹⁴³ Lord Donaldson MR made it clear:

... beyond a peradventure that in the light of the special nature of the panel, its functions, the market in which it is operating, the time scales which are inherent in that market and the need to safeguard the position of third parties, who may be numbered in thousands, all of whom are entitled to continue to trade upon an assumption of the validity of the panel's rules and decisions, unless and until they are quashed by the court, I should expect the relationship between the panel and the court to be historic rather than contemporaneous. ... court to allow contemporary decisions to take their course, considering the complaint and intervening, if at all, later and in retrospect by declaratory orders which would enable the panel not to repeat any error and would relieve individuals of the disciplinary consequences of any erroneous finding of breach of the rules.¹⁴⁴

One of the principles derived from the ruling in *Datafin* is the non-interventionist principle – the relationship between the Panel and the court is to be historic rather than contemporaneous. This principle has two limbs: the courts will not intervene in an ongoing takeover case; and the courts will only give guidance to the Panel as to how a similar case should be dealt with in the future. Taking the non-interventionist principle into account, there would be zero incentive for a person to bring judicial review challenging Panel procedure because it would not help his case. However, the non-interventionist principle has never been strictly a legal principle but a practical one, in the sense that, according to Lord Donaldson MR:

... when the takeover is in progress the time scales involved are so short and the need of the markets and those dealing in them to be able to rely on the rulings of the panel so great that contemporary intervention by the court will usually either be impossible or contrary to the public interest'.¹⁴⁵

¹⁴³ *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815.

¹⁴⁴ [1987] QB 815, 842.

¹⁴⁵ *R v Panel on Takeovers and Mergers ex parte Guinness* [1989] 1 All ER 509, 512 (Sir Donaldson MR).

It is the impracticability of intervention, given the highly fluid nature of the takeover market, which makes the courts very reluctant to intervene, not a fetter on their discretion. Although the courts have been reluctant to intervene in takeovers, access to the courts has never been curtailed. Indeed, the courts have always maintained that the Panel's rulings are subject to judicial review,¹⁴⁶ albeit that such review is rarely granted. In appropriate circumstances, the courts would intervene to give relief to a litigant, albeit very rarely. If that is the correct understanding of the principle in *Datafin*, it should explain why, after the ruling in *Datafin*, the Panel continued to fear that tactical litigation would increase.

The UK Government having averred that there might be some potential for increased tactical litigation as a result of the new legal framework created by the Takeovers Directive,¹⁴⁷ set out in the CA 2006 to disable any possibility of tactical litigation by confining the business of takeovers to the Panel and its rules. There are seven provisions in the CA 2006 that makes it very difficult for a litigation culture to develop in takeovers.

The CA 2006 provides that:

(1) The Panel has a statutory mandate to supervise and make rules on takeovers, including similar rules in the Code.¹⁴⁸

(2) The Panel's ruling has binding effect, and the Panel can make directions that must be complied with.¹⁴⁹

(3) A party affected by the Panel's decision must first go through a review process by the Panel's Hearings Committee.¹⁵⁰

¹⁴⁶ *R v Panel on Takeovers and Mergers ex parte Guinness* [1989] 1 All ER 509.

¹⁴⁷ DTI, 'Company Law Implementation of The European Directive on Takeover Bids: A Consultative Document' (London, January 2005) 15 para.2.33.

¹⁴⁸ See CA 2006, s 942 and s 943.

¹⁴⁹ See CA 2006, s 945 and s 946.

¹⁵⁰ See CA 2006, s 951(1).

(4) A party who is still dissatisfied must appeal to the Panel's independent tribunal, the Takeover Appeal Board.¹⁵¹

(5) The Panel has the right to take a party to court.¹⁵²

(6) An affected party has no right of action against the Panel for breach of statutory duty.¹⁵³

(7) Unless an affected party can prove bad faith against the Panel, neither the Panel, nor its member, officer or staff of the Panel, is to be liable in damages for anything done (or omitted to be done) in, or in connection with, the discharge or purported discharge of the Panel's functions.¹⁵⁴

The seventh restriction on litigation,¹⁵⁵ should end all fears the Panel might have perceived in the past. The Panel is immune from prosecution, unless bad faith on the part of the Panel can be proved. This provision helps the Panel avert litigation of the kind seen in *Three Rivers DC v Bank of England (No 3) (Summary Judgment)*,¹⁵⁶ where depositors blamed the supervisor of UK banking, by then the Bank of England, for allegedly failing, in bad faith, to prevent their financial losses resulting from the operations of the BCCI back in 1980. With all these restrictive provisions of the CA 2006, it is very unlikely that tactical litigation in respect of takeovers will increase.

2.3 Implications of articles 9, 11 and 12 of the Directive

Under Article 9, the Directive restricts the ability of directors of an offeree company in a takeover bid to adopt defensive measures that may frustrate the

¹⁵¹ See CA 2006, s 951(3).

¹⁵² See CA 2006, s 955.

¹⁵³ See CA 2006, s 956.

¹⁵⁴ See CA 2006, s 961.

¹⁵⁵ See CA 2006, s 961.

¹⁵⁶ [2001] 2 All ER 513 – in the case, on 22 March 2001, the House of Lords by a 3-2 majority refused to strike-out the depositors' claim. In other words, the House decided that the depositors could sue the Bank of England, leaving the matter for trial; for a detailed

bid, unless the directors obtains prior approval from the general meeting of the shareholders to take such defensive measures. The Code has always had a similar restrictive provision to Article 9 of the Directive.¹⁵⁷ Whether this prohibition is justified in the light of UK company law is beginning to be questionable. The justification or otherwise of this prohibition is beyond the scope of this thesis; the concern here is on its effect. Suffice to mention that, leading on this debate, some commentators have argued that there would be minimal scope for director-deployed defences in the absence of the non-frustration prohibition, and that, in the context of UK company law, such defences have limited scope to be deployed for entrenchment purposes.¹⁵⁸

Justification of the prohibition apart, the Code retains its centrepiece rule against directors taking defensive action without shareholders approval. In implementing Article 9 of the Directive, the CA 2006 simply gives the Panel power to make rules, including adopting the rules already in the Code.¹⁵⁹ Under the Code, defensive measures can only be taken with the approval of the company's shareholders in general meeting – which, ‘as a practical matter, usually means that the Target's shareholders have in any event decided not to accept the hostile offer’.¹⁶⁰ Where both the offeree and the offeror are regulated by the Panel as a competent supervisor within the meaning of the Directive, and restrictions under Article 9 are not disapplied by Article 12, the takeover system remains ‘business as usual’ with the Directive being of no effect.

Article 12 contains a reciprocity provision – giving Member States the choice of opting out and to allow their companies to opt in again to the

discussion and implications of this case, see also M Andenas, ‘Misfeasance in public office, governmental liability, and European influences’ (2002) 51 ICLQ 757.

¹⁵⁷ General Principle 7 (Code, 7th edition, 2002), and Rule 21(1) of the Code (8th edition, 2006) prohibits the board from taking frustrating action without prior authorisation of the shareholders.

¹⁵⁸ See for example David Kershaw, ‘The illusion of importance: reconsidering the UK's takeover defence prohibition’ (2007) 56 ICLQ 267.

¹⁵⁹ CA 2006, s 943.

optional provisions. However, it is unclear whether Article 12(2) allows individual companies to opt out of the restrictions where their Member States have opted in. A strict interpretation would mean that, once a Member State opts in to Article 9, under Article 12(1) the target company has no right to opt out of Article 9, until relieved by the Member State under Article 12(3) where the companies become subject to an offer from a bidder that does not apply Article 9. In the UK, whether or not Article 12(2) can be read with the effect that it allows companies to opt out of Article 9 where the state has opted in, any such issue is unlikely to end up being resolved in the courts, as the UK participants are already accustomed to applying the equivalent of Article 9 under the Code. Besides, the UK has opted not to apply a reciprocity provision.¹⁶¹

2.4 *Pre-bid and post-bid defences*

Pre-bid defences are measures that exist in the company structure prior to the offer for a takeover being made. Examples of pre-bid defences include: differential share structures under which minority shareholders exercise disproportionate voting rights; limitations on share ownership and restrictions on transfers of shares set out in the company's articles or in contractual agreements. To prevent such measures from frustrating the bid, Article 11 of the Directive provides for what is called 'break-through' provisions. The Directive's 'break-through' provisions are optional. The UK has decided not to apply the 'break-through' provisions in all cases but instead to allow companies with voting shares traded on a regulated market to opt in to these provisions, should they wish to do so.¹⁶²

¹⁶⁰ S Kenyon-Slade, *Mergers and Takeovers in the US and UK: Law and Practice* (OUP, Oxford 2004) 693.

¹⁶¹ See A Kay and others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39-45 <www.practicallaw.com/crossborder> accessed 07 August 2007.

¹⁶² See CA 2006, sections 966 to 972.

Post-bid defences are measures that can be taken to frustrate a bid once the offer has been made. Examples of post-bid defences include sale of key assets of the company, and issuing of shares aimed at frustrating the bid. Article 9 of the Directive is aimed at preventing the management of the target company from taking such post-bid defences, unless the management obtained the approval of shareholders at the time of the bid. Article 9 is optional, such that Member States may choose to opt out of it. The UK has decided to opt in to Article 9; this had been the approach under the Code.

The takeover regulatory regime in the UK has not always concerned itself with pre-bid defences, and the Code has no provisions that deter such defences. Given that the rules under the Code against defensive measures apply where a bid is contemplated, directors of companies could prevent their companies being taken over by evading the application of the Code. Where defensive measures are put in place, directly or indirectly, prior to the bid, these are not caught by takeover regulation. Although the Code does not deal with pre-bid defences, they are generally regulated by other rules contained in the CA 2006.

Looking at some pre-bid defences such as the restriction on the transfer of shares, one soon realises that they only work in private companies. Public companies trading on a regulated market are required under the Listing Rules to have their shares free of any restriction on the right of transfer.¹⁶³ Transfer restrictions on shares cannot therefore be used as pre-bid defences in takeover situations. Where shares are allotted but not issued, to deplete share value of potential hostile bidders, directors may issue new shares to friendly persons. This, however, is subject to provisions contained in sections Part 17 of the CA 2006. Where potential hostile bidders are existing shareholders, it is difficult for new shares to be issued to an outsider without these potential bidders having the first right of purchase under section 561 CA 2006. As such, pre-bid devices in the form of issuing of new shares are limited to this extent. If the fear of takeover is due to outsiders joining the company, but the company is in need of issuing new shares for the purpose of increasing funds in the company,

this could be done through the allotment of non-voting shares. Any potential bidder who buys non-voting shares effectively does not build up a strong stake that threatens the livelihood of directors who would have an interest in mounting defensive measures against a takeover.

The other example of pre-bid defences directly aimed at preventing a takeover is what is commonly known as ‘poison pills’. A poison pill is an arrangement which becomes financially damaging once a company is taken over; a typical pill being a warrant issued to target shareholders giving them rights to subscribe for further shares in the target at half the prevailing market price if any predator company gets a controlling stake in the target.¹⁶⁴ If this is used as a defensive measure against future takeover, it would be in the interest of the target to make the device known to the predator so that the latter avoids attempting to takeover. How far the directors are likely to succeed in the use of poison pills is questionable, especially following the decision in *Criterion Properties Ltd v Stratford UK Properties LLC*,¹⁶⁵ where a poison pill was held to be an abuse of directors’ powers. Having been rejected by the courts early enough, it is unlikely that this poison pill culture will become common.

Generally, any measures that directors may adopt in pre-bid defences are subject to the scrutiny of the codified requirement for directors to act in the interest of the company.¹⁶⁶ For directors to avoid falling foul of their fiduciary duties to the company, they ought to act for a proper purpose in the interest of the company ‘as a whole’.¹⁶⁷ The obligation extends to the company as a separate legal entity, and also extends to shareholders, as the word ‘as a whole’ connotes. There is an argument that in interpreting the term ‘company’, the company may be properly viewed as comprising the interests of the company as a whole, that is the interests of all of its human constituents and persons who

¹⁶³ G Morse, *Charlesworth’s Company Law* (7th edn Sweet & Maxwell, London 2005) 223.

¹⁶⁴ B Pettet, *Company Law* (Longman, Harlow 2001) 423.

¹⁶⁵ [2004] 1 WLR 1846.

¹⁶⁶ CA 2006, s 172.

have a financial stake in its well being.¹⁶⁸ Arguably, the proper purpose requirement and proper use of directors' powers in the interest of the company restricts the ability of directors to effectively mount pre-bid defences that would later defeat or prevent a takeover.

Moreover, the nature of takeover business makes it difficult for directors to be in a better position to take pre-bid defensive actions. Takeovers are concerned with the selling and buying of shares. In companies with dispersed share ownership, information on the ownership of shares is often not in the control of directors. Interestingly, if directors are minded to take pre-bid defensive actions, company law both facilitates and hinders such a process. Under the CA 2006, the company can require any shareholder, or suspected shareholder, to disclose the extent, if any, of its beneficial ownership of the company's shares.¹⁶⁹ Directors may actively engage in issuing section 793 notices to suspected empire builders and take pre-bid defences that would not be caught by Article 9 of the Directive. That section 793 CA 2006 runs along side rule 21 of the Code is an indication that the rules against defensive tactics are effective enough to allow directors not to be caught by surprise by a bidder who comes as a result of systematic empire building. Once disclosed, it is arguable that directors would monitor potential offerors, or at least be alert to the growing shareholding interest that may in future trigger a mandatory-bid requirement to cause a takeover battle. This work is not made easy by the abolition of Substantive Acquisition Rules,¹⁷⁰ which rules in effect assisted in monitoring empire building. However, rather than have the potential to increase defences in takeovers, section 793 can be effective in allowing transparency in share dealings, especially where shares could be held using

¹⁶⁷ *Piercy v Mills* [1920] Ch 77; *Hogg v Cramphorn* [1967] Ch 254; *Bamford v Bamford* [1970] Ch 212; *Charterbridge v Lloyds Bank* [1970] Ch 62.

¹⁶⁸ S Griffith, *Company Law: Fundamental Principles* (4th edn Longman, Harlow 2006) 313.

¹⁶⁹ CA 2006, s 793.

¹⁷⁰ Panel Response Statement RS 2005/4 issued on 21 April 2006. These abolished rules had been designed to restrict the speed with which a person could acquire shares in a company that would give an aggregate holding of between 15 and 30 per cent of the voting rights of the company; these rules would cease to apply once an offer had been announced.

overseas nominees who may not be amenable to the jurisdiction of the Panel and the Code.

2.5 Split jurisdiction for the competent supervision of bids

This part of the thesis seeks to answer the question: is the split jurisdiction likely to increase litigation? The Directive provides for split jurisdiction under Article 4(2). The basic rule under Article 4(2) is that a bid will be subject to control by the supervisory authority in the Member State where the offeree company has its registered office if the company's shares are traded on a regulated market in that Member State. If that is not the case, then the supervisory authority is that of the Member State on whose regulated market the shares are traded, while the company law obligations would remain to be governed by the law of the State of incorporation. Before the Directive, the Panel had jurisdiction where the offeree company was incorporated within the UK with its place of central management within the UK, and it was irrelevant where the company's shares were traded.¹⁷¹ In implementing the Directive, the Code provides for the Panel to supervise companies that are listed and trading on the London Stock Exchange, but are not incorporated in the UK and have their place of central management elsewhere.¹⁷²

As European integration progresses with the increase in freedom of establishment and free movement of labour, companies that are incorporated in other Member States and get their securities listed and traded only in the UK, are likely to increase. In those situations, Article 4(2)(e) provides that the Panel will supervise 'matters relating to the bid procedure' while a supervisor in the state where the company is incorporated supervises 'matters relating to company law'. This split jurisdiction is common at European Union level, where in banking regulation, supervisory jurisdiction is determined by principles of home-country control and host-country control in European

¹⁷¹ Introduction to the City Code, 7th edition, 2002.

¹⁷² Introduction to the City Code, 8th edition, 2006.

law.¹⁷³ The question here is whether this split jurisdiction will become a source of litigation.

As it would not be in the interest of other regulators or foreign companies not to cooperate with the Panel, it is unlikely that the split jurisdiction will cause any practical problem. All regulators have a duty to cooperate with one another.¹⁷⁴ Nothing in the Directive prevents intervention by the Commission if cooperation between regulators fails.¹⁷⁵ Companies that engage in takeovers in the UK have a vested economic interest that they will not wish to jeopardise by not cooperating with the Panel. Overall, takeovers are but financial transactions, the financial City in the UK is accustomed to listening to the Panel, companies that become subject to the Panel's jurisdiction, albeit that they are registered in other Member States, will either cooperate with the Panel or find that they have to comply reluctantly with City norms. To this extent, the answer to the question above (is the split jurisdiction likely to increase litigation?) is no.

2.6 Panel decisions, powers and enforcement by the courts

The Directive requires that the supervisory authority be vested with all the powers necessary for the purpose of carrying out its duties, including that of ensuring that the parties to a bid comply with the rules made or introduced pursuant to the Directive.¹⁷⁶ In implementing this part of the Directive, the CA 2006 gives the Panel new powers to apply to court to enforce the rules contained in the Code. Where the Panel applies to the court, and if the court is satisfied, either that there is a reasonable likelihood that a person will contravene a rule-based requirement, or that a person has contravened a rule-

¹⁷³ See generally R Cranston, *Principles of Banking Law* (2nd edn OUP, Oxford 2002).

¹⁷⁴ Recital 5 of the Directive.

¹⁷⁵ Recital 29 of the Directive suggests a monitoring role for the Commission; alternatively, the Commission may, if necessary, take steps under Article 226 of the EC Treaty, as a last resort – which is unlikely.

¹⁷⁶ Article 4.5 of the Directive.

based requirement or a disclosure requirement, the court may make any order it thinks fit to secure compliance with the requirement.¹⁷⁷ Professor Morse has suggested that the Panel is only likely to use these powers as a matter of last resort or in urgent cases.¹⁷⁸ This would not be surprising given that the Panel would be keen to avoid opening a window of litigation.

Since its establishment in 1968, the approach of the Panel to compliance has always been by ‘coercion’ of its subjects.¹⁷⁹ The City participants have always complied with the Panel’s decisions, not because of fear of legal consequences but because most companies are members of the fraternity of parties in the takeover industry to which the Panel itself belongs. The Panel was instituted by the Bank of England and contains representatives of all the major City institutions.¹⁸⁰ The participants have always subscribed to the Panel and its rules; hence they restrain themselves from challenging the Panel’s decisions, lest they fall foul of their own authority. The other tool used by the Panel was the ‘threat that an individual found to be in breach of its provision may lose the necessary licence to practise in the area of investment business’ – which proved to be ‘a sufficiently powerful threat to ensure near-complete compliance with rulings of the Panel’.¹⁸¹

Using the power of persuasion can now be confined to history, for the CA 2006 gives the Panel certain powers. The Panel now has powers to require documents and information from any party in a takeover situation. Section 9(b) of the introduction to the Code, and the CA 2006,¹⁸² give the Panel certain

¹⁷⁷ CA 2006, s 955.

¹⁷⁸ G Morse, ‘Proposed amendments to the Takeover Code to implement the 13th EC Directive’ (2006) JBL 242, 244.

¹⁷⁹ The term coercion is here used to refer to persuasion approach as opposed to taking forceful approach or legal action – see B Pettet, ‘Private Versus Public Regulation in the field of Takeovers: The Future under the Directive’ (2000) EBLR 381, 386.

¹⁸⁰ G Morse, *Charlesworth’s Company Law* (17th edn Sweet & Maxwell, London 2005) 675.

¹⁸¹ S Deakin and Others, ‘Implicit contracts, takeovers, and corporate governance: in the shadow of the City Code’ (2002) Centre for Business Research, University of Cambridge, Working Paper 254, 8 <<http://www.cbr.cam.ac.uk/pdf/WP254.pdf>> accessed 28 December 2007.

¹⁸² CA 2006, s 947.

powers to require documents and information in the case of a transaction and rule, subject to the requirements of the Directive. In the exercise of this power, where documents or information are reasonably required in connection with the exercise of its functions, the Panel may, by giving notice in writing, require any person to produce such documents or information as specified or described in the notice. Failure to comply with the notice is a breach of the Code. The only defence for a party refusing to comply with such notice is on the grounds of legal professional privilege. Remotely, determining the validity of this privilege has the potential for causing some kind of litigation, but it is unlikely that participants accustomed to complying with the rulings of the Panel will suddenly resort to litigation.

If there is a breach of the Code, or evidence to suggest a likely breach of the Code, the Panel now has powers to enforce the Code. Sections 10(a) to 10(c) of the introduction to the Code set out certain rules pursuant to which the Panel enforces the Code. In dealing with breaches of the Code, the Panel is not concerned with punishing the offender *per se*, but rather aims at providing appropriate remedial or compensatory action in a timely manner. Under the CA 2006, the Panel has the power to give directions restraining a person from doing (or continuing to do) a particular thing, pending determination of whether that or any other conduct of his is or would be a breach of rules.¹⁸³ By such directions, the Panel can prevent breaches or further breaches of the Code, and by the same directions the Panel can secure compliance with the rules. Breaches of certain rules are enforced by compensation.¹⁸⁴ In particular, where a person has breached the requirements of any of Rules 6, 9, 11, 14, 15, 16 or 35.3 of the Code, the Panel may make a ruling requiring the person concerned to pay, within such period as is specified, to the holders, or former holders, of securities of the offeree company such amount as it thinks just and reasonable so as to ensure that such holders receive what they would have been entitled to receive if the relevant Rule had been complied with.

¹⁸³ CA 2006, s 946.

¹⁸⁴ CA 2006, s 954.

The CA 2006 also allows the Panel to issue sanctions or other remedies for breach of the Code.¹⁸⁵ The Code provides the sanctions to include the panel issuing a private statement of censure, or a public statement of censure. The Panel may suspend or withdraw any exemption, approval or other special status which the Panel has granted to a person, or impose conditions on the continuing enjoyment of such exemption, approval or special status, in respect of all or part of the activities to which such exemption, approval or special status relates.

The Panel may choose to report the offender's conduct to another UK or overseas regulatory authority or professional body (most notably the Financial Services Authority ('FSA')) so that that authority or body can consider whether to take disciplinary or enforcement action. For example, the FSA has power to take certain actions against an authorised person or an approved person who fails to observe proper standards of market conduct, including the power to fine. The Panel may publish a Panel Statement indicating that the offender is someone who is not likely to comply with the Code. The effect of such publishing by the Panel is to have the FSA, and other professional bodies, use their powers to oblige their members not to act for the person in question, that is, to 'cold-shoulder' such a person. An example of this 'cold-shouldering' is given in the Code as where the FSA's rules require a person authorized under the Financial Services and Markets Act 2000 ('FSMA') not to act, or continue to act, for any person in connection with a transaction to which the Code applies if the firm has reasonable grounds for believing that the person in question, or his principal, is not complying or is not likely to comply with the Code.

The above kind of information-sharing is designed to comply with Article 4(4) of the Directive. In implementing Article 4(4) of the Directive, the CA 2006 the Panel is required to cooperate with other regulatory authorities in order to enforce measures taken in connection with bids.¹⁸⁶ This also includes

¹⁸⁵ CA 2006, s 952.

¹⁸⁶ See CA, s 950.

seeking such other assistance as may reasonably be requested by the Panel for the purpose of investigating any actual or alleged breaches of the Code. After all the above measures have been tried and failed, the Panel is likely, as a measure of last resort, to take the option of enforcing the Code through the courts. Section 11 of the introduction to the Code reiterates the provision under section 955 of the CA 2006, such that in the case of a breach of a rule or requirement that is subject to the requirements of the Directive, the Panel may seek enforcement by the courts.

Pursuant to the rules in the Code, since the implementation of the Directive the Panel has so far continued to make decisions that have yet been respected by the parties concerned. One of these decisions was in relation to the BAA plc takeover process. Following an announcement by Goldman Sachs Infrastructure Group (the ‘Consortium’) that it was continuing to review its options after its offer proposal had been rejected, the Panel ruled on 2 June 2006 that the Consortium should make its statement clear. For the purpose of Note 1 on Rule 19.3 of the Code, the Panel ruled that the statement by the Consortium be clarified, and that either by the Consortium announcing a firm intention to make an offer under Rule 2.5 of the Code or by announcing that it will not proceed with an offer for BAA. Further, the Panel ruled that if the Consortium were not to proceed with the offer, it would be bound by the restrictions in Rule 2.8 of the Code for six months from the announcement date. A similar ruling was made on 3 July 2006 against *Middleby* and *Manitowoc* in respect of the takeover process of *Enodis*. All these rulings were respected.

The foregoing goes to show that the Panel still maintain its powers of decision-making, and that parties involved in takeovers are accustomed to obeying takeover rules without resorting to lawsuits. It is unlikely that the Panel will find it necessary to apply to the courts for compliance, but it is too early to rule out the possibility of the Panel calling upon the courts to enforce its powers.

2.7 Conclusion

The problem in implementing the Directive has never been so much with the potential litigation chaos it was likely to cause the Panel, but with the fact that the Directive attempted to harmonise an activity that predominantly occurs within the UK and that it was likely to do so at the expense of the Panel's ability to control its business. The implementation of the Directive placed the Panel and the Code on a statutory footing, resulting in an end to self-regulation of takeovers in the UK. Silent on the fear of loss of control, the Panel throughout its hostility to the Directive has instead pointed at the fear of tactical litigation, notwithstanding that the UK market is accustomed to a non-legal approach and that the courts have always been reluctant to intervene in takeovers.

As the UK market would suffer detriment if the impact of the Directive meant a litigation culture emerging, the consolation to the Panel is the provision under Article 4(6) that allows courts of Member States to decline to hear legal proceedings. In implementing this provision, the CA 2006 replicates, to the greatest extent possible, the Panel's previous jurisdiction, practices and procedures, including giving the Panel power to make statutory rules, and only allowing courts a limited intervention by way of judicial review. Thus, in implementing the Directive, the CA 2006 has made it difficult for a litigation culture to develop in UK takeovers. An aggrieved party has a number of layers to go through before resorting to the courts, which include seeking redress from a Hearing Committee of the Panel, and then appealing to an Appeal Board of the Panel.¹⁸⁷ It also depends on what the party's grounds for redress are. For example, the CA 2006 does not allow a party to challenge a transaction in court on the grounds of breach of the Panel's rules, and the Panel itself is exempt from liability for anything it has done or has omitted to do in connection with its functions.

¹⁸⁷ See CA 2006, ss 945, 951, 955, 956 and 961.

As far as pre-bid and post-bid defences are concerned, they are difficult to apply in the UK. Both Listing Rules and the CA 2006 limit pre-bid defences. Post-bid defences are directly prohibited by rule 21 of the Code. As such, post-bid defences can only be mounted with the approval of shareholders. A tactical litigation culture is also difficult in the UK. With the Panel operating as it has always done under self-regulation, albeit with legal force, market participants being accustomed to resolving matters without resorting to the courts, and given that the CA 2006 limits such possibility, a notorious litigation culture is very unlikely to develop in the UK. To that extent, the fear that the implementation of the Directive would create a culture of litigation remains a myth.

Chapter 3: Protection of Shareholders in Takeovers

3.1 *Introduction*

This chapter analyses the extent to which the Directive protects the interests of the shareholders on the one hand, and the facilitation of cross-border takeover activities on the other. With regard to shareholders, particular attention is given to the interests of minority shareholders who may be squeezed out by the controlling majority who take over the company. This chapter also looks at whether the Directive adds anything that the Code would not provide were the Directive not to be implemented. The argument advanced here is that the Directive generally provides for shareholder protection, which is already enshrined in national measures, the Code, whilst failing in the facilitation of cross-border takeover activities. To that extent, this chapter argues that the Directive adds nothing of value to takeover regulations in the UK in this context. The chapter also looks at the possible conflict between protecting shareholders in a target company on the one hand, and facilitating investment through unrestricted takeover activities for a competitive European economy on the other.

The regulatory objectives here include ensuring that shareholders have adequate information, and protecting shareholders from being pressured by managers into making decisions on a takeover bid. In achieving these objectives, Articles 3 and 9 of the Directive are applicable. The Directive requires that managers provide full information to shareholders concerning the bid. Managers should refrain from denying shareholders the opportunity to decide the merits of a bid. If managers wish to resist any bid, they should obtain approval of the shareholders to do so, otherwise managers should refrain from taking action that would frustrate the bid. These requirements are not novel to the UK, as they have always been applied under the Code. For example, rule 19 of the Code requires that information concerning the bid be given to shareholders, and rule 21 requires managers to refrain from frustrating a bid. Thus, the Directive's requirements reaffirm UK takeover rules under the Code, which have now been specifically implemented by section 943 of the

CA 2006. It is, however, for takeover regulation at Community level a preference to act in the interest of all stakeholders including investors (or rather predators). This could possibly create a conflict of objectives.

It should be remembered that shareholder protection is not the only objective of the takeover regulation at Community level. There is also the objective of facilitating cross-border investment in takeover activities by removing barriers to takeovers. These two objectives emanate from the Winter Report. It would appear that the emphasis on shareholder protection could be in conflict with the facilitation of cross-border takeover activities. Article 9 seeks to remove defensive tactics barriers, vesting decision power in shareholders, in order to protect their interests. If it is in the interest of shareholders to authorise defensive measures to frustrate a takeover bid under Article 9 of the Directive, that could be seen as contrary to the objective of facilitating takeover activities. Needless to mention that a takeover would not succeed if opposed by shareholders. Of course, if the shareholders specifically refuse a takeover, their informed decision ought to be respected.

The problem is that the application of Article 9 is optional under Article 12 of the Directive. This is not a problem in regard to protecting shareholders within the UK with an exclusively UK takeover bid. It is likely to be a problem if a UK bidder would attempt to take over an offeree in another Member State that does not apply Article 9; the management of the offeree may defeat the takeover by defensive measures without shareholder approval and contrary to the interests of shareholders. In that sense, the Directive, by making Article 9 optional, fails to facilitate takeover activities.

There is also a problem with other barriers, such as restriction on voting, which might affect control of the successful bidder and in turn defeat cross-border takeovers. To make good this barrier, the Directive provided for what is commonly known as the break-through provision under Article 11. Once a bidder has obtained a certain stake in the target company, by virtue of Article 11, the bidder is allowed to break through any restrictions imposed by the shareholders or by the company – this is designed to facilitate cross-border

takeover activities. But this break-through provision only applies to barriers after the bidder has acquired a controlling stake in the target company; defensive measures authorised to defeat initial bidding would remain in conflict with the facilitation of takeover activities. However, and despite the recommendations of the Winter Report,¹⁸⁸ Article 12 of the Directive makes both Articles 9 and 11 optional.

Facilitation of investment through takeover activities is important, as is shareholder protection, for a competitive European economy. Both Articles 9 and 11 of the Directive were meant to serve these dual conflicting objectives of takeover regulation. Political interests seem to have led to a compromise that optimised these objectives. As such, shareholder protection remains in conflict with the need to facilitate investment through unrestricted takeover activities. Rather than question the commitment of European legislators to facilitating takeover activities, one has to appreciate the reality of a political role in the Community legislative process; a political compromise had to be struck. However, sight should not be lost of the general strengthening of takeover regulation in Europe brought about by other provisions of the Directive, much of which is undoubtedly a step forward in many Member States.

3.2 Principle of shareholder decision-making

3.2.1 Inadequate common law decision-making power to shareholders

Until recently, company law provided inadequate decision-making powers to minority shareholders to protect their interests. Whereas shareholders are the residual owners of a company as a legal entity, the control of company affairs is generally vested in the management, the directors. Unless the articles of the company do not provide power to the directors, the shareholders cannot exercise the residual power to act on behalf of the company. Even then, decision-making powers are vested in the majority shareholders in a general

¹⁸⁸ Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids (Brussels 2002).

meeting. Where the articles give power to the directors to issue new shares, the directors are likely to use this power to issue new shares in order to defeat a takeover bid or to promote their own interests.¹⁸⁹ The effect of such action may well be contrary to the interests of shareholders who would have preferred a different outcome of takeover bid.

The inadequacy of common law in providing power of decision-making to minority shareholders stems from the legal treatment of the relationship between directors and shareholders in regard to the legal entity, the company. In general terms, a company is a legal entity separate from its shareholders. The directors are agents of the company and not agents of the shareholders, and directors primarily act in furtherance of the interests of the company as a legal entity and not *per se* in the interests of shareholders. This stems partly from the rule in *Percival v Wright*¹⁹⁰ which states that directors' duties are owed to the company and not to shareholders. Where the directors are in breach of their duty to the company, the rule in *Foss v Harbottle*¹⁹¹ precludes a minority shareholder from disciplining such directors. At common law, unless the shareholder can complain through the exceptions in the rule in *Foss v Harbottle*, a minority shareholder remains inadequately protected and has little influence on decision-making that affects the outcome of a takeover bid.

One situation illustrating the inadequacy of decision-making powers to minority shareholders at common law can be found in the case of *Hogg v Cramphorn Ltd*.¹⁹² Directors in this case were approached by a prospective bidder for all the issued shares in the company. If the bidder was successful, the directors feared that the bidder would have effective control of the company due to the voting power such shares would provide. To prevent the bidder succeeding, the directors used their powers in the articles to allot

¹⁸⁹ An example of such misuse of directors' power was attempted in *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, where directors had issued shares in order to influence the outcome of a takeover in their favour.

¹⁹⁰ [1902] 2 Ch 421.

¹⁹¹ (1843) 2 Hare 461.

¹⁹² [1966] 3 All ER 420.

unissued shares in the company to a trustee. This allotment was aimed at defeating the takeover bid. Shareholders were not contacted, and it was clear that this action was not in their best interests. The shares were issued for a collateral purpose not in the interests of all the shareholders. A minority shareholder, who was interested in the success of the takeover bid, sought the assistance of the court. The court referred the matter to the shareholders' general meeting by which an ordinary resolution was passed to accept the allotment of the new shares. An opportunity for the minority shareholders to make a decision on the bid was effectively prevented.

This inadequacy of decision-making powers to minority shareholders is further illustrated in another case, *Bamford v Bamford*,¹⁹³ where directors similarly issued shares for a collateral purpose other than bona fide for the interests of all shareholders. The opportunity to make the decision was equally denied to shareholders. In this case, after allotting new shares aimed at defeating a takeover bid, the directors caused an ordinary resolution to be passed to affirm their action. Again, the minority shareholders complained without success.

3.2.2 Statutory protection of shareholders' interests

Company law statutes, in the past, have also been inadequate to remedy the plight of minority shareholders. Section 172(1) of the CA 2006 does not resolve this but simply endorses the common law position. This requires directors 'to promote the success of the company for the benefit of its members as a whole', but adds that in so doing the director is to 'act in the way he considers, in good faith, would be most likely' to fulfil the duty. Unless the duty owed to the company was to be construed 'as a duty to promote the success of the business venture in order to benefit the members,'¹⁹⁴ company law has always given inadequate protection to minority shareholders. Where shareholders are faced with a takeover bid, adequate protection was only found in the provisions of the Code. Principle 3 and rule 21 of the Code preclude the

¹⁹³ [1970] Ch 212.

target directors from taking any action (unless authorised by the shareholders) that would defeat or frustrate a takeover bid. The Directive requires the same standard under its Article 9, which is implemented by the CA 2006.

Thus, the law on takeovers, by way of regulations, starting with the provisions in the Code and now the CA 2006 that implements the Directive, provides a wider protection to interests of all shareholders faced with a takeover bid. By making Article 9 optional, the Directive lacks in providing decision-making power to shareholders. Instead, the Directive protects all shareholders by requiring that they receive timely and adequate information concerning the bid, and particularly protects minority shareholders' interests albeit only to the extent that they obtain a fair price for their shares on exiting the company.¹⁹⁵

3.2.3 Shift of decision power to shareholders

For all its rhetoric about respecting national contexts and ensuring transparency, the Directive sought to impose a rule granting shareholders the sole right to decide on the outcome of takeovers. While uncontroversial to British eyes accustomed to the Code, the Directive would have had the effect of changing the centre of gravity of more managerialist and stakeholder-orientated systems of corporate governance, but for the compromises that reduced some provisions into optional ones.¹⁹⁶ The cornerstone of shareholder protection is Article 9 of the Directive, which prohibits management from taking decisions that would frustrate the bid but leave the decision-making on the bid to shareholders. However, this provision is made optional, such that Member States are free to allow management to make the ultimate decision even to prevent a bid. Apart from Article 9, it is a question of how far other provisions in the Directive provide for shareholder supremacy in making decisions on takeover bids.

¹⁹⁴ J Parkinson, *Corporate Power and Responsibility* (Clarendon Press, Oxford 1993) 77.

¹⁹⁵ See further the discussion below on 'squeeze-out right' which in effect denies investment rights to minority shareholders.

The general approach taken under the Code has been to protect shareholders by giving them all the powers to decide on takeover bids. It is not for the directors to decide on a bid. Directors have a duty to pass on information to shareholders concerning the bid, and to advise shareholders. Although until 20 May 2006 the Code had no legal force, it kept at bay the directors on using defensive measures to defeat a takeover bid. As Davies has put it, ‘the directors of the target are thrown back on their powers of persuasion’ and ‘the final decision on the success of these defensive moves rests with others’.¹⁹⁷ With this sting from the Code, the directors’ option in defeating a takeover bid lay in the economics of management. Pettet summed up these economics very well:

... it is the orthodox view that the most effective method of preventing a bid is a well-run company with a high share price. The economics of this make it relatively difficult for the bidder to come up with a higher offer price, or to want to. The corollary of this is the painful fact that if the share price is low and the company appears not to be well run, then there may well not be a great deal which can be done’.¹⁹⁸

There is an argument that managerial decision supremacy in the face of a takeover bid has the merits of securing a better deal for shareholders. For instance, if the management decided to resist a particular takeover bid, this might result in the offeror revising the offer and in turn creating a higher share premium for shareholders.¹⁹⁹ This argument imports as its rationale a solution to a situation where an offer is being resisted for being low. However, often, it is not for low share price that the management seek to resist bids, but due to a

¹⁹⁶ A Johnston, ‘The European Takeover Directive: Ruined by protectionism or respecting diversity’ (2004) 25 Co Law 270.

¹⁹⁷ PL Davies, *Gower's Principles of Modern Company Law* (6th edn Sweet & Maxwell, London 1997) 784.

¹⁹⁸ B Pettet, *Company Law* (Longman, Harlow 2001) 423.

¹⁹⁹ Darren Henery, ‘Directors’ Recommendations in Takeovers: An Agency and Governance Analysis’ (2005) 32 Journal of Business Finance & Accounting 129-159.

whole range of reasons including mere fear that management will lose control and their jobs. At any rate, shareholders are capable of deciding on the adequacy of the price offered, and the market price can be used as an index for shareholders to decide. It is also argued that any uncoerced decision against acceptance of a bid can only be made at the board of directors' level.²⁰⁰ Implicit in this argument is a suggestion that shareholders are incompetent to make decisions favourable to their own interests. Followed to its conclusion, the power of decision-making would shift from shareholders to directors, or rather remain with directors.

Arguably, subject to appropriate safeguards, boards should be able to take defensive measures when the organisation they should know better than anyone else is threatened by potential break-up and asset-stripping through hostile takeovers.²⁰¹ However, that argument ignores the danger of relying on director primacy to ensure shareholder protection. Once a takeover bid is eminent or made, managers' attitude is bound to change naturally. 'Often their own performance and plans are brought into question and their own jobs are in jeopardy. Their interest is in saving their jobs and reputation instead of maximising the value of the company for shareholders'.²⁰² Moreover, in UK company law it is extremely difficult to find that directors have not acted for the interest of the company. With all the difficulties of aggrieved minority shareholders litigating against directors, the answer lies in promoting shareholder supremacy. If the directors reasonably believe it to be for the good of the company and its future business to resist a takeover, then they should convince the shareholders of that and only take action against unwanted bids through the consent of the shareholders.

²⁰⁰ M Lipton, 'Takeover Bids in the Target's Boardroom' (1979) 35 Bus Law 101, 114.

²⁰¹ J Dean, 'Directors' Duties in Response to Hostile Takeover bids' (2003) 14 ICCLR 370, 377.

²⁰² Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids (Brussels 2002) 21.

3.2.4 Pre-bid versus post-bid shareholder decisions

Company law generally gives power of decision-making to shareholders by means of a vote in the general meeting. The Directive takes the same approach when it requires that directors should seek shareholders' approval in a general meeting before adopting measures or actions that may frustrate a takeover bid. The need to defer decision-making on the merits of a takeover bid to shareholders was also supported by the Winter Report. This is referred to as the shareholders decision-making principle. To the Winter Report, Article 9 of the Directive ensures that shareholders can decide on whether or not to tender in a bid, and that any action to frustrate the bid requires the specific authorisation of the general meeting of shareholders at that time.

Thus, in applying the shareholders' decision-making principle, the Winter Report recommended that, shareholders' decisions taken prior to a bid (a pre-bid decision), even in a general meeting, should not be used by directors to frustrate a bid. Only when a bid is actually announced, and the shareholders can really assess relevant information, can they in fairness be asked to decide whether this takeover bid should be frustrated by the board or not.²⁰³ Further, the Winter Report suggested that the board should not take steps to favour a bid that in any way pre-empts the right of shareholders to reject it – in other words, shareholders must have the final word on the outcome of a takeover bid.²⁰⁴ The Directive adopts the spirit of the Winter Report on the question of pre-bid versus post-bid decisions.²⁰⁵ This has the effect of limiting when shareholders may make their choice to the period during the bid and not before. The rationale seems to be that shareholders can only fairly decide on

²⁰³ Winter Report, 2002, Recommendation 1.2.

²⁰⁴ Winter Report, 2002, 27.

²⁰⁵ Article 9(2) of the Directive partly provides that, 'such authorisation shall be mandatory at least from the time the board of the offeree company receives the information referred to in the first sentence of Article 6(1) concerning the bid and until the result of the bid is made public or the bid lapses. Member States may require that such authorisation be obtained at an earlier stage, for example as soon as the board of the offeree company becomes aware that the bid is imminent.' The example given suggests that interpretation of Article 9(2) would prevent directors from relying on a resolution made years ago by shareholders authorising defensive measures.

the merits of a takeover bid once they are actually faced with one. This has the effect of suggesting that shareholders cannot calculate the risk of their decision in the pre-bid period or that they are not capable of doing so, and hence they should only decide in a post-bid period. Ferrell rightly observed that:

... if shareholders are too confused or disinterested to make this calculation, then why assume that shareholders are sufficiently competent to make decisions on defensive tactics in the post-bid period? Surely an across-the-board assumption of shareholder incompetence in the pre-bid period is too sweeping.²⁰⁶

Although the rationale of the Winter Report is a common sense approach to protecting the right of shareholders to make decisions, it appears to adopt an approach which is too paternalistic. It also curtails freedom of contracts that shareholders may wish to make. It also renders agency obsolete in respect of the shareholders-management relationship. Legally, there is no justification, it is argued here, for rendering ineffective an authorisation given prior to a bid by shareholders in a general meeting for directors to frustrate a takeover bid. Shareholders are free to make decisions that are potentially detrimental to them, that is that allow management to frustrate a bid even if *ex post* shareholders will find it in their interest that management cannot interfere with the acceptance of the bid.²⁰⁷

On a contractual basis, if parties to a contract were to wait on making decisions until they had the full facts and information of the market, few contracts would be made. If such few contracts were prevented on the basis of parties not having full information, such approach would potentially curtail freedom of contracts. If shareholders by their election chose to have directors act as their agents to frustrate future bids, wholly or on a specified basis, just

²⁰⁶ Allen Ferrell, 'Why Continental European Takeover Law Matters' In: Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 561, 573.

²⁰⁷ P O Mulbert, 'Make it or break it: the break-through rule as a break-through for the European takeover Directive?' in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 711, 724-725.

because shareholders do not assess a particular bid at the time it is made does not mean that they should be regarded as having failed to exercise their right of decision-making in regard to a bid in question – it only means that they took the decision in advance, and should not be paternalistically protected from the risk that they took voluntarily unless it could be established that they were grossly misled.

Moreover, shareholders' decision-making in a pre-bid period could be left open-ended, entitling shareholders to review and alter their own prior decision that may have authorised a defensive approach and to decide to accept an offer. Possibly for the purpose of avoiding legal proceedings in determining on what basis shareholders took a decision, and avoiding a situation where minority shareholders may demand to review a pre-bid decision, it is much fairer to take a paternalistic approach and defer decision-making to post-bid period.

3.2.5 Shareholder value versus corporate autonomy

The Directive exposes the tension between promotion of 'shareholder value' and the promotion of 'corporate autonomy' as far as takeovers are concerned. Johnston²⁰⁸ observes that the compromise in the Directive as to Article 9 comes as a disappointment to those who wanted to see provisions analogous to the Code rolled out across the EU. Johnston explains that advocates of the approach taken under the Code would argue that the Directive fails to create the market for corporate control that would expose entrenched management to the discipline of the hostile takeover, and is therefore fundamentally flawed. Johnson further explains that those opposed to corporations being governed purely with a view to generating shareholder value may consider the compromise a victory for managerialism and corporate autonomy, with potentially beneficial effects for other stakeholders. For them, Johnston explains, the compromise will demonstrate that there is no Europe-wide consensus that shareholder value should be the sole goal of publicly traded

²⁰⁸ A Johnston, 'The European Takeover Directive: Ruined by protectionism or respecting diversity' (2004) 25 Co Law 270

corporations, and could even be seen as a qualified rejection of the idea that a market for corporate control always leads to optimal resource allocation.

Shareholder value is commensurate with the wider EC aims of free market and free movement of capital. If power to decide the transfer of shares in the company or the outcome of a takeover bid is left in the hands of directors, who are often sophisticated professionals keen to promote the interest of the company but only if that do not endanger their existence and interest, takeovers could hardly achieve the wider EC aims. Notwithstanding the benefit of delegating power in governance, unless power ultimately belongs to the people in any organisation, whether it is an economic or political organisation, the interests for which such power is supposed to protect, are prone to being trampled by the holders of such power if the same are not the end beneficiaries. It is possible that the high level of concentrated share ownership in continental Europe is the reason why compromising of Article 9 is found acceptable. In companies with concentrated share ownership, corporate autonomy is more likely to be accepted, for with the majority or block shareholding also comes management control, and the rules on prior authorisation under Article 9 and the concept of shareholder value becomes less important and remain only a matter for the minority shareholders to worry about.

3.2.6 Community versus national interests

The regulatory analysis of takeovers cannot be complete without considering the tension between the interests of the Community at European level on the one hand, and the interests of individual Member States at the national level on the other. National interests may lie in staying the course on sector self-regulation to protect local markets, whilst Community interests may lie in harmonisation of regulation of the market at large. The cherished values of flexibility in self-regulation may mean that the Panel is able to change the rules as and when it suits it to do so. Whilst such rules may reflect national business expectations, such freely changing rules would be difficult to harmonise at Community level. The spirit of national interests taking priority over Community interests has, unfortunately, historically marred the process of and

led to the compromises that ushered in the Directive. Provisions like Article 9 on defensive measures and Article 11 (the break-through rule), reflect the spirit of Community interests but for having been rendered ineffective by the nationalist interests that reduced them to optional provisions.

Optional provisions apart, even in what is left of the provisions in the Directive, it is easy to over look at first glance that these are implemented in a manner that gives priority to national interests at the expense of Community interest. Take for instance, if a Member State, as it is free to do so, sets a higher threshold for a mandatory bid, whilst another sets a low threshold. The likely outcome is that takeovers would be hard to occur in a Member State that has a higher threshold. A higher threshold would mean that it takes a little more acquisitions of shares and possibly longer to trigger a mandatory bid rule. Yet if that were the result of implementing the Directive, Community interests in achieving free movement of capital would be defeated, even when a mandatory bid provision is not optional. Once a piece of legislation is allowed to be moulded by much political agenda, as it seems to have happened with the Directive, it is bound to produce political rules. Such rules, unlike legal rules, require constant appeasements of the political participants, an art the Community may not be competent to provide. The results are likely to be a piece of legislation that achieves only the form, and not the substance, of regulating takeovers as intended. Ultimately then, shareholders at Community level are not adequately protected, as the diversity of rules and their application gives no uniformity.

3.2.7 Ultimate decision-making vested in shareholders

By recital 3 of the Directive, the Directive aims at creating Community-wide clarity and transparency in respect of legal issues to be settled in the event of takeover bids. This aim is taken a step further by Article 9, which facilitates transparency by vesting the power of decision-making in the shareholders. As directors are traditionally answerable to the company and not to shareholders, their decisions during a takeover bid could be questionable as to whether they are in the interest of shareholders. As such, ensuring protection of the interests

of shareholders, Article 9 precludes directors from taking any action, or decision which would otherwise frustrate a bid. This is a principle of proper purpose decision, which is checked and supervised by shareholders to whom the ultimate benefit of a takeover lies. The same principle exists in company law, requiring directors to act for a proper purpose in the interest of the company as a whole.²⁰⁹ Article 9 simply applies this principle in a practical context.²¹⁰

However, it is difficult to see how shareholders, who are likely to focus on short-term profit exhibited in the offer price, can make a better decision than professional directors of the target company. The bidder negotiates through professional agents, while the target does so directly as shareholders, often with little professional skills of negotiation. That would create an imbalance of bargaining power. The resultant effect of a strict interpretation of Article 9 is to deprive target shareholders of a vital service of professional directors in negotiating for a better deal. It is not necessarily that a higher price offer is a better deal for shareholders. It may well be that an offer should be rejected after the informed opinion of the directors for long-term gains. If directors are rendered passive by a strict application of Article 9, then the unfortunate result is likely to be a short-term profit at the expense of long-term interests of the company as whole including the interests of other stakeholders.

However, whereas directors will have the expertise in share value and company prospects, faced with the possibility of being ousted out by the new controllers if the bid were to be in favour of shareholders' interests, directors may not make the right decision. Whether this can be resolved by agency principles requiring that directors, as agents, work in the best interest of the shareholders, as principals, is difficult to assess. Rather than take risks, it is no wonder that Article 9 sensibly cuts through all these by vesting decision-making power into the hands of shareholders. The risk of directors making

²⁰⁹ *Hogg v Cramphorn* [1967] Ch 254; *Howard Smith v Ampol* [1974] AC 821.

²¹⁰ Note however, Article 9 is broader than the proper purpose principle, which is only part of the analysis in Article 9.

decisions solely to protect their positions far outweighs the risk of shareholders being deprived of a professional service in deciding what is in the best interests of the shareholders and the company as a whole.

Further, a strict application of Article 9, equivalent to the long-standing provision of the Code,²¹¹ creates transparency and thereby creates market confidence. As residual beneficiaries of the company assets, combined with the common law requirement that decisions be taken for a proper purpose,²¹² it is sensible to vest decision-making ultimately with shareholders themselves. However, for the purpose of facilitating cross-border takeovers, the compromise of Article 9 of the Directive is a watering down of the centrepiece rule 21 of the Code.²¹³ This central feature of the Code has always had the effect of limiting defensive tactics such that management would not appeal to shareholder loyalty or patriotism or use their own resources to buy target company shares in the market.²¹⁴ Instead of extending this central principle to takeover regulations in Europe to facilitate cross-border takeovers, the Directive waters it down by making it optional. Thus, shareholder autonomy in decision-making and the ability to limit management's defensive tactics cannot be applied with certainty in cross-border takeovers.

²¹¹ Rule 21(1) of the City Code provides: 'During the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, without the approval of the shareholders in general meeting:— (a) take any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits ...'.

²¹² In *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, directors issued shares to a bidder for an improper purpose, that is, not per se in the interest of the company or shareholders but to influence the outcome of a takeover in the interest of directors – the court set aside the issuing of these shares.

²¹³ Since its inception in 1968, the central feature of the Code has always been its prohibition of defensive actions by management without authorisation of shareholders. The rule first contained in General Principle 7 of the Code in the 1968 version prohibited management from taking any action that would frustrate a bid, in the event of an offer or imminent offer, without prior authorisation of shareholders.

²¹⁴ PL Davies, 'The Regulation of Defensive Tactics in the United Kingdom and the United States' in Hopt and Wymeers, *European Takeovers* (Butterworths, London 1992) 200.

3.3 *Proportionality between risk-bearing and control*

The principle of proportionality between risk-bearing capital and control is one of the two guiding principles relied upon by the Winter Report in recommending measures for inclusion in the Directive, including Article 11 or the so-called break-through rule. According to the Winter Report,²¹⁵ the extent to which a shareholder holds risk-bearing capital should determine the extent to which he is able to determine the affairs of the company and the operation of its business, and further more that the holder of the majority of risk-bearing capital should be able to exercise control. Thus, a successful bidder who has acquired a substantial part of the risk-bearing capital in a general bid for all the shares of the company should have the ability to break-through any mechanisms that frustrate the exercise of proportionate control.²¹⁶ It is unclear why the Winter Report viewed the break-through rule as compatible with the proportionality principle – when the effect of the former is to disable the latter. One matter seems clear – the break-through rule is novel to the UK's company law approach of breaking through entrenched rights, and it may accord less protection to shareholders.

The Winter Report's break-through recommendations are adopted in Article 11 of the Directive. At the core of Article 11 are two meanings of the break-through rule. First, when shareholders exercise their power of decision-making under Article 9, restrictions on voting rights provided for in the articles of association of the offeree company shall not have effect at the general meeting. This means that, in seeking to authorise or otherwise restrict defensive measures in accordance with Article 9, regardless of any contractual or other restrictions on voting rights or whether some shares carry multiple-voting rights, all shareholders are to exercise one vote per share at the general meeting. Second, if following a bid, the offeror holds 75 per cent or more of the capital carrying voting rights, no restrictions on the transfer of shares or on

²¹⁵ Herein before referred to as the 'Winter report' – Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids (Brussels, 10 January 2002) 21.

²¹⁶ Winter Report (2002) 29.

voting rights nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided for in the articles of association of the offeree company shall apply. The effect of this provision is again that, all shareholders are to exercise one vote per share at the general meeting convened by a successful offeror in order to amend the articles of association or to remove or appoint board members.

The principle behind Article 11 is the realisation that, if restructuring of companies and capital markets are to be facilitated, entrenched company rights must give way. The principle is not novel in company law, but the Directive's approach is too radical. Company law in general has always sought to achieve a balance between the rights secured by shareholders as a reflection of their bargains, and the economical need to remove barriers that stifle the expansion of company business. Where rights are contained in the articles of association of the company, company law provides for a mechanism of altering the articles.²¹⁷ Where the rights are classified as class rights, which may include multiple-voting rights attached to particular shares, company law provides a particular mechanism for altering or removing such rights.²¹⁸ Minority shareholders who have certain rights entrenched in the articles of association, such as the right to appoint a director, are particularly protected in company law.²¹⁹ Where the rights cannot be altered or removed by other mechanisms company law provides a compromise arrangement that involves the holders of the rights and the courts.²²⁰ What the Directive requires in Article 11 is

²¹⁷ For instance, section 21 CA 2006 allows shareholders to alter provisions in the articles of association by passing a special resolution, that is, 75 per cent of the majority shareholders must agree to the alteration. The alteration, however, must be for the benefit of shareholders and not merely for the company as a legal entity – *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656; *Greenhalgh v Ardenne Cinemas Ltd* [1950] 2 All ER 1120.

²¹⁸ The procedure is laid down in section 630 CA 2006, which requires consent of at least 75 per cent of shareholders of a particular class affected.

²¹⁹ In *Cumbrian Newspapers Ltd v Cumberland & Westmoreland Printing Ltd* [1987] Ch 1 a minority shareholder holding only 10 per cent of the shares successfully claimed class rights, including the rights to appoint a director.

²²⁰ Section 895 CA 2006 provides a particular procedure that involves making compromises and arrangements. This broadly requires meetings of holders of the rights, and approval by the courts of the compromise reached with holders of those rights.

tantamount to a radical approach that cuts through and ignores the provisions of UK company law – an approach which UK participants are not accustomed to and would undoubtedly find hard to accept.

The rights attached to shares not only represent the financial interest of the shareholder in the company but also reflect investment bargains the shareholders made when they bought the shares, and, money being at stake, require protection. Unless the purported rights are mere privileges,²²¹ the holders are vested with expectations that their bargains will be protected. Where rights exist it is only fair that when such rights are to be removed, rather than simply rendering the rights ineffective, a fair mechanism is followed. Company law statutes provide a high level of protection of shareholder rights.²²² To match this protection closely, the Directive requires that shareholders, who suffer any loss as a result of having their rights removed or made ineffective, must be given an equitable compensation in accordance with the terms to be determined by national laws. To the extent of an equitable compensation being offered to shareholders, one would find the Directive striking the balance between on the one hand protecting the interests of shareholders, and on the other hand facilitating takeovers by removing structural barriers.

However, Article 11 is optional, such that Member States may choose not to apply it.²²³ Possibly, because of the perceived complication of the compensation requirement, the UK has opted not to apply the break-through

²²¹ For example, in a recent dispute adjudicated by the Takeover Appeal Board, the Eurotunnel plc 2007/2, the appellants, had relied heavily on the decision in *Cumbrian Newspaper Group Limited v Cumberland & West Moreland Herald Newspaper & Printing Co Ltd* [1987] Ch 1, claiming that their travel privileges were class rights entitling them to either receive a separate offer or their consent to be sought before those rights could be varied. The Takeover Appeal Board, chaired by Lord Steyn, found that there was no evidence that Eurotunnel intended to create a separate class of share through its travel privileges scheme, either through the prospectus or otherwise, and that no rights attaching to the shares had been incorporated in the articles of association of the company which, if the intention was to create a separate class of shares, would normally be the case.

²²² A range of provisions is available to resolve issues affecting shares – the provisions include sections 21, 630 and 895 CA 2006, discussed above.

²²³ Article 12 of the Directive makes Article 11 (and Article 9) optional.

rule. As the UK has not opted in to Article 11 of the Directive, there is no direct rule in the Code dealing with the so-called break-through rule. Although the UK has opted out of this provision, nevertheless in implementing the Directive, the CA 2006 includes a right for any company to opt into the break-through provision of Article 11 pursuant to Article 12 of the Directive.²²⁴ Whether the UK will lose out for opting out of Article 11, or whether companies will gain anything for opting in, is questionable. In the UK, the dictates of the market for securities on a regulated market have reduced the number of companies with preferential share and voting structures that would be subject to a break-through rule – as a result, whether or not a company should opt in to Article 11 of the Directive is unlikely to be relevant in most cases.

At any rate, a UK company opting to opt in to Article 11 of the Directive is likely to face upheaval on the question of compensation.²²⁵ Possibly because Article 11 of the Directive is optional, and the UK has generally opted out, the issue of compensation is inadequately provided for in the CA 2006. It is not stated in the CA 2006 who is to pay, how much is to be paid, and how the courts are to determine or calculate the amount to be paid.²²⁶ In contrast, the Code levies the compensation and its determination on the offeror.²²⁷ The CA 2006 seem to suggest that compensation is determined by the courts, yet the

²²⁴ It is clear from the CA 2006 that Article 11 of the Directive is not to be applied in all cases of takeovers. In keeping with Article 12 of the Directive, sections 966 to 972 of the CA 2006 provide an option for listed companies to opt in to Article 11 should they wish to. These sections provide for conditions that have to be met if listed companies wish to opt in to Article 11 – broadly, a special resolution is required for both initial opting in and subsequent option out.

²²⁵ CA 2006, s 968.

²²⁶ Referring to removal of company restrictions pursuant to Article 11 of the Directive, for companies that have opted in, section 968(6) CA 2006 simply provides that, if a person suffers loss as a result of any act or omission that would (but for this section) be a breach of an agreement to which this section applies, he is entitled to compensation, of such amount as the court considers just and equitable, from any person who would (but for this section) be liable to him for committing or inducing the breach.

²²⁷ Rule 24.2(d)(xv) of the Code, 8th edition, 2005, requires the offeror to include in the offer document: the compensation (if any) offered for the removal of rights pursuant to Article 11 of the Directive together with particulars of the way in which the compensation is to be paid and the method employed in determining it.

Code seem to suggest that this is a matter for the offeror. Whichever interpretation is adopted, the effect of an offeror paying for compensation is to defeat incentives for investors, as it would increase the costs of takeovers and make takeovers unattractive. Moreover, a UK company that opts in has no reciprocity safety-net if faced by an offeror who does not apply Article 11 of the Directive – the alternative is to opt out again altogether. Why then would a UK company, well advised, be interested in opting in to Article 11 of the Directive in the first place?

3.4 Equal treatment of shareholders

Although the Directive adds nothing in the matter of shareholders' protection to what is already contained in the Code, even prior to the current version of the Code, the general statutory protection of shareholders is a progressive landmark in the UK. The Directive's addition is in the form of giving legal force to the provisions in the Code; prior to the Directive the Code had no legal force albeit fully complied with. At the heart of the objective of protecting shareholders is the principle of equal treatment of all shareholders. Company laws have come a long way in providing an effective protection of shareholder interests, especially minority shareholders. It is in this regard that the principle of equal treatment, being cemented in company law by the Directive, is a commendable progress in the UK.

From the common law perspective, shareholders have always had very little protection. First, shareholders do not manage the business of the company, it is the directors who do so.²²⁸ Secondly, the directors who manage the

²²⁸ Table A Regulations Article 70 (1985) provides: – 'Subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company. No alteration of the memorandum or articles and no such direction shall invalidate any prior act of the directors which would have been valid if that alteration had not been made or that direction had not been given. The powers given by this regulation shall not be limited by any special power given to the directors by the articles

company are not answerable to the shareholders but to the company itself.²²⁹ The traditional statutory power of the shareholders to manage the business of the company is to appoint and remove directors from office;²³⁰ even then, the practical dimension of this limited power lies with the majority shareholders in the general meeting, which leaves the minority less protected. In the landmark case of *Foss v Harbottle* (1843) common law showed that minority shareholders were less protected. Two points emerged in this case. First, where there is an alleged wrong on the company, the proper claimant is the company itself and not the aggrieved shareholder. Secondly, if the majority approved of the act of the directors, the minority shareholder could not be heard in court.

Gradually, this common law lack of adequate protection of minority shareholders changed. The courts have acknowledged the lack of protection given to minority shareholders. Indeed, in the words of Hoffmann:

... the emancipation of minority shareholders is a recent event in company law. For most of the twentieth century minority shareholders were virtually defenceless, kept in cowed submission by a fire-breathing and possibly multiple-headed dragon called *Foss v Harbottle*. Only in exceptional cases could they claim protection of the court. ... A statutory remedy was provided for the first time in 1948 but this proved relatively ineffectual. It was not until 1980 that Parliament forged the sword ... section 459 of the CA 1985 and which enables the unfairly treated minority shareholder to slay the dragon'.²³¹

and a meeting of directors at which a quorum is present may exercise all powers exercisable by the directors'.

²²⁹ Directors do not, in general, owe any contractual or fiduciary duty to shareholders; see *Percival v Wright* [1902] 2 Ch 421.

²³⁰ Shareholders can remove directors from office – (see section 168 CA 2006) – A company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in its articles or in any agreement between it and him.

²³¹ Robin Hollington, *Minority Shareholder's Rights* (Sweet & Maxwell, London 1999) Foreword [a 'Foreword' by Lord Hoffmann].

Whereas the CA 1985 offered some protection to minority shareholders, by virtue of section 459, now section 994 CA 2006, this has not been without its shortfalls. The principles of common law have time and again led the interpretation of section 994 to the extent that the majority of minority shareholders are looked upon to decide the fate of a minority within a minority.²³² It is perhaps due to the weakness of the common law that shareholder protection became the iconic theme of the self-regulated takeover industry, with the emergence of the Code in 1968. The Code introduced rules including the mandatory bid rule: requiring that an acquirer who accumulated 30 per cent or more of the target company's shares to tender for all the shares at the same price has paid for the shares already acquired. The underlying objective is to prevent the transfer of effective control through selective acquisitions at inflated prices without offering the same terms to all shareholders.²³³ The Directive introduces nothing novel but reaffirms the rules in the Code, and the principle of equality of treatment of all shareholders in regard to the process of a takeover.

The rules on equal treatment of shareholders are in keeping with the guiding principle developed by the Company Law Review Steering Group. The guiding principle is that company law should be primarily enabling or facilitative – which does not eliminate legal intervention – examples of which include the avoidance of substantial market failure, by providing mandatory provisions to protect shareholders.²³⁴ Section 943 of the CA 2006 enables the Panel to make rules required to implement the Directive, which includes rules

²³² In *Smith v Croft (No. 2)* [1987] 3 All ER 909, 942 (Knox J), the idea of paying regard to the views of an independent majority of shareholders within a minority shareholders who petition the courts in a derivative action was developed.

²³³ T Tridimas, 'Self-regulation and investor protection in the UK: the takeover panel and the market for corporate control' (1991) 10 CQJ 24, 32.

²³⁴ Modern Company Law for a Competitive Economy – Final Report (DTI, London July 2001) 5.

on equal treatment of shareholders. These rules are now contained in the Code.

As already stated, the main body of law implementing the Directive is contained in the Code. Under the Code, the principle of equal treatment for all shareholders has two limbs: equivalent offer value extended to all shareholders; and same information to be given to all shareholders. The rules on equivalent offer value are detailed and extensive enough to offer equal treatment to all shareholders.²³⁵ As to providing same information to all shareholders, the rules are equally comprehensive in order to accord equal treatment.²³⁶ The rationales of the Code are the equality of access to the market as between institutional investors and their private counterparts, the protection of the minority, and the prevention of the pressure to tender.²³⁷ To the extent of its comprehensiveness in regard to the rules, and in terms of achieving equal treatment of shareholders, the Code surpasses most regulatory rules elsewhere, including regulations in the USA,²³⁸ – and to that extent the Code imports nothing from the Directive.

²³⁵ The rules in the Code range from requiring comparable offers (rule 14); appropriate offer (rule 15); no special deals (rule 16); same price (rule 6.1); revised offer (rule 6.2); all entitled to revised offer (rule 32.3); if acquired by cash then extend cash offer to all (rule 11.1); to requiring that if shares are acquired by exchange of shares then the bidder must extend exchange of share offer to all shareholders (rule 11.2).

²³⁶ The rules in the Code range from requiring sufficient information dissemination by the boards – rule 23; timely information – rule 20.1; detailed financial information – rules 24 and 25; accurate information – rule 19.1; up to date information – rule 27.1; board to take responsibility for information – rule 19.2; to requiring of the giving of same information to competing offerors – rule 20.2.

²³⁷ Panel answers to DTI inquiry of July 1974, cited in MA Weinberg and MV Blank on *Takeovers and Mergers* (4th edn Sweet & Maxwell, London 1979) 569.

²³⁸ See DA DeMott, 'Current issues in tender offer regulation: lessons from the British' (1983) 58 NYUL Rev 945, 983-987.

3.5 *The mandatory bid principle*

3.5.1 The nature and effect of the rule

Article 5 of the Directive requires Member States to have a mandatory bid rule, the object of which is the protection of minority shareholders. This requires that where a natural or legal person, as a result of his own acquisition or the acquisition by persons acting in concert with him, holds securities of a company which, added to any existing holdings of those securities of his and the holdings of those securities of persons acting in concert with him, directly or indirectly give him a specified percentage of voting rights in that company, giving him control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. In the UK, this is implemented by section 943 of the CA 2006, which essentially gives effect to the relevant rules of the Code. On reaching a 30 per cent of voting shares, a mandatory rule is triggered under the Code. The Directive itself does not define the threshold at which a mandatory rule is triggered. By not providing a percentage of voting rights above which control has been acquired to trigger a mandatory bid requirement, the Directive defeats its harmonising objective.

Rule 9 of the Code provides for a mandatory rule. This requires that: (a) any person who acquires, whether by a series of transactions over a period of time or not, an interest in shares which (taken together with shares in which persons acting in concert with him are interested) carry 30 per cent or more of the voting rights of a company; or (b) any person, together with persons acting in concert with him, is interested in shares which in the aggregate carry not less than 30 per cent of the voting rights of a company but does not hold shares carrying more than 50 per cent of such voting rights and such person, or any person acting in concert with him, acquires an interest in any other shares which increases the percentage of shares carrying voting rights in which he is interested, such person shall extend offers to the holders of any class of equity share capital whether voting or non-voting and also to the holders of any other class of transferable securities carrying voting rights. Offers for different

classes of equity share capital must be comparable; the Panel should be consulted in advance in such cases. An offer will not be required under this Rule where control of the offeree company is acquired as a result of a voluntary offer made in accordance with the Code to all the holders of voting equity share capital and other transferable securities carrying voting rights.

The mandatory bid rule aims at: (1) preventing clusters of share purchases that would transfer control in the target company thereby locking in shareholders without being offered an opportunity to decide on such control; and (2) preventing the offering of different levels of share prices without extending the same price to all shareholders. Article 5 of the Directive requires an equitable price to be extended to all remaining shareholders, which is determined by reference to the highest price paid in the previous 12 months. In suggesting an equitable price criterion, the Winter Report sought to avoid a litigation culture where issues on price would be determined by the courts. In particular, the Winter Report was of the view that it is not desirable that such a question – which will arise in the midst of a complex transaction where time is of the essence and where the issue will depend very much on particular circumstances if it is left undefined – should be determined by long drawn out court proceedings.²³⁹ Thus, if the criterion is so set, national regulators will be able to determine the equitable price to be paid and participants will not need to refer the case to the European Court of Justice to determine an equitable price under the Directive.

Further, in recommending this criterion, the Winter Report sought to enable efficient functioning of capital markets in the EU by providing a sufficient degree of predictability as to the consideration to be offered in a mandatory bid.²⁴⁰ By means of this criterion, an offeror is able to predict how much he will pay for the shares, and the shareholders are able to predict how much to expect. Thus, on one hand the rule prevents arbitrary control in the company against interests of other investors, and on the other hand it prevents unfair

²³⁹ Winter Report (2002) 48.

²⁴⁰ Winter Report (2002) 49.

treatment of shareholders. If arbitrary control is not prevented, such control would make the holding of shares in the company unattractive for the other shareholders who denied an opportunity to assess whether to remain holding shares in the company or to sell off their shares.

However, the very rule is capable of escalating arbitrary control, as uncertainty increases when shareholders are lured by the offer and many shareholders give in rendering the others minority and making shareholding for such minority less attractive. An investor who may only want to raise his portfolio to say 35 per cent, leaving other shareholders in investment, is forced by the rule to bid for all remaining shares, causing a panic of sale by other shareholders who otherwise would have lived with a 35 per cent majority shareholder. It is, however, difficult to see a better way than by a mandatory rule regulation. If it is left to the market forces of demand and supply, minority shareholders may not even have the remedy of selling their shares at a fair price. But a point not to be ignored is the effect of acceleration of arbitrary control in the company causing a squeeze out of the minority, who may not have the means to invest elsewhere, thereby destabilising minority investment portfolios.

The mandatory rule also has the potential of limiting investment growth to 29.9 percent, as beyond that point, an investor must make a mandatory bid to all the shares. Thus, small stake investors cannot invest beyond 29.9 per cent unless they have enough capital to own all the shares in a company. Other than a condition of obtaining 50 per cent or more acceptances, rule 13 of the Code limits an investor's ability to attach conditions to the offer. Thus, if an investor cannot comply with all the requirements, his option only lies in maintaining a low share portfolio capped at 29.9 per cent and to sell his shares to a majority and wealthier bidder.

Whether a mandatory rule is justified in legal terms is another matter. Enriques argues that, whilst well-identified interest groups will gain from an EC mandatory bid rule provision, the rule have no legal justification in terms of equal treatment. Enriques argues:

... some it cannot be viewed as an application of the general principle that companies have a duty of equal treatment of shareholders, because in our setting the ‘relationship between the shareholders horizontally’ is involved, and European company laws have no principle imposing equal treatment horizontally.²⁴¹

This is arguably an example of how takeover rules have the effect of altering the understanding of mainstream company laws. The alternative way of looking at this point is to view takeover rules as not imposing the equal treatment duty on companies but rather on investors or bidders (whether legal persons or natural persons). In such an alternative view, a mandatory bid has legal justification by way of equal treatment under capital markets generally beyond a narrow understanding of company laws. But even under company laws, the duty is legally justified as our company laws do not particularly address the question of duties owed by investors or bidders to shareholders.

3.5.2 Progressive application of the mandatory rule

Under the so-called self-regulation, the Panel in general applied the mandatory rule, and the rules in a flexible manner. There is a need to define in practical terms what is meant by the flexibility of the Panel. A good example is given by Tridimas,²⁴² where the Panel created an exception around its mandatory requirement rule. Following the October 1987 stock market crash and the failure of the British Petroleum privatisation, the Bank of England offered to repurchase British Petroleum’s partly paid shares from private investors. This had the effect of putting the shareholding of the Bank of England to 36 per cent, which in accordance with the Code would have required the Bank of England to make a mandatory offer to all investors. Because of the flexibility of the Panel, the Panel agreed that, if the bank of England were to purchase the shares and thereby reach a 36 per cent stake, it would not be required to make a

²⁴¹ Enriques, ‘The Mandatory Bid Rule in the Proposed EC Takeover Directive: Harmonization as Rent-Seeking?’ In Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 767, 790.

mandatory offer, provided the Bank of England agreed to vote only 29.9 per cent of its shareholding. It is this kind of flexibility that was lost when the Panel transformed from self-regulator to statutory regulator. However, this so-called flexibility is capable of rendering takeover rules uncertain. To avert this uncertainty, whilst the Panel may change the rules in the Code, section 944 of the CA 2006 now requires that the Panel publishes such changes first. As such, the flexibility that would allow the Panel to suddenly change the rules, thereby causing uncertainty, has been limited.

Like any other rule there are often parties who would seek to evade the rules through some loophole. The mandatory rule requires that the same price paid to shares within the last 12 months be offered to all the remaining shares. The offeror includes all concerted parties – these being parties that collude to buy shares or that may later hold shares in common. In *Gilgate Holdings Ltd*,²⁴³ a number of parties bought shares in a manner that was against the spirit of the rule, and yet they were not found to be in breach of the rule. These parties bought 29 per cent of the shares at 22.5 pence per share, and after 12 months plus one day they bought more shares equivalent to 7 per cent at only 8.75 pence per share. This meant that enforcing the mandatory bid required the concerted parties to offer to pay only 8.75 pence per share; being the highest price they had paid for shares in the last 12 months. This loophole is not covered by the Code in its present form and is not covered by the Directive as implemented by the CA 2006.

Another way that parties may seek to avoid triggering a mandatory rule is to use other parties to acquire shares. The terminology used to refer to such other parties is parties acting in concert. A definition of persons acting in concert is given in the Code. The definition is wide enough to cover general behaviours parties may develop to avoid the scourge of a mandatory rule. Persons acting in concert comprise of persons who, pursuant to an agreement or

²⁴² T Tridimas, 'Self-regulation and investor protection' (1991) 10 CJK 24, 30.

²⁴³ < <http://www.thetakeoverpanel.org.uk/new/statements/DATA/1980/1980-01.pdf> > Panel Statement (14th March 1980) accessed 20 July 2006.

understanding (whether formal or informal), co-operate to obtain or consolidate control of a company or to frustrate the successful outcome of an offer for a company. Under the Code, the definition of persons acting in concert presumes certain persons to be acting in concert,²⁴⁴ the effect of which is to close this loophole, making the mandatory rule effective.

3.5.3 Economic reasoning on equal treatment

There is an argument that it is wasteful to regulate takeover activities if only to achieve equal treatment of shareholders by way of a mandatory rule. Easterbrook and Fischel argue that shareholders need not be treated equally in particular takeover transaction, because, by diversifying their investment portfolios, investors may protect against the risk of consistently falling on the losing side of unequal treatment.²⁴⁵ The authors argue that if the market can even out apparent inequality in this way, the costs of unneeded regulation to promote equality might well be thought socially wasteful.²⁴⁶

However, DeMott,²⁴⁷ in response to this market argument, finds that the total portfolios of most individual investors are so small that they are unlikely to achieve adequate diversification through direct investment in shares and that

²⁴⁴ Under 'Definitions' of the Code, persons presumed to be persons acting in concert with other persons include:— (1) A company, its parent, subsidiaries and fellow subsidiaries, and their associated companies, and companies of which such companies are associated companies, all with each other (for this purpose ownership or control of 20% or more of the equity share capital of a company is regarded as the test of associated company status); (2) A company with any of its directors (together with their close relatives and related trusts); (3) A company with any of its pension funds and the pension funds of any company covered in (1); (4) A fund manager (including an exempt fund manager) with any investment company, unit trust or other person whose investments such fund manager manages on a discretionary basis, in respect of the relevant investment accounts; (5) A connected adviser with its client and, if its client is acting in concert with an offeror or with the offeree company, with that offeror or with that offeree company respectively, in each case in respect of the interests in shares of that adviser and persons controlling, controlled by or under the same control as that adviser (except in the capacity of an exempt fund manager or an exempt principal trader); and (6) Directors of a company which is subject to an offer or where the directors have reason to believe a bona fide offer for their company may be imminent.

²⁴⁵ Easterbrook and Fischel, 'Corporate control transactions' (1982) 91 Yale LJ 698, 712-714.

²⁴⁶ Easterbrook and Fischel, 'Corporate control transactions' (1982) 91 Yale LJ 698, 708-711.

²⁴⁷ DeMott, 'Current issues in tender offer regulation: lessons from the British' (1983) 58 NYUL Rev 945, 983.

adequate diversification is difficult to achieve in the light of the difficulty of determining in advance what investments might be subject to some degree of unequal treatment in an acquisition transaction. Thus, a legal response by way of the Directive that affirms the long-standing principle of the Code should be seen as the most appropriate protection of shareholders' interests.

3.6 *Squeeze-out and sell-out*

The notion of a squeeze-out refers to the right of a majority shareholder to buy out a minority shareholder, and the notion of a sell-out refers to the right of a minority shareholder to sell to a majority shareholder. Anticipating an increased post-takeover share value, shareholders may hold out during the bid, and hope to sell at a later stage, creating the free rider problem. The squeeze-out allows the bidder to overcome the free rider problem.²⁴⁸ These rights are contained in Articles 15 and 16 of the Directive, which were a result of the recommendations of the Winter Report. Article 15 deals with the squeeze-out right and Article 16 deals with the sell-out right. These rights have long existed under UK company laws, specifically, they were provided for under Part 13A of the CA 1985. The implementation of Articles 15 and 16 under the CA 2006 simply restates with minor changes the provisions under Part 13A.²⁴⁹ However, the acceptance of the squeeze-out right in company law is in effect a promotion of capitalism at the cost of protection of minority shareholders where such minority does not wish to give up his shareholding. It is a naïve law's response to commercial demands and reality.

Articles 15 and 16 of the Directive were adopted from the recommendations of the Winter Report.²⁵⁰ The Winter Report found that both the squeeze-out right and the sell-out right, prior to the Directive, were not regulated at

²⁴⁸ M Burkart and F Panunzi, 'Mandatory bids, squeeze-out and the dynamics of the tender offer process' in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 737, 793.

²⁴⁹ Sections 974 to 991 CA 2006 restate provisions in Part 13A of the CA 1985, incorporating recommendations of the Company Law Review 2001, and in line with the Directive.

European Union level. The Winter Report also found that these rights existed in most Member States but were applied with greater diversity. There was therefore a need to regulate and harmonise these rights at European Union level. In the light of the greater diversity of squeeze-out and sell-out regimes in different Member States, the Winter Report recommended that Member States should have the possibility to set the threshold for triggering the squeeze-out right either by reference to the capital (between 90% and 95%) or by reference to the number of acceptances in the offer (at 90%). A threshold for a sell-out right was also recommended to be determined by reference to the capital (between 90% and 95%). Further, where there are several classes of securities outstanding, the Winter Report recommended that the rights (squeeze-out and sell-out) should apply on a class-by-class basis. The provisions contained in Articles 15 and 16 of the Directive largely adopt the recommendations in the Winter Report.

At common law, a company that made an offer for another company's shares had no power to compel any shareholder to part with his holding against his will. This common law position changed with the enactment of the Companies Act 1928.²⁵¹ Subsequently over the years the right of squeeze-out, together with the right of sell-out, were fully cemented in company law, under Part 13A of the CA 1985. A restatement of these rights, taking into account the recommendations of the Company Law Review,²⁵² and for the purpose of implementing the Directive, are now contained in sections 974 and 991 of the CA 2006.

Paradoxically, it is at the heart of the Directive to provide protection to minority shareholders, yet for the wider public interests in seeking to keep bids more attractive for potential bidders, property rights of minority shareholders

²⁵⁰ The Winter Report (2002) 67-68.

²⁵¹ This was followed by the Companies Act 1948 of which section 209 imposed an equivalent of a squeeze-out right by which a minority shareholder was compelled to sell his shares to a successful bidder who became a majority shareholder: see also *Re Castner-Kellner Alkali Co Ltd* [1930] 2 Ch 349; and *Re Hoare & Co Ltd* [1933] All ER Rep 105.

are rendered obsolete. The Winter Report considered this enigma and concluded that, so long as the squeeze-out right applies only when the minority is fairly small and appropriate compensation is offered, the use of squeeze-out to address these public interests is appropriate. The Company Law Review Steering Group saw the minority's plight as follows:

A minority shareholder, without control over the company, and most probably without any ready yardstick against which to measure the value of his shares, the strength of his bargaining position is in any event based solely on *his ability to refuse to sell*. We do not think that it would be possible to devise ... sufficient safeguards to protect a minority shareholder's interests, to justify depriving him of the one card of value he retains in his hand.²⁵³

It is a pity that the Company Law Review Steering Group, as well, recognised the infringement of property rights that a compulsory squeeze-out creates, and could only empathise with the plight of minority shareholders. Although squeeze-out rights have long been accepted as part of company law in the UK, it does not seem right that a shareholder should be compelled to sell his shares, rendering shareholding an illusory right.

If the bidder who has either acquired, or contracted to acquire, 90 per cent or more of the shares carrying voting rights in a given class of shares, wishes to acquire the remaining shares in the target company, he may give notice of his intention and require the holders of the remaining shares to sell those shares to him. This notice must be given to the minority shareholder within three months of the bidder acquiring the threshold shares.²⁵⁴ It would appear that, the mere fact that the minority shareholder does not wish to sell his shares is no ground for defeating a compulsory purchase of his shares. The courts have,

²⁵² See Modern Company Law for a Competitive Economy – Final Report (DTI, London July 2001) 292.

²⁵³ Modern Company Law for a Competitive Economy – Final Report (DTI, 2001) 283 – *emphasis added*.

²⁵⁴ Article 15.4 of the Directive.

under the old statutory regimes, only looked at applications resisting compulsory purchase if founded on grounds that the offer was unfair; but even then the courts have not favoured such applications.²⁵⁵ Moreover, the onus is on the minority shareholder to prove that the offer was unfair.²⁵⁶ The test of fairness is not on whether it is fair for a minority's property rights and liberties of investment to be removed, but on whether the price offered to the minority shareholder in return is a commercially acceptable offer price. However, the compulsory purchase is only restricted to takeovers.²⁵⁷ Thus, fairness in takeovers is all about economics, not law; and the law's intervention is only an economical dimension applied to maintain commercial usage.

Although the Winter Report found that the ability of one party to enforce the acquisition of the shares of another represents a significant infringement of the latter's vested property rights, it felt that there was a justification for such infringement. The Winter Report found that various courts in the Member States had ruled that the squeeze-out right was not to be regarded as incompatible with property rights, as the squeeze-out right is not exercised to satisfy private interests only but public interests. The Winter Report argued that without a squeeze-out right, takeover bids are less attractive to potential bidders – because of the costs and risks relating to the existence of minority shareholders after the bid. The Winter Report was of the view that it is in the public interest to have companies efficiently managed on the one hand, and securities markets sufficiently liquid on the other hand. And that, so long as the squeeze-out right applies only when the minority is fairly small and appropriate compensation is offered, the use of squeeze-out to address these

²⁵⁵ In *Re Bugle Press Ltd* [1961] Ch 270, 276-277 Buckley J said: 'In the ordinary case of an offer under this section [s 430C Companies Act 1985], where the 90 per cent majority who accept the offer are unconnected with the persons who are concerned with making the offer, the court pays the greatest attention to the views of that majority. In all commercial matters, where commercial people are much better able to judge of their own affairs than the court is able to do, the court is accustomed to pay the greatest attention to what commercial people who are concerned with the transaction in fact decide'.

²⁵⁶ *Re Gierson, Oldham and Adams Ltd* [1968] Ch 17.

²⁵⁷ *Re Bugle Press Ltd* [1961] Ch 270.

public interests is proportionate.²⁵⁸ It is difficult to see how forcing a minority shareholder out of the company against his will thereby creating concentrated share ownership makes takeovers attractive to potential future bidders.

Take for example, a company that started off as a one-man private company, increased its value over the years and changed to a public company, then listed to trade its shares on a regulated market. A takeover bidder comes along and acquires 90 per cent of the shares. A minority shareholder and founder of the company wishes to retain his investment in the company for his retirement income; he pleads to the law for his vested interests. In response, the law is only concerned with whether a fair price has been offered to him. It is a naïve legal response to commercial demands and reality. If that were the law's response in protecting the vested interests of this minority shareholder, he would be horrified at the manner of protection accorded to him. In the end, the acceptance of the squeeze-out right in company law is in effect a promotion of capitalism at the expense of protecting minority shareholders who may not wish to give up their vested shareholding.

Moreover, if the shareholder being squeezed out should sacrifice his property interests for the public good to make takeovers attractive to future bidders, it is difficult to see how that rationale is justified. The bidder will in turn hold 100 per cent shares, turning the share structure of the company into a concentrated ownership, which makes it the more difficult for future bidders. According to Ferrell, in concentrated share ownership, especially if shares are vested in a single shareholder after a bid, 'an acquisition will only occur when – and only when – the controller consents or has somehow lost control'²⁵⁹ – hence, favouring a bidder to squeeze-out a minority does not attract future bidders but rather repels them. Most of continental Europe has for a long time had a concentrated share ownership structure, and so no wonder many EU Member States found the squeeze-out right favourable.

²⁵⁸ See the Winter Report (2002) 61-62.

²⁵⁹ Allen Ferrell, 'Why Continental European Takeover Law Matters' In: Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 561, 562.

Rather than the law's naïve response to the plight of minority shareholder in whom there is no interest to sell his shares, a principle prohibiting prejudicial conduct of a shareholder, should be developed. Under this suggested principle, the conduct of a shareholder should not prejudice the interests of the company. Lord Evershed MR said that a minority shareholder should only be squeezed-out if 'the minority shareholder was in some way acting in a manner destructive or highly damaging to the interests of the company from some motives entirely of his own'.²⁶⁰ In assessing a shareholder's conduct, the test should be subjective and regard should only be had to the personal conduct of the shareholder in question. Nothing in the Directive precludes developing a measure applying the squeeze-out right in the manner suggested. The courts of equity would be accustomed with this body of principles. The suggested principle appears unlikely to be adopted in the present climate of opinion.²⁶¹

3.7 Conclusion

A major task in the Directive is to strike a balance between on the one hand the objective of protecting the interests of minority shareholders, and on the other hand the objective of facilitating cross-border takeover activities. Both Articles 9 and 11 of the Directive were meant to serve these dual conflicting objectives of takeover regulation. National and political interests seem to have led to a compromise that has optimised these provisions. As such, shareholder protection remains in conflict with the need to facilitate investment through unrestricted takeover activities. Whilst the UK has opted to apply Article 9, as it always has done, many other Member States are likely to opt out of Article 9, as they always have done. The likely result is a weak facilitation of cross-border takeover activities. However, the principles of equal treatment of

²⁶⁰ *Re Bugle Press Ltd* [1960] 3 All ER 791, 796 (Lord Evershed MR) – the ratio in this case was that a determination of improper use of a squeeze-out right and not how the right should be applied, which is the argument here.

²⁶¹ For detailed analysis of the squeeze-out right, see: B Hannigan, 'Altering the articles to allow for compulsory transfer - dragging minority shareholders to a reluctant exit' (2007) JBL 471.

shareholders and the mandatory bid rule, to an extent, promote the protection of shareholder interests.

The protection accorded to minority shareholders at common law has always been very weak. Takeover regulations, predating the Directive, have sought to vest decision-making powers in the hands of shareholders in a takeover situation. Article 9 of the Directive furthers this by seeking to promote shareholder supremacy. With all the difficulties for aggrieved minority shareholders in litigating against directors, the answer lies in promoting shareholder supremacy. Regrettably, the Directive makes Article 9 optional, such that Member States are free to allow management to make the ultimate decision – even to prevent a bid. If power to decide the outcome of a takeover bid is left in the hands of directors, who are often sophisticated professionals keen to promote the interest of the company but only if that does not endanger their existence and interest, minority shareholder protection, at least in Member States that opt-out of Article 9, remains a myth.

The mandatory rule contained in Article 5 of the Directive has always been a feature of the Code. Much as it is meant to prevent arbitrary control if bidders would freely buy shares, the rule is arguably capable of escalating arbitrary control. An investor who may only want to raise his portfolio to, say, 35 per cent, leaving other shareholders in investment, is forced by the rule to bid for all remaining shares, causing a panic of sale by other shareholders who otherwise would have lived with a 35 per cent majority shareholder. The mandatory rule has the effect of accelerating arbitrary control in the company causing a squeeze-out of the minority, who may not have the means to invest elsewhere, thereby destabilising minority investment portfolios.

Where a minority shareholder is squeezed-out, the bidder will in turn hold 100 per cent shares, turning the share structure of the company into a concentrated ownership, which makes it more difficult for future bidders. In concentrated share ownership, especially if shares are vested in a single shareholder after a bid, acquisition of shares depend on either the controller's consent or his loss of control. Hence, contrary to the Winter Report, favouring

a bidder to squeeze-out a minority does not attract future bidders but rather repels them. It is, however, difficult to see a better way than by a mandatory rule and squeeze-out regulation. If it is left to the market forces of demand and supply, minority shareholders may not have even the remedy of selling their shares at a fair price.

Notwithstanding concerns about the optional nature of Articles 9 and 11, and the harsh effect of the squeeze-out provision, the Directive, as implemented by the rules contained in the Code, offers a greater protection to shareholders than accorded by mainstream company law. Although the Directive adds nothing in the matter of shareholders' protection to what is already contained in the Code, even prior to the current version of the Code, it is through the Directive that the Code acquired legal force, and to that extent, the general statutory protection of shareholders is a progressive landmark in the UK in regard to takeovers.

Chapter 4: Directors' Duties and Takeover Regulation

4.1 Introduction

This chapter deals with the question of how directors' duties, as currently understood in company law, are affected by the relevant provisions of the European Community Directive on Takeover Bids (the 'Directive'),²⁶² as implemented by the Companies Act 2006 (the 'CA').²⁶³ The chapter looks at the disclosure obligations under the Directive, the obligations to shareholders and to employees. Then it assesses whether these obligations are to be understood as extending the traditional duties of directors owed to the company. It also sets out the theoretical framework to deal with the problem of the conflict of interest in respect to directors' decision-making during takeover bids.

A major part of this chapter is devoted to analysing how directors' duties affect transactions in takeovers. Directors' duties have traditionally been laid down under common law, now codified under Part 10 of the CA 2006. Traditionally, directors' duties are enforced by the company itself – through the directors as agents of the company or through a collective action of the shareholders on behalf of the company under the so-called derivative action – this remains the case, albeit that the derivative action itself is now codified as well.²⁶⁴

The 'codified' duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.²⁶⁵

²⁶² Directive 2004/25/EC [2004] OJ L142/12.

²⁶³ Part 28 of the CA 2006 deals with takeovers, brought into force on 6th April 2007 by Statutory Instrument 2007/1093 The Companies Act 2006 (Commencement No 2, Consequential Amendments, Transitional Provisions and Savings) Order 2007 – replaced the interim regulations, The Takeovers Directive (Interim Implementation) Regulations 2006 – Regulations had come into force on 20 May 2006 for the purpose of implementing the Takeover Directive, awaiting enactment of the CA 2006.

²⁶⁴ Part 11 of the CA 2006 deals with the derivative action.

²⁶⁵ See CA, 2006 s 170(3).

Section 170(4) of the CA 2006 requires these duties to be interpreted and applied in the same way as common law rules or equitable principles, and that regard must be had to the corresponding common law rules and equitable principles in interpreting and applying the codified general duties.

As such, it is still the law that fiduciary duties are owed to the company, and only owed to shareholders if a special factual relationship between the directors and the shareholders is established in a particular case.²⁶⁶ The analysis in this chapter seeks to highlight such special factual relationship in takeovers. A close evaluation of the general duties reveals that these corporate law duties do not sit properly with specific duties under takeover rules contained in City Code on Mergers and Takeovers (the 'Code'). The CA 2006 codifies directors' duties at the same time when it codifies the rules in the Code. This chapter examines the likely conflict created by this dual codification of directors' duties and the Code, and suggests that directors' duties during takeovers should be treated as *sui generis* in order to align the Code with corporate law.

4.2 Holding directors accountable for breach of duty

4.2.1 Holding directors accountable in general company law

The most efficient way of ensuring directors promote the interest of the company is to have their interests aligned with the interests of the company as a whole. One way of aligning management interests with those of shareholders is by holding directors accountable to shareholders for a breach of their duty. Unfortunately, until a company is in liquidation, or a successful takeover bid ensues, it is almost impossible for shareholders to maintain an action for breach of duty against directors. Even then, either the liquidator is interested in bringing an action against the directors, or the majority, having elected a

²⁶⁶ *Peskin v Anderson* [2001] BCC 874, CA.

new board of directors after a successful takeover, are willing to maintain an action against the old board.²⁶⁷

That the control of day-to-day management of the company is solely in the hands of directors, whose appointment and removal follow a particular form, makes it difficult for shareholders to hold directors accountable. Initial appointment of directors is usually on the formation of the company,²⁶⁸ and the law requires every company to have directors;²⁶⁹ shareholders have little choice in this process. Once the company is formed, the general and day-to-day management of affairs of the company is vested in the directors;²⁷⁰ shareholders begin losing control. Although a company has two main organs – the shareholders in general meeting, and the board of directors – the first organ has little influence on day-to-day management. The shareholders in a general meeting have no power to give instructions or directions to the board of directors on matters of day-to-day management, and nor can the shareholders overrule the business decisions of directors, unless the directors are acting contrary to statute or the memorandum or articles.²⁷¹ However, the shareholders in a general meeting can remove a director (or all of the directors) by an ordinary resolution,²⁷² and they retain ultimate strategic control by virtue of their ability to alter the articles by which mechanism they can (for example) restrict the future powers of the directors.²⁷³ In theory, shareholders may remove and replace directors who manage the affairs of the company in a manner that does not add value to shares. In practice, the cost of removing

²⁶⁷ See *Regal (Hastings) Ltd V Gulliver* [1942] 1 All ER 378.

²⁶⁸ See CA 2006, s 12.

²⁶⁹ See CA 2006, s 154.

²⁷⁰ *Automatic Self Cleansing Filter Syndicate Co Ltd v Cunningham* [1906] 2 Ch 34; Regulation 70 of Table A of 1985 Model Articles of Association, as amended by Statutory Instruments 2007/2541 and 2007/2826 The Companies (Table A to F) (Amendment) Regulations 2007 – Minor amendments were made to bring the 1985 version of Model Articles in line with provisions of the Companies Act 2006.

²⁷¹ See *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34; *Salmon v Quin and Axtens Ltd* [1909] AC 442; *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC 100; *Rose v McGivern* [1998] 2 BCLC 593.

²⁷² See CA 2006, s 168.

directors and replacing them may not serve the collective interests of shareholders.²⁷⁴

The complexity of ownership in a company further makes it difficult for shareholders to maintain an action against directors. Shareholders own the shares in a company, but do not own the company itself.²⁷⁵ Directors are appointed by shareholders, but owe their duties only to the company and not to shareholders.²⁷⁶ If there is any breach of duty by the directors, shareholders may have no direct cause of action against directors. Moreover, the duty of care and skill owed by directors has not always been onerous; a director was required at common law to take such care in the performance of his duties as an ordinary man might be expected to take on his own behalf.²⁷⁷ Whilst section 214 of the Insolvency Act 1986 imposes the risk of liability to directors, there is no strict duty on a director to ensure that the company does not trade at a loss.²⁷⁸ In investing into company shares, a shareholder 'takes the risk that management may prove not to be of the highest quality', and 'there is prima facie no unfairness to a shareholder in the quality of the management turning out to be poor'.²⁷⁹

In such a relaxed atmosphere, if directors cause any wrong to be done on the company, say a wrong causing financial loss on the company, shareholders cannot sue – the company alone can sue, through its directors.²⁸⁰ The shareholders can only sue if they can establish a personal claim, say a loss directly affecting their share value. However, a shareholder cannot recover a sum equal to the diminution in the market value of his shares, or equal to the

²⁷³ See CA 2006, s 21.

²⁷⁴ See CA 2006, 168(5) – removal of a director does not deprive him compensation or damages against the company.

²⁷⁵ See *Salomon v Salomon* [1897] AC 22; *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279, 288 (Farwell).

²⁷⁶ *Percival v Wright* [1902] 2 Ch 421.

²⁷⁷ *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498, 501-502.

²⁷⁸ *Secretary of State for trade and Industry v Taylor* [1997] 1 WLR 407, 414 (Chadwick J).

²⁷⁹ *Re Elgindata Ltd* [1991] BCLC 959.

diminution in dividend, because such a loss is merely a reflection of the loss suffered by the company.²⁸¹ With the power to initiate and control litigation for the wrongs done on the company vested in the directors, even when such wrongs directly affect the value of shares, and where the directors are the wrongdoers, it is fateful to shareholders' interests to leave decision-making entirely in the hands of directors.

The remedies available to shareholders aggrieved due to share value decline are not particularly explicit in the body of law and literature. The rule in *Foss v Harbottle* does not make the plight any easier. Most of the exceptions to the rule in *Foss v Harbottle* are not easily reconcilable with share value grievances in public companies, as the majority of case law concerns small and medium private companies. There are legal arrangements for removing directors and replacing them with a new board that would increase share value. However, there are insurmountable impediments ranging from costs of removing the old board, uncertainty about the proposed new board, to difficulties common in staggered board structures.²⁸² The so-called proxy battles are prevalent in the public companies. These battles are just too fierce for minority shareholders to fight. The practical remedy may well lie in shareholders simply selling their shares and investing elsewhere.

In public companies whose shares are traded on a regulated market, the shareholders' plight is more manageable but purely on economical terms. In dispersed ownership structures, directors still have almost total control of the company and their removal is difficult. In dispersed ownership companies, say where each shareholder holds 1 per cent of the shares, shareholders tend to have little economic incentive to bother removing directors. In such structures, shareholders do not have the time and the means to investigate directors' incompetence or bad dealings. If the shareholders have shares in say 80 listed

²⁸⁰ *Foss v Harbottle* (1843) 2 Hare 461.

²⁸¹ See *Prudential Assurance v Newman* [1982] 1 Ch 204 at 222-223; Jonathan Mukwiri, 'The no reflective loss principle' (2005) 26 Co Law 304.

²⁸² L A Bebchuk, 'The myth of the shareholder franchise' (2007) Virg LRev 101, 114-120.

companies holding 1 per cent shares in each, they are only concerned with the share value on the stock market, and if the other company's shares are not doing well, they tend to simply sell the shares and invest somewhere else. The disciplining of directors in dispersed structure also tends to be left to the forces of economics – where competitiveness in the market would force management to converge on good and reasonable management, thereby increasing share value. The argument here is that directors will very much avoid the lowering of share prices, as low share price on the market makes the company vulnerable to a hostile takeover bid, which, if successful, will usually result in the dismissal of the directors.

In general, company law does not explicitly provide remedies to shareholders where the affairs of the company are managed in a manner that causes loss in the form of share value or premium decline. The law's response to such problem has always been to give an exit strategy to a shareholder – a mechanism of selling shares at a fair price.²⁸³ To strengthen this exit strategy, the law now heavily regulates takeover activities, which gives a fair exit strategy to aggrieved shareholders. To the aggrieved shareholders takeovers will only serve the purpose of a regulated exit strategy, for 'while takeovers might serve an industrial restructuring purpose, they serve no function in disciplining management'.²⁸⁴ Whether or not threat of takeovers align management interests to those of shareholders, the more these interests are not aligned the easier takeovers are likely to succeed, giving a low cost exit strategy to minority shareholders. In the end, where the share value is declining due to the incompetence or otherwise of directors' dealings (a matter which may be difficult and costly to prove in court), minority shareholders have little legal redress but to sell their shares and invest elsewhere.

²⁸³ For example, a fair price following a successful petition under the unfair prejudice remedy – formerly s 210 CA 1948, then 459 CA 1985, and now s 994 CA 2006; see also *O'Neill v Phillips* [1999] 1 WLR 1092 for application of this remedy.

²⁸⁴ A Johnston, 'The European takeover directive: ruined by protectionism or respecting diversity' (2004) 25 Co Law 270, 275.

4.2.2 Holding directors accountable through derivative action

Part 11 of the CA 2006 puts in place a statutory mechanism for shareholders to bring a derivative action against directors for the wrongs against the company. A derivative claim under section 260(3) CA 2006 ‘may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company’; of which ‘cause of action may be against the director or another person (or both)’. Potentially, shareholders aggrieved with share value decline, may attempt bringing an action against directors for breach of duty to promote the success of the company (s 172).²⁸⁵ Whereas it may seem that this adds liability risk to directors, it is only a codification of the rules – derivative actions have long been established at common law. Whether the potential for extending directors’ exposure to risk will be realised will depend, to a large extent, on how the courts discharge the wide discretion entrusted to them.²⁸⁶ This is unlikely to open up floodgates, as the difficulties of effecting a derivative action will still remain.

Under the CA 2006, the courts will control a derivative claim – shareholders will have to apply to the court for permission, to determine a *prima facie* case before continuing a derivative claim.²⁸⁷ Under s 261(4) the court has discretion to grant permission, to refuse permission and dismiss the claim, or adjourn the proceedings and give such directions as it thinks fit.²⁸⁸ It will still be the case that minority shareholders are the more likely to bring a derivative action, as majority shareholders often get their way in the general meeting and have the ability to influence directors. That being the case, common law approach of having the derivative action supported by the

²⁸⁵ Section 172 is further discussed below at para 4.6.2.

²⁸⁶ Arad Reisberg, *Derivative Actions and Corporate Governance* (OUP, Oxford 2007), 160.

²⁸⁷ See CA 2006, ss 261, 262.

²⁸⁸ Arad Reisberg, *Derivative Actions and Corporate Governance* (OUP, Oxford 2007), 144.

independent majority within the minority might still be applicable.²⁸⁹ In addition, ‘the practicalities of financing shareholder litigation will remain a major obstacle’.²⁹⁰

It is therefore unlikely that codifying the derivative action will give shareholders an upper hand in enforcing directors’ duties. However, it may go far as sending warning signals to directors, which may have the effect of aligning their interests with those of shareholders in a manner that may resultantly increase shareholder value. The range of rules on takeovers and the policing of the Panel make it unlikely that shareholders affected by directors’ actions during a takeover bid, will need to invoke a derivative action.

4.3 *Disclosure obligations to the offeree/offenor*

To remedy the plight of shareholders, takeover regulation imposes an information disclosure duty on directors where a company is faced with a takeover bid. Shareholders looking for opportunities within the company to increase their shareholding or to purchase shares in other companies would need information on share structures and control prevailing at the time. Whereas aligning management interests with those of shareholders remains generally under-facilitated at law, the Directive facilitates this indirectly by requiring directors to provide relevant and timely information to all stakeholders. The same thinking has informed the review of company law, as it was observed that ‘shareholders need timely and high quality information to enable them to assess the performance of the company and the directors’ stewardship of the assets’.²⁹¹

Article 8 of the Directive contains a general disclosure obligation. This is implemented by section 943 of the CA 2006, which requires the Takeover

²⁸⁹ See CA 2006, s 263(4) – ‘In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter.’

²⁹⁰ Arad Reisberg, *Derivative Actions and Corporate Governance* (OUP, Oxford 2007), 166.

²⁹¹ Modern Company Law for a Competitive Economy – Final Report (DTI, 2001) 39.

Panel on Mergers and Takeovers (the “Panel”) to make rules in that regard. The rules so made are contained in Rules 24 and 25 of the Code. The extent of the obligation in the Code is similar to that required by the Directive. First, this requires that a bid is made public in such a way as to ensure market transparency and integrity for the securities affected by the bid, in particular in order to prevent the publication or dissemination of false or misleading information. Secondly, it requires that all relevant information be disclosed in such a manner as to ensure it is both readily and promptly available to the holders of securities and to employees, or to representatives of the employees.

Article 10 of the Directive contains a specific disclosure obligation. This is implemented by section 992 of the CA 2006, which amends Part 7 of the CA 1985. First, the obligation requires listed companies to publish detailed information on a number of matters such as capital structures, classes of shares and rights attached, any share transfer restrictions, and any employee share scheme. Secondly, the obligation requires that the information referred to above be published in the company’s annual report. Thirdly, the obligation requires that the board present an explanatory report to the annual general meeting of shareholders on the matters published in the annual report.

It will continue to be the case that directors are liable to a fine if they fail to include in the annual report, either the detailed information concerning control and share structures, or explanatory material.²⁹² Further, amendments to this obligation can be made by secondary legislation or by further regulation, possibly making stringent requirements for directors to explain in plain English what the share structures and controls are in the company.²⁹³

Whilst the disclosure obligation under Article 10 of the Directive may seem onerous, in practice this may not be the case. The information required is to be contained in an annual report, probably given at the end of each financial year. Moreover, UK listing companies are accustomed to this obligation. In fact, the

²⁹² See CA 2006, s 415.

²⁹³ Part 15 of the CA 2006 gives amending powers to the Secretary of State to make future regulations concerning the contents of the annual reports.

obligation is a continuing obligation under the Listing Rules issued by the FSA. The need for continuing obligations arises almost innately out of the need for the law to protect modern shareholders against possible malpractice by their company's directors.²⁹⁴ Where there is a likelihood of a takeover, the continuing obligation ensures that such information reaches the shareholders in a timely manner. Coupled with the requirements under Rule 23 of the Code, the disclosure obligation does not *per se* align management interests to those of shareholders but provides the vital information that shareholders need to exercise their power of decision-making on whether to sell their shares and invest elsewhere or to resist a takeover bid.

The disclosure obligation not only falls on directors but also on shareholders. By virtue of section 793 of the CA 2006, the company can require any shareholder, or suspected shareholder, to disclose the extent, if any, of its beneficial ownership of the company's shares. Directors may actively engage in issuing section 793 notices to suspected empire builders and take actions that would not be caught by Article 9 of the Directive.²⁹⁵ That section 793 runs along side with rule 21 of the Code is an indication that the rules against defensive tactics are effective enough to allow directors not to be caught by surprise by a bidder who comes as a result of systematic empire building – although the mandatory bid rule would preclude empire building.

4.4 Duties to shareholders, employees and investors

4.4.1 Duties to shareholders

The relationship between directors and the company is on the one hand analogous to that of a trustee expected to keep custody of company assets,²⁹⁶

²⁹⁴ See O Omoyele, 'Disclosure, financial misconduct and listed companies: a critical analysis of the UKLA's continuing obligations regime' (2005) JFC 310.

²⁹⁵ Article 9 of the Directive – precludes directors from frustrating a takeover bid without authorisation from the general body of shareholders – similar to Rule 21 of the Code.

²⁹⁶ See *Re Lands Allotment Co* [1884] 1 Ch 616, 631 (Lindley LJ).

and on the other hand analogous to ‘a dynamic entrepreneur whose job it is to take risks with the subscribed capital and multiply the shareholders’ investment’.²⁹⁷ Directors’ duties broadly fall into two categories: fiduciary duties,²⁹⁸ and common law duties of care and skill.²⁹⁹ These duties are primarily owed to the company.³⁰⁰ This stems from the idea that the company is a separate entity from its shareholders. However, ‘the view that a company can have separate and distinct interest in a given project, an interest which is independent of the interests of its human constituents and players, is in reality, somewhat of a myth’.³⁰¹

In the particular situation of a takeover bid, directors’ duties should be treated as owed to shareholders. Once the directors have assumed, or have been obliged by law to, advise or negotiate or in any way act as a-go-between the shareholders and the bidder, then they should owe a fiduciary duty to shareholders. This argument is based on the definition of a fiduciary.³⁰² Indeed, in *Re Chez Nico (Restaurants) Ltd*,³⁰³ Browne-Wilkinson VC acknowledged that circumstances might arise placing directors in a fiduciary capacity vis-à-vis the shareholders. In an earlier case, *Allen v Hyatt*,³⁰⁴ where directors held themselves out as agents of shareholders in negotiations of amalgamation of the company, the Privy Council held the directors accountable to shareholders for the profit the directors had made on shares. Indeed, under the Code, takeover rules ‘embodies in a particularly clear way

²⁹⁷ B Pettet, *Company Law* (2nd edn Longman, Harlow 2005), 160.

²⁹⁸ See *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461; *Re Smith & Fawcett* [1942] Ch 304.

²⁹⁹ See *Re City Equitable Ltd* [1925] Ch 407; *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498.

³⁰⁰ *Percival v Wright* [1902] 2 Ch 421; cf CA 2006, s 172(1).

³⁰¹ S Griffin, *Company Law: Fundamental Principles* (fourth edition, Longman, Harrow 2006) 313.

³⁰² See *Bristol & West Building Society v Mothew* [1998] Ch 1, 18 (Millet LJ) – ‘a fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence’.

³⁰³ [1992] BCLC 192.

³⁰⁴ [1914] 30 TLR 444.

the principle that, during the course of a takeover bid, directors of the target company are meant to act as the agents of the shareholders'.³⁰⁵

4.4.2 Duties to employees

A particular mention is made in the Directive requiring that the directors of the offeree company give their employees sufficient information on the effects of the bid on employment and conditions of employment.³⁰⁶ Under mainstream company law, directors owe to the company a duty to have regard to interests of employees.³⁰⁷ This being a duty owed to the company, 'makes it virtually impossible for employees to get any legal remedies for a breach of directors' duties'.³⁰⁸ The Directive makes radical changes in the corporate culture, which changes were long applied in takeover situations and continue to be contained in the Code.³⁰⁹ The duty on informing employees under the Directive is more onerous than merely having regard to their interests previously under s 309 CA 1985. Thus, implementation of the Directive creates a new emphasis and duty on directors, but only in regard to takeovers. Outside takeovers, the position remains that directors owe no general duty to employees unless a factual relationship is established.

As to the duty of directors of an offeror that takes over, the Directive is silent. There is an argument that takeovers improve economic efficiency and enhance the position of those who deal with the firm, such as employees. That as such, the new owner would harm himself if he were to discard valuable

³⁰⁵ S Deakin and Others, 'Implicit contracts, takeovers, and corporate governance: in the shadow of the City Code' (2002) Centre for Business Research, University of Cambridge, Working Paper 254, 14 <<http://www.cbr.cam.ac.uk/pdf/WP254.pdf>> accessed 28 December 2007.

³⁰⁶ Recital number 23 of the Directive; Articles 9(5) of the Directive.

³⁰⁷ See CA 2006, s 172(1).

³⁰⁸ B Pettet, 'Duties in Respect of Employees under the CA 1980' (1981) 34 CLP 199, 200-204.

³⁰⁹ Rule 25 of the Code, 8th edition 2005, deals with the requirement for the board to give information to employees regarding a takeover bid.

employees.³¹⁰ Company law has not gone that far to oblige the offeror to act in a particular way, whether to retain employees or discard them. This is because transfer of ownership of the company's shares changes nothing in law at a lower level – the company's obligations are unaffected, although employee expectation may change.³¹¹ Where the offeror wishes to modify or escape from any of its legal obligations in regard to employees, employment law will apply. There is no good reason for takeover law to seek to pre-emptively second-guess the intentions of the offeror.

4.4.3 Duties to investors

Directors may owe their duties to investors.³¹² The law recognises the need for directors to run the affairs of the company, for the interest of investors including the creditors.³¹³ This includes a prohibition of creating the so-called 'poison pills' to make the shares of the company unattractive to investors.³¹⁴ Regulation of takeovers is, in particular, a measure to cater for the interests of investors who may otherwise be unnecessarily resisted by directors. As the UK applies Article 9 of the Directive, in addition to the common law prohibition of poison pills,³¹⁵ investors are protected – unless shareholders elect to authorise measures frustrating a takeover bid.

The Directive sets out provisions for a basic level of disclosure of information in respect of takeover offers,³¹⁶ ensuring that there is transparency

³¹⁰ See F H Easterbrook and D R Feschel, 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) 94 Harv LRev 1161, 1190.

³¹¹ Jonathan Rickford, 'The Emerging European Takeover Law from a British Perspective' (2004) 15 EBLR 1379, 1384.

³¹² The term 'investor' is here used to refer to a party who does not yet hold shares (or not yet a shareholder) and seeking to acquire shares as a means of investment, or/and a party already holding some shares and seeking to increase shareholding.

³¹³ *Winkworth v Baron* [1987] 1 All ER 114; *West Mercia Safety Wear v Dodd* [1988] BCLC 250.

³¹⁴ *Criterion Properties Ltd v Stratford UK Properties LLC* [2004] 1 WLR 1846, HL.

³¹⁵ In *Criterion Properties Plc v Stratford UK Properties LLC* [2004] 1 WLR 1846, HL, [2003] BCC 50, a poison pill was held to be an abuse of directors' powers.

³¹⁶ See mainly Article 10 of the Directive.

during takeover bids to enable investors to make informed choices. Information is vital in takeovers and without it, or if the information is not accurate, investors will not evaluate the value of shares in order to launch a takeover bid or merely to make an investment. However, disclosure under the Directive is confined to ‘takeover offers’, and unless such disclosures were to extend to other company law matters, investors’ interests are inadequately protected.

At the national level, in the UK disclosure is not only required under company law on matters of public interest, but is also required under financial sector regulation.³¹⁷ Investors who are already shareholders, holding shares with voting rights of at least 10 per cent of the share capital, can require the company to serve notice on other members requiring information on their shareholding.³¹⁸ This would enable investors to have information needed to decide when and how to launch a bid. However, this right is only open to an investor-shareholder; an outsider will have to rely on general disclosure. But does the law have to intervene with strict enforcement measures in order to compel managers of companies to disclose certain information?

There are a number of reasons why the law must intervene to force managers to disclose information. One of the reasons is the perceived threat on job security for managers if certain information, say loss in company accounts, were to be made public. This perceived insecurity arises for a number of reasons, one of which is the lack of alignment of management interests and those of investors or other stakeholders. Economists describe this insecurity as ‘agency problem’ – referring to the relationship between one party called the principal and another called the agent, where the former depends on the latter for some service, performance of which depends on whether there is enough incentive to perform or whether their interests are

³¹⁷ Includes requirements under Transparency Obligations Directive EC 2004/109; Part 6 of FSMA 2000.

³¹⁸ See CA 2006, s 803.

aligned.³¹⁹ Mandating disclosure of news, whether good or bad, minimises this agency problem for public investors – providing, of course that the law’s mandate is effectively enforced.³²⁰

However, divergent interests among regulators in different EU Member States, coupled with divergent disclosure requirements on company matters other than takeovers, does not enable investors to engage in cross-border takeovers or to make informed choices on cross-border investment. The problem according to Sealy is that:

[S]ome jurisdictions require much less disclosure from companies than others, and this lack of transparency may put a bidder, especially a foreign bidder, at a disadvantage in deciding whether to bid for a company and what price to offer. Differing accounting standards and differing approaches to the requirements for the filing of accounts may add to the problem.³²¹

A study by Hopt has shown that these differences in respect of shareholders’ rights, the one-tier and the two-tier board system, the independence of board members and of the auditors, board committees, and the content and degree of disclosure, still exist across Europe.³²²

4.5 Conflicts between directors and shareholders

The relationship between directors and shareholders, as far as managing the affairs of the company is concerned, creates conflicts of interests that are difficult to reconcile. The separation of ownership and control of the company

³¹⁹ See generally S Deakin and A Hughes, ‘Economics and company law reform: a fruitful partnership?’ (1999) 20 Co Law 212.

³²⁰ G Hertig, R Kraakman and E Rock ‘Issuers and investor protection’ in R Kraakman and others, *The Anatomy of Corporate Law* (Oxford, Oxford University Press 2004) 193, 204.

³²¹ LS Sealy ‘The Draft Thirteenth E.C. Directive on Take-overs’ in M Andenas and S Kenyon-Slade (eds) *EC Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 135, 141-145.

is crucial to this conflict. On the one hand there is ownership vested in shareholders as residual owners of the company, and on the other there is control-power vested in the directors as agents of the company with its separate legal personality. In concentrated ownership companies often shareholders and directors are one or rather the former adequately controls the latter, and delegation of control and decision-making from shareholders to directors is only abstract or rare. In dispersed ownership companies, whereas shareholders have control-power through a general meeting to make decisions affecting the affairs of the company, the costs are unjustified; hence control is delegated to directors. In these companies shareholders tend to be passive as far as control is concerned. This leaves directors wholly in control of the affairs, even though shareholders in a general meeting retain power of control but for being passive. The conflict that ensues is that directors are agents of the company and not of shareholders, and often, 'management's interests are not generally aligned with those of shareholders'.³²³ Unless there is a clearly defined mechanism for ensuring that directors are accountable, whether to the company or to shareholders or both, returns on share investment by way of high premium remain uncertain.

One of the factors explaining the prevalence of director-shareholder conflict is ownership structure. Where ownership is dispersed, shareholders' interests are usually not aligned with those of managers, and takeovers often provide an easy exit strategy to disgruntled shareholders. With the US having the highest dispersed ownership structures, it has been argued that the shareholder-manager conflict is more acute than elsewhere, and the US exhibit most takeovers.³²⁴ That in France, concentrated ownership gives controlling shareholders the power to discipline managers without the need for corporate takeovers. The effect of concentrated share ownership on takeovers has been consistently shown to be a distortion of the market for ownership and

³²² K Hopt, 'Comparative company law' (2006) ECGI Working Paper No. 77, 1183, Available <<http://ssrn.com/abstract=980981>> or <<http://www.ecgi.org/wp>> accessed 13 August 2007.

³²³ L A Bebchuk, 'Letting shareholders set the rules' (2006) 119 Harv LRev 1784, 1789.

³²⁴ H Hansmann and R Kraakman, 'The basic governance structure' in R Kraakman and others, *The anatomy of corporate law: A comparative and functional approach* (Oxford University Press, Oxford 2004) 33, 53.

control.³²⁵ It is here argued that where share structures are concentrated, takeovers are difficult to occur. The argument here is that the controlling shareholders will only sell when their interests are some how not aligned with those of management or if for other reasons they consent or in some way they lose control. It seems, where share structures are dispersed, as in the US, ‘shareholder-manager conflict is more acute’, and takeovers more likely, which provides an exit strategy to aggrieved shareholders.

Although share ownership is more fragmented in the UK, cooperation among institutional investors ensures that shareholder’s interest is dominant in most public corporations.³²⁶ It must be said that these mechanisms seem to depend on market forces and the power of persuasion to keep interests of managers aligned to those of shareholders. Moreover, with majority shareholders more likely to be institutional investors rather than natural persons, shareholder collective action is likely to be great enough to influence and align management interests with those of shareholders. However, when faced with a hostile takeover bid, these non-legal mechanisms are likely to give way to the self-interests of managers, unless the law prohibits certain managerial behaviours. With control and ownership separated, and control delegated to directors, it is little wonder that the majority of takeovers occur in companies with dispersed ownership structures.

It should be borne in mind that it is one of the principles of company law that shares are freely transferable.³²⁷ This is one principle that vests exclusive decision-making in the hands of shareholders – to decide on whether or not to

³²⁵ A Dignam, ‘The globalization of General Principle 7: transforming the market for corporate control in Australia and Europe?’ (2008) 28 LS 96, 111-112; C Weir and D Laing, ‘Ownership structure, board composition and the market for corporate control in the UK: an empirical analysis’ (2003) 35 Applied Economics 1747; D North, ‘The role of managerial incentives in corporate acquisitions: the 1990s evidence’ (2001) 7 Journal of Corporate Finance 125.

³²⁶ H Hansmann and R Kraakman, ‘The basic governance structure’ in R Kraakman and others, *The anatomy of corporate law: A comparative and functional approach* (Oxford University Press, Oxford 2004) 33, 53.

³²⁷ See CA 2006, s 544 – all shares are transferable in accordance with the company’s articles subject to (a) the Stock Transfer Act 1963 (which enables securities of certain descriptions to be transferred by a simplified process), and (b) regulations under sections 783-790 of the

sell/transfer their shares. Transferability of shares, if coupled with free tradability, maximises the liquidity of shareholdings and the ability of shareholders to diversify their investments.³²⁸ Takeover regulation further strengthens this principle of share transferability by requiring that directors should refrain from actions that may frustrate a takeover bid.³²⁹ This sets an exit strategy for shareholders and an entry for acquirers or investors (takeover bidders), the effect of which is to provide incentives for managers to align their interests with those of the shareholders. The argument here is that the rules facilitate the transfer of shares to the highest value user, and ‘the threat of a takeover bid provides a low-cost (to shareholders) incentive to the board to keep the interests of the shareholders centre-stage even when no bid is imminent’.³³⁰ Thus, whether or not threat of takeovers align management interests to those of shareholders, the more these interests are not aligned the easier takeovers are likely to succeed, giving a low cost exit strategy to aggrieved shareholders.

4.6 Codified directors’ duties under the Companies Act 2006

The CA 2006 has codified directors’ duties, forming seven general duties, the aim of which was to clarify and simplify directors’ duties. However, (a) consequences of breach (or threatened breach) of the seven general duties are the same as would apply if the corresponding common law rule or equitable principle applied, and (b) all the seven duties (with the exception of duty to exercise reasonable care, skill and diligence) are enforceable in the same way

CA 2006 (which enable title to securities to be evidenced and transferred without a written instrument).

³²⁸ H Hansmann and R Kraakman, ‘What is corporate law?’ in R Kraakman and Others, *The anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, Oxford 2004) 1, 11.

³²⁹ Article 9 of the Directive; Rule 21 of the Code.

³³⁰ P Davies and K Hopt, ‘Control transactions’ in R Kraakman and Others, *The anatomy of corporate law: A comparative and functional approach* (Oxford University Press, Oxford 2004) 157, 173.

as any other fiduciary duty owed to a company by its directors.³³¹ With the codified duties applied on common law principles, the impact of this codification is unlikely to be significant. In a takeover situation, the range of rules on takeovers and the policing of the Panel makes it unlikely that shareholders affected by directors' actions during a takeover bid, will need to invoke any of the range of general duties of directors.

4.6.1 Duty to act within powers (CA 2006, s 171)

The first duty requires a director to (a) act in accordance with the company's constitution, and (b) exercise powers only for the purposes for which they are conferred. This codifies, in part, the fiduciary duties – including a duty to act for a proper purpose. The duty echoes the words of Hoffmann LJ that a director 'must exercise the power solely for the purpose for which it was conferred'.³³² To use powers for the purpose for which they are conferred also means to use the powers for a proper purpose. For instance, if the constitution provides a power to allot shares, that power has to be used for a proper purpose. It will not be for a proper purpose if used to defeat a takeover bid.³³³ In *Howard Smith Ltd v Ampol Petroleum*,³³⁴ the allotment of shares, aimed at destroying a majority shareholding thereby defeating a takeover bid, was set aside for being an exercise of directors' powers for an improper purpose – it was unconstitutional for directors to so use their powers.³³⁵

Traditionally, powers of directors are given in the articles of association. Most companies will adopt the CA 1985 model articles.³³⁶ Table A of the model articles, regulation 70, provides directors with all the powers to manage the business of the company. So long as directors act within their powers in

³³¹ See CA 2006, s 178.

³³² *Bishopsgate Investment Management Ltd* [1993] BCC 140.

³³³ See *Piercy v Mills & Co Ltd* [1920] 1 Ch 77; *Hogg v Camphorn Ltd* [1967] Ch 254; *Bamford v Bamford* [1970] Ch 212.

³³⁴ [1974] AC 821.

³³⁵ [1974] AC 821, 837 (Lord Wilberforce).

the articles, on matters confided by the articles to the conduct of business by the directors, shareholders' resolutions passed in a general meeting have no effect and can be ignored.³³⁷ What the shareholders might do then is either to pass a special resolution or alter the articles. However, if directors use their power within the articles, but not for the interest of the company, say allotting shares by way of defensive tactics to an anticipated takeover bid, the act will be voidable though ratifiable by an ordinary resolution.³³⁸

Other matters may not be caught by the rules on takeovers, there being no takeover announced or eminent, and will have to be resolved by general duties. For instance, where directors propose a transfer of shares at a price in excess of the market value, if that arrangement is not in accordance with the articles of association, it will be a breach of this duty to act within powers and not enforceable.³³⁹ In the light of how difficult it has always been at common law to find that directors owe a fiduciary duty to shareholders in regard to the disposal of their shares in a takeover,³⁴⁰ the effect of this statutory duty is either to keep in check breaches that may amount to pre-bid barriers or to reinforce takeover rules for a greater shareholder protection.

4.6.2 Duty to promote the success of the company (CA 2006, s 172)

The second duty obliges a director to act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. This codifies, in part, the fiduciary duties –

³³⁶ As amended by Statutory Instruments 2007/2541 and 2007/2826 The Companies (Table A to F) (Amendment) Regulations 2007 – Minor amendments were made to bring the 1985 version of Model Articles in line with provisions of the Companies Act 2006.

³³⁷ See *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34; *Salmon v Quin and Axtens Ltd* [1909] AC 442; *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC 100; *Rose v McGivern* [1998] 2 BCLC 593.

³³⁸ *Bamford v Bamford* [1970] Ch 212.

³³⁹ *Heron International Ltd v Lord Grade* [1983] BCLC 244.

³⁴⁰ In *Dawson International plc v Coats Patons plc* (1988) 4 BCC 305, the court rejected the view that directors are under a fiduciary duty to current shareholders in regard to the disposal of their shares in a takeover.

including a duty to act bona fide in the interests of the company. For ‘the benefit of its members’ would exclude the promotion of simply the interests of fellow directors.³⁴¹ However, the emphasis in the CA 2006 seems to differ from that at common law.

First, there is a question of whether a subjective or objective test is to apply as to whether directors have promoted the success of the company. At common law the duty of good faith is one that is required of directors – it is a duty to act with honesty otherwise in breach.³⁴² In the CA 2006, this may seem to be one of best endeavours for the director to ‘act in the way he considers’ best. But a closer look would reveal that this is a subjective test of honesty, which has always been the standard at common law.³⁴³ In other words, what the director considers has got to be ‘credible’.³⁴⁴

Secondly, the wording may seem to give too much discretion to directors. The difficulty with this is that there are no definite standards against which the actions of directors can be assessed; directors can merely say that they acted in good faith, and their position then becomes virtually unassailable.³⁴⁵ This is unlikely to cause problems, as courts have always taken this approach – it is what the director, not the court, consider to be for the benefit of the company.³⁴⁶

³⁴¹ For example, in *Lee v Chou When Hsien* [1985] BCLC 45, a director was removable under the articles if requested in writing by all his co-directors to resign; the Privy Council held that it did not matter that a notice for removal was given for an ulterior motive – the provision was not merely for the benefit of fellow directors but for the company as a whole.

³⁴² For example, in *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598

³⁴³ In *Regentcrest Ltd v Cohen* [2001] 1 BCLC 80, 105 (Jonathan Parker J) – ‘the duty imposed on directors to act bona fide in the interests of the company is a subjective one ... the question is whether the director honestly believed that his act or omission was in the interests of the company ... the issue is to the director’s state of mind ... where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company’s interest; but that does not detract from the subjective nature of the test’.

³⁴⁴ See *Re Pantone 485 Ltd* [2002] 1 BCLC 266.

³⁴⁵ Andrew Keay, ‘Section 172 of the Companies Act 2006: an interpretation and assessment’ (2007) 28 Co Law 106, 108.

³⁴⁶ See *Re Smith & Fawcett* [1942] Ch 304.

Thirdly, if this is to be interpreted as a duty owed to the existing body of shareholders, then that changes and extends directors' duties in mainstream company law.³⁴⁷ However, there is an argument that in interpreting the term 'company', the company may be properly viewed as comprising the interests of the company as a whole, that is 'the interests of all of its human constituents and persons who have a financial stake in its well being'.³⁴⁸ In general, common law still affirms that directors do not owe fiduciary duties to shareholders but owe them to the company, except in certain special circumstances where there is a duty of disclosure.³⁴⁹

Fourthly, in aiding directors' decisions, section 172 of the CA 2006 provides a list of factors to be taken into account. This may limit good judgment were directors simply adopt the list as a rulebook and tick off the list. On the other hand, it may enhance what is already the practice of good governance. At the extreme end, the list may be a source of potential litigation by shareholders alleging that the list is not followed. If the director has acted *bona fide* in the interest of the company, it is unlikely that the court will find a breach of s 172,³⁵⁰ unless the action is construed as not taken *bona fide* in the interest of the company.³⁵¹

On the other hand, the duty to promote the success of the company may conflict with the duties in respect to takeovers. Suppose the directors have the power to allot shares. They honestly believe that a looming takeover would be substantially detrimental to the company. They then allot shares to prevent a

³⁴⁷ As directors duties are owed only to the company as a legal entity – *Percival v Wright* [1902] 2 Ch 421; Section 309 of the CA 1985 required director to have 'regard o the interests of shareholders' and added that 'this duty is owed to the company alone'; the latter wording is omitted under section 172(1) CA 2006 – it will be interesting to see how courts align this to common law.

³⁴⁸ S Griffith, *Company Law: Fundamental Principles* (4th edn Longman, Harlow 2006) 313.

³⁴⁹ *Re Chez Nico (Restaurants) Ltd* [1992] BCLC 192, 208 (Browne-Wilkinson VC); *Peskin v Anderson* [2001] 1 BCLC 372, CA.

³⁵⁰ *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62.

³⁵¹ *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91.

takeover. They could be in breach.³⁵² The allotment is for the wrong purpose, but honest belief; the act frustrates a bid, but it is borne out of independent judgement (s 173 below). The breach would depend on the basis of the action – if brought for breach of the proper purpose rule (s 171 above), it may succeed, but it may fail if for breach of promoting the success of the company (s 172). It seems that these codified duties are irreconcilable with the duties imposed by the Directive, and codification may have exacerbated the conflict. To resolve this conflict, directors duties in takeover situations should be regarded as being governed by takeover rules rather than codified general duties; but the analysis is difficult when all these duties are on an equal statutory footing.

An explanation to resolve the foregoing conflict has been attempted by Ogowewo, using an illustration of the target board seeking to protect the company.³⁵³ Ogowewo illustrates that a target board faced with an insurgent with evil designs for its treasury and that has violated any of the takeover ‘traffic’ laws will no doubt regard as genuine its suit (based on those violations) to frustrate the bidder, in the sense that it is brought to protect the company from harm; yet such a suit, if unauthorised by target shareholders, will be viewed by the Panel as frustrating to the target shareholders. Ogowewo then examines that the fact that the target board is promoting the success of the company pursuant to section 172 of the CA 2006 should not alter the view of the Panel in this regard since the section 172 duty only applies within the space defined by section 171 (i.e. the board will not be permitted to act unconstitutionally under the guise of promoting the success of the company).

If the foregoing analysis is viewed strictly in the takeover context, Ogowewo’s interpretive approach offers a pragmatic solution to the seemingly irreconcilable sections. Rule 21 of the Code requires that directors should refrain from taking actions that may frustrate a takeover bid, unless such action

³⁵² In *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, the Privy Council found that the directors had exercised their powers to issue new shares for an improper purpose and the allotment was set aside.

is authorised by the shareholders. If directors honestly believe it to be in the best interest of the company that they should frustrate a takeover bid, rule 21 of the Code is clear that they should first seek authorisation from shareholders. However, if the forgoing conflict is viewed in the context of directors' duties generally, the interpretive approach above does not resolve the conflict. Section 172(1), especially when read with s 170, makes it clear that the duty imposed on directors is to consider the interests of persons other than the company (e.g. employees, suppliers, customers, the community) but that directors do not owe a duty directly to those persons; a director's duty is owed to the company alone (s 170).³⁵⁴ A strict legal approach reveals that it is for the directors to decide how best to promote the success of the company, and the courts will not inquire into the reasonableness of such decision.³⁵⁵ To resolve the conflict between directors' general duties and specific duties in a takeover situation, directors' general duties should be treated as being *sui generis* to a class of stakeholders affected by the actions of directors of the company involved in a takeover bid. This should be confined to takeover rules contained in the Code, and provisions under Part 28 of the CA 2006.

4.6.3 Duty to exercise independent judgement (CA 2006, s 173)

The third duty obliges a director to exercise independent judgement – but at the same time acknowledges that a director's discretion may be limited by an agreement duly entered into by the company or by the company's constitution. This duty codifies the general principle at common law that directors must not fetter their discretion.³⁵⁶ By allowing the possibility of limiting or fettering the directors' discretion to act or to take decisions, the CA 2006 imports from

³⁵³ Tunde Ogowewo, 'Tactical litigation in takeover contests' (2007) JBL 589, 598-599.

³⁵⁴ L Sealy and S Worthington, *Cases and materials in Company Law* (8th edn OUP, Oxford 2008) 294.

³⁵⁵ *Re Smith & Fawcett Ltd* [1942] Ch 304; *Regentcrest plc v Cohen* [2001] 2 BCLC 80.

³⁵⁶ *Kregor v Hollins* (1913) 109 LT 225

decided cases,³⁵⁷ the commercial reality that recognises that it may be appropriate for directors to bind the company to a certain course of future conduct. Limiting discretion apart, the reference to ‘independent judgment’ has the potential of diminishing the collective responsibility of the board of directors. It would be absurd though for any director to prefer his own independent decision to that of the board – and so this is unlikely. On the other hand, this duty has the potential of increasing the severity of liability for directors on decisions found not in the best interests of the company. A question might be asked of a director raising as a defence the collective decision responsibility of the board – would a prudent and diligent director go along with such a decision?

The duty also serves as a protection measure for directors against unnecessary pre-bid actions by shareholders. Directors ought to manage the company business without being overly afraid of being sued by shareholders. If they make a decision which they honestly believe to be in the best interests of the company, then the law need not second-guess what should have been the right decision. At the extreme end of interpretation of this duty, provided any judgement which a director is required or permitted to exercise under the company’s constitution has been exercised bona fide, there is no liability for the consequences of faulty judgement.³⁵⁸ If on the face of it the consequences of the decision are substantially detrimental to the company’s business, it is unlikely that the courts will be reluctant to second-guess the directors’ decision.

³⁵⁷ In *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363 – the Court of Appeal held that there was no rule that directors cannot bind themselves – fetter their discretion, as to the future exercise of their power in a particular way if the contract is for the benefit of the company; the Australian High Court had already ruled in similar manner in *Thornby v Goldberg* [1964] 112 CLR 597.

³⁵⁸ See M Trabilcock, ‘The liability of company directors for negligence’ (1969) 32 MLR 499.

4.6.4 Duty to exercise reasonable care, skill and diligence (CA 2006, s 174)

The fourth duty is to exercise reasonable care, skill and diligence – this means that directors should have the attributes of a reasonably diligent person, considering: (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and (b) the general knowledge, skill and experience that the director has. This duty, which reflects a standard found in section 214 of the Insolvency Act 1986, is in direct alignment with the equivalent common law duty.³⁵⁹

The question here is to whom is the duty owed – the shareholders or the company? If the directors were to publish annual accounts that later proved to be adrift, causing loss to a shareholder who has bought more shares in the company on that basis, can the shareholder sue the directors for breach of that duty? Unless the annual accounts were given for the particular purpose of enabling the acquisition of extra shares, the shareholders will find it difficult to sustain a claim against the directors.³⁶⁰ Equally, an offeror relying on the published accounts of the offeree company that are seriously adrift may not have a claim against a negligent director.³⁶¹ A remedy might be sought under the takeover rules, but even then, unless the takeover was imminent, the rules might not apply. There is a possibility of a *lacuna* here – with a shareholder unable to claim under statutory general duties and equally not qualifying under the takeover rules.

The duty is ordinarily owed to the company, from which the shareholders recoup through share value addition by virtue of good management. However, where a takeover bid is in the offering, the duty is owed to the shareholders,

³⁵⁹ *Norman v Theodore Goddard* [1991] BCLC 1028; *Re D'Jan of London Ltd* [1994] 1 BCLC 561; *Base Metal Trading Ltd v Shamurin* [2005] 1 WLR 1157.

³⁶⁰ He may have a claim on grounds of a misleading statement but it is difficult to succeed at common law: see *Hedley Byrne Ltd v Heller Ltd* [1964] AC 465, HL; *Caparo Industries plc v Dickman* [1990] 2 AC 605, HL.

albeit a matter of interpretation and aligning takeover rules with the rest of the statute. The starting point is that there is a presumption that there is no conflict between the takeover duties and the statutory general duties of directors. A reading of the requirements of the Code suggests that directors of companies involved in a takeover bid not only owe this duty to shareholders but also owe it to shareholders at a higher standard than that owed at common law.³⁶² However, the standard expected of a director at common law had somehow been raised to parallel that used under the statutory wrongful trading provision.³⁶³ It is likely that this interpretation will continue.³⁶⁴ At any rate directors will be bound by the Code's high standard of care where takeovers are involved – shareholders need not resort to the general statutory duties in this regard.

4.6.5 Duty to avoid conflicts of interest (CA 2006, s 175)

The fifth duty requires a director to avoid a situation in which he has, or can have, a direct or indirect interest which conflicts, or possibly may conflict, with the interests of the company. This applies, in particular, to the exploitation of any property, information or opportunity, and it is immaterial whether the company could take advantage of the property, information or opportunity.³⁶⁵

³⁶¹ See *Caparo Industries plc v Dickman* [1990] 2 AC 605, HL.

³⁶² The requirements under Code, rules 3(1), 19, 20, 23, 25, and 28, impose a high duty of care on directors for a direct benefit of shareholders affected by a bid: for example, rule 3.1 provides: 'The board of the offeree company *must* obtain competent independent advice on any offer and the substance of such advice *must* be made known to its shareholders', rule 19 provides: 'Each document ... statement ... *must* be prepared with the *highest* standard of care ... This applies whether it is issued by the company direct or by an adviser on its behalf', and rule 32 provides: 'Shareholders *must* be given sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer ...', these places directors' duties owing to the shareholders on a higher standard of care than previously known in company law.

³⁶³ *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407; *Lister v Romford Ice & Cold Storage Ltd* [1957] AC 555; *Norman v Theodore Goddard* [1991] BCLC 1028; *Re D'Jan of London Ltd* [1993] BCC 646.

³⁶⁴ CA 2006, s 178(1) provides that the consequences of breach of the statutory general duties are the same as would apply if the corresponding common law rule or equitable principle applied.

³⁶⁵ This imports the decision in *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443 – a retired director was found to have improperly taken advantage of an

This also codifies an approach long held at common law that a director cannot benefit from a situation that ostensibly gives rise to a conflict of interest.³⁶⁶ The duty is very detailed and includes an exception or defence if: (a) the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or (b) the matter has been authorised by the directors. The exception strikes a balance between the rigid rule and the need not to stifle business – a balance also developed at common law.³⁶⁷ Takeover related transactions would benefit from a balancing approach in enforcing the duty to avoid conflict of interest – to the extent that it facilitates corporate restructuring.

The CA 2006 also tightens the authorisation regime of the board, such that a conflicting arrangement can only be authorised by the board if the articles of association allow it.³⁶⁸ If not allowed in the articles, directors may ask shareholders to alter the articles – a further decision-making power given to the shareholders. Where a ratification of directors' action is required, a further decision-making power is given, even to the minority. In ratifying, the votes of a director who also holds shares are to be disregarded. This is designed to avoid a danger of board collusion, the concept of an independent board to get involved in authorisation.³⁶⁹ If then such director is a majority shareholder, the effect of the CA 2006 is to vest the power to decide the director's fate in the hands of a minority. Authorisation apart, how the statutory no conflict duty will be enforced may cause some contentions. One potential contention is the defence available to the director, where the purported arrangement 'cannot

employment offer that came to his notice in his capacity as a company director, and it was immaterial that the company could not have taken advantage; see also *Gencor ACP Ltd v Dolby* [2000] 2 BCLC 734.

³⁶⁶ *Keech v Sandford* (1726) 25 ER 223; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; *Boardman v Phipps* [1967] 2 AC 46; *IDC v Cooley* [1972] 1 WLR 443; *Carlton v Halestrap* (1988) 4 BCC 538; *Attorney General for Hong Kong v Reid* [1994] 1 AC 324.

³⁶⁷ For instance, in *Island Export Finance Ltd v Umunna* [1986] BCLC 460, it was found on the facts that the director had not breached the duty to avoid conflict of interest when he took a business opportunity which the company was not actively pursuing; similar balancing decisions include *Framlington Group plc v Anderson* [1995] BCC 611; *CMS Dolphin Ltd v Simonet* [2002] BCC 600.

³⁶⁸ Under section 175(5) of the CA 2006, an authorisation is only valid if the constitution enables the directors to authorise the matter.

³⁶⁹ See Modern Company Law for a Competitive Economy – Final Report (DTI, 2001) 46-47.

reasonably be regarded as likely to give rise to a conflict'. Courts should be prepared to develop doctrines and concepts in respect of determining this defence – which is likely to be an easy task, as courts are accustomed to the concepts of reasonableness.

The duty to avoid conflicts of interest imports a strict interpretation at common law that, if a director's own interest would conflict with that of the company, then the latter should take precedent.³⁷⁰ Thus, if it is in the directors' interests that a takeover bid, whether imminent or speculated, should be resisted, directors may be liable via a breach of their duty to avoid a conflict of interest. In such a situation, the directors should let the company's interest take precedence. It is in the company's interest to protect the share value for the benefit of its members. The shareholders collectively may bring a derivative action if the company, through its directors, is not willing to sue for this breach. If this fails, the shareholders can appeal to the Panel via the specific takeover rules and duties.

Ordinarily, even without reference to takeover rules, directors that receive a takeover offer have a duty to be honest about the offer and not mislead their shareholders.³⁷¹ One example of a conflict of interest is where directors urge shareholders to accept an offer in which they, the directors, have a financial interest, while ignoring a much more favourable alternative offer – here it is open to shareholders to raise a derivative claim for breach of this duty or to petition as unfairly treated shareholders.³⁷² In a way the duty to avoid a conflict of interest reinforces the specific takeover duties and rules.

³⁷⁰ *Mercantile Credit Association Liquidators v Coleman* (1870) 6 Ch App 558, 563 (Malins VC) – 'it is the duty of directors of companies to use their best exertion for the benefit of those whose interests are committed to their charge, and that they are bound to discharge their own private interests wherever a regard to them conflicts with the proper discharge of such duty'.

³⁷¹ *Gething v Kilner* [1972] WLR 337.

³⁷² See *Re A Company* (No.008699 of 1985) (1986) PCC 296. Note, failure to be honest about a takeover offer or misleading shareholders, could lead derivative action under Part 11 of the CA 2006 or to a petition for unfairly prejudicial conduct under Part 30 of the CA 2006.

4.6.6 Duty to not to accept benefits from third parties (CA 2006, 176)

The sixth duty prohibits a director from accepting benefits from third parties. This duty derives from common law concepts dealing with conflict of interest and creates a new specific duty. The duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest. The benefits may include information vital to the company but which for confidentiality the director who may have received it due to being a director of another company will not release it. For example, such information may include another company's early plans to launch a bid when conditions are right, and a director sitting on both the potential bidder's and potential target boards will have an ostensible conflict due to information received in confidence. Such a conflict is unlikely to be resolved by disclosure.³⁷³ It may not be enough to disclose that the director also sits on the board of another company from whereof the information was received, for it is the information required. It is only when a company is involved in a takeover, either as an offeror or offeree, that takeover rules of disclosure would resolve this conflict.

4.6.7 Duty to declare interest in proposed transaction or arrangement (CA 2006, s 177)

The seventh duty requires that, if a director is in any way interested (directly or indirectly) in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors. As an exception, a director need not declare an interest: (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest; or (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware). The latter exception means that disclosure can

³⁷³ See CA 2006, s 182 – deals with directors' declaration of interest.

be implied from circumstances suggesting that the other directors are aware.³⁷⁴ This duty remains a light duty of disclosure to the board as it has been applied under the old statute.³⁷⁵ If the disclosed interest creates a conflict of interest, it is up to the board to raise an objection on behalf of the company. If this interest would cause loss to shareholders, unless there is collusion or cover-up by the board, such that a derivative action is likely on those grounds, shareholders might never be protected. To that extent, the duty to declare interest seems remote to takeover duties.

4.7 Conclusion

The imposition by the Directive of certain obligations on directors for the benefit of employees and shareholders, as implemented by the Companies Act 2006, is unlikely to lead to radical changes in the corporate culture in regard to directors' duties. In general, directors owe their duties to the company. A duty can be owed to other interested parties – shareholders, employees and investors – if special factual relationship can be established in a particular case. In regard to takeovers, that special factual relationship can be established. Indeed, the Companies Act 2006, in codifying directors' duties at the same time codifying takeover rules to implement the Directive, creates a legal presumption that directors owe their duties to shareholders and other parties interested in takeover activities for which the company is involved. The conflict created by this dual codification of directors' general duties and specific duties pertaining takeovers under the Code, can be resolved if directors' duties are treated as *sui generis* to stakeholders affected by actions of directors of a company involved in a takeover bid.

Although the statutory derivative action under Companies Act 2006 seem to expose directors to a greater risk, the difficulties of effecting a derivative action will still remain. The action will still be required to have a support of an

³⁷⁴ *Lee Panvision Ltd v Lee Lighting Ltd* [1992] BCLC 22; *Runciman v Walter Runciman plc* [1992] BCLC 1084

independent majority within the aggrieved minority shareholders. The practicalities of financing shareholder litigation will remain a major obstacle. An effective remedy for aggrieved shareholder may well lie in the mechanism of a fair share price on a takeover bid. Moreover, the range of rules on takeovers and the policing of the Panel make it unlikely that shareholders affected by directors' actions during a takeover bid, will need to invoke a derivative action or any breach of the statutory directors' duties. Even then, the policing of the Panel may only serves a purpose of a regulated exit strategy for aggrieved shareholders – to sell their shares at a fair price and invest elsewhere.

³⁷⁵ See CA 2006, s 182 – replaces a similar duty in CA 1985, s 317.

Chapter 5: Implementing the Directive in selected States

5.1 *Introduction*

In implementing the Directive, Member States have taken different approaches to the controversial provisions of Articles 9, 11 and 12 of the Directive. The approach taken on these provisions is a key factor in determining the ultimate impact of the Directive. Whilst the Directive partly aims at removing barriers to takeovers, these diverse approaches are likely to create more barriers to takeovers across Europe. To remedy this problem, it is suggested in this chapter that the Directive ought to be interpreted in the light of the EC Treaty obligation to remove all restrictions to free movement of capital. It is argued that Member States that allow their companies to apply a reciprocity rule under Article 12 of the Directive are likely to be found in breach of their Treaty obligation under Article 56 of the EC Treaty.

This chapter undertakes a limited comparative study,³⁷⁶ looking at the approaches taken to Articles 9, 11 and 12 of the Directive by a selection of five Member States. The selected Member States chosen are: Germany, France, Belgium, Netherlands, and Italy. The chapter also analyses how a UK bidder would succeed in taking over a company in one of the selected Member States in the light of how those Member States have implemented Articles 9, 11 and 12 of the Directive. It will be recalled that Article 12 makes Articles 9 and 11 optional. These options for individual member states and companies create a level of uncertainty for bidders as to which provisions will apply in any particular target's case.³⁷⁷ Even where Member States make their option known, say to opt out of Article 9, there may still be restrictions existing in

³⁷⁶ One of the limitations of this study is finding relevant data available in the English language. This language barrier limits the extent to which takeover barriers are analysed in this comparison.

³⁷⁷ A Kay and Others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39, 40 <<http://www.practicallaw.com/crossborder>> accessed 07 August 2007.

their local laws that are similar – for example, Germany has opted out of Article 9 but has retained its current restrictions on frustrating actions. It is this uncertainty created by the options that informs the study in this part of the thesis.

With the varied corporate culture across Member States, comparison is a vital part of appreciating the likely impact and success of the Directive. Across different Member States, ‘one encounters not only statutory company law, but also practices, codes of conduct and rules of behaviour adhered to by the companies, the shares of which are listed or traded on the securities markets – what extent these practices or rules are accepted as part of the company law is hard to say’.³⁷⁸ It is against this background that comparison, albeit not detailed, is a necessary component of this thesis.

The choice of Member States to compare with the UK regulatory system is also informed by the variation of the prevailing regulatory provisions prior to the Directive. For instance, in relation to Article 9 of the Directive France and Italy are similar to the UK regime in that they have had national provisions that favour an opt in approach, whilst Germany and the Netherlands have not had such provisions. As to Article 11 of the Directive, unlike the UK corporate system, Germany has had no multiple voting shares. Some of the controversies that led to the compromise in Article 12 are a direct consequence of the varied legal and corporate cultures in different Member States. It is in this context that it is of interest to examine how varied the Directive has been implemented and its impact on cross-border takeovers.

As a result of these varied cultures, it is not surprising that the Commission in its February 2007 report found that ‘a large number of Member States have shown strong reluctance to lift takeover barriers’. Given the manner of implementation by some states, the Commission, quite rightly, was of the view that ‘the new board neutrality regime may even result in the emergence of new

³⁷⁸ E Wymeersch, ‘The Effects of the Regulation of Securities Markets on Company Law within the EEC’ in RR Drury and PG Xuereb (eds) *European Company Laws* (Dartmouth, Aldershot 1993) 61, 62.

obstacles on the market of corporate control'.³⁷⁹ No Member State has chosen (or intends) to impose the board neutrality rule where it was not (fully) applied before transposition, except for Malta; and the vast majority of Member States have not imposed (or are unlikely to impose) the breakthrough rule, but have instead made it optional for companies.³⁸⁰

Further, the Directive is founded on the basis of Article 44 of the EC Treaty,³⁸¹ which Treaty provision essentially requires Member States to remove all obstacles to freedom of establishment. Arguably, defensive measures that seek to frustrate a takeover bid, unless approved by shareholders, are likely to be seen as counter the EC Treaty.³⁸² While Article 12 of the Directive allows Member States to opt in/out of Article 9, an approach of opting out of Article 9 is likely to render illusory the freedom of establishment. Such an approach is also likely to make it difficult for investors to buy shares in a target company, thereby constituting a restriction to free movement of capital contrary to Article 56 of the Treaty.³⁸³ This chapter aims to: identify the different approaches taken by selected Member States in implementing the Directive (particularly Articles 9, 11 and 12); and to assess the implications of these different approaches.

³⁷⁹ European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007) 10.

³⁸⁰ Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007) 9.

³⁸¹ See the preamble to the Directive and recital 1 of the Directive.

³⁸² Treaty Establishing the European Community, Consolidated Version, 24 December 2002 OJ C325/33 <http://eurpa.eu.int/eur-lex/eu/treaties/dat/EC_consol.html> accessed 31 August 2007.

³⁸³ Article 56 provides '... all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited ...'.

5.2 *Regulatory approach in Germany: Articles 9, 11 and 12*

5.2.1 **The state of implementation of the Directive in Germany**

The Directive was implemented in Germany on 14 July 2006 by way of amendment to the existing Wertpapiererwerbs- und Übernahmegesetz (WpÜG) – translated in English as Securities Acquisition and Takeover Act.³⁸⁴ The Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) – translated as Federal Financial Supervisory Authority, is the UK's equivalent of the Panel. Taking advantage of Article 12 of the Directive,³⁸⁵ Germany has opted out of both Articles 9 and 11 of the Directive.³⁸⁶ This is not surprising, as German law on defensive actions has always been unclear. In general, company boards are restricted from taking defensive actions. The grey area is in regard to a reserve authorisation (Vorratsbeschlüsse) usually given by shareholders. This is usually valid for 18 months. The management board would require a further approval by the supervisory board if it decides to act upon the Vorratsbeschlüsse. In that sense then, boards do not fend off a takeover bid easily.

It is difficult to conclude that this is the only proper interpretation of the German law on defensive actions. For example, others have argued that prior to the Directive, German takeover law allowed management to take defensive measures merely upon approval of the supervisory board [Aufsichtsrat], without first going to shareholders for prior approval.³⁸⁷ Others have strongly argued that supervisory board approval can be used to override shareholder

³⁸⁴ Translated using standard Internet translation software and verified by a native German.

³⁸⁵ Paragraph 33c of the WpÜG allows companies to apply a reciprocity rule in keeping with Article 12 of the Directive.

³⁸⁶ See A Kay and Others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39-45 <<http://www.practicallaw.com/crossborder>> accessed 07 August 2007.

³⁸⁷ J N Gordon, 'American experience and EU perspectives' in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 541, 545.

decisions.³⁸⁸ The analysis is not helped by Germany opting out of Article 9, which might suggest that indeed German law in some ways favours and facilitates defensive measures without shareholder approval. If that is correct implication of German law, then in opting out of Article 9 of the Directive, Germany has retained its pre-Directive partial restrictions on defensive actions.

A close analysis reveals that German law partially allows the management board to employ defensive actions. As a general rule, the first part of § 33(1) of the WpÜG prohibits the board of the target company from taking actions that would frustrate a takeover bid.³⁸⁹ However, the second part of § 33(1) makes it clear that the prohibition does not apply to acts, which are also a decent and conscientious business manager of a company that is not a takeover bid target, would have made in the search for a competing offer, and for acts which the supervisory board of the target company has agreed. Paragraph 33(2) provides for the shareholders in the general meeting with the option of giving a *Vorratsbeschlüsse* (reserve authorisation) to the board to take future defensive actions against a takeover bid. This resolution requires a majority of at least three-quarters of the decision-making in the share capital represented and voting in the general meeting. Before the *Vorratsbeschlüsse* is applied, § 33(2) requires that the management board obtain the consent and further approval of the supervisory board.

A reading of the above-translated text (essence thereof) of the WpÜG suggests that § 33 in some ways empowers the management board to take defensive actions against a takeover bid. First, there is the pre-bid reserve authorisation by shareholders for management to take defensive actions (§ 33(2)). Notwithstanding that Article 9 of the Directive is made optional by Article 12, the *Vorratsbeschlüsse* is contrary to Article 9. According to Article 9(2)(b) of the Directive, authorisation for defensive actions is only taken at the

³⁸⁸ See J McCahery and Others, 'The economics of the proposed European takeover Directive' in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 575, 633-635.

time the board of the offeree company receives the information concerning the bid or as soon as the board of the offeree company becomes aware that the bid is imminent. Article 9 of the Directive is in keeping with the recommendations of the Winter Report against the 18 months Germany-style prior authorisation (Vorratsbeschlüsse), that ‘the board of the offeree company should not be permitted to take actions frustrating a takeover bid on the basis of a general meeting authorisation given prior to the bid’.³⁹⁰ With the Vorratsbeschlüsse enshrined in the German law, it is not surprising that Germany opted out of Article 9 of the Directive.

Secondly, there is the post-bid authorisation by the supervisory board for management to take defensive actions (§ 33(1)). This is outside and independent of decisions taken in a general meeting. In other words, outside the scope of a Vorratsbeschlüsse and other than actions that can be taken for the purpose of seeking alternative bids, the management board can take defensive actions if authorised by the supervisory board, even without specific approval of the shareholders. In this sense, McCahery and Renneboog have rightly argued that ‘supervisory board approval can be used to override shareholder decisions’.³⁹¹ That Germany has opted out of Article 9 of the Directive may only confirm the incompatibility of § 33 WpÜG with Article 9.

Thirdly, there is discretion of the management board to solicit for an alternative offer to counter the bidder’s offer (§ 33(1)). Although this is in keeping with Article 9(2)(a) of the Directive, in light of the first and second arguments herein above, a proper use of this discretion is questionable. This has the potential to be used as an indirect defensive action or delaying tactics with alternative offers that may either be restricted to favoured-friendly bidders or that may never materialise. It is more question given that this discretion

³⁸⁹ For the full version of the WpÜG visit <<http://www.buzer.de/gesetz/4413/index.htm>> last accessed 25 February 2008 – this is a German text. The above quoted § 33 has been translated into English using standard Internet translation software.

³⁹⁰ Winter Report (2002) pp 6 and 27.

does not require approval of the supervisory board and not subject to shareholders' approval, and applies when an actual offer is in place.

It appears that a number of Member States have implemented the Directive in a protectionist way.³⁹² One would suppose that protectionism is at the heart of the German position and many other Member States that take full advantage of Article 12 of the Directive. In its February 2007 report the Commission found that 'the number of Member States implementing the Directive in a seemingly protectionist way [was] unexpectedly large'. The Commission, quite rightly, was of the view that this manner of implementation would hold back the emergence of a European market for corporate control, rather than facilitate it.³⁹³ As such, the manner of implementation adopted by Germany, defeats the Directive's objective of facilitating corporate restructuring through takeovers.

The fear that offerors from other Member States would swamp the economies of another Member State, and diversify, or downsize company resources in that other Member State, seems to be a precursor to this protectionism. This in turn creates economic nationalism. Much as opting out of both the neutrality and breakthrough rules may seem a solution, it is likely to cause negative consequences to the European economy thereby defeating the aims of the Directive. If Member States were to subject themselves to uniform rules, by not taking advantage of Article 12 of the Directive, market forces would protect the economies of all Member States better than legal barriers seek to do. It has been argued, quite plausibly, that if firms in all countries are equally exposed to the threat of hostile takeover, this will help constrain the economic nationalism that is the greatest threat to the EU project,

³⁹¹ See J McCahery and Others, 'The economics of the proposed European takeover Directive' in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 575, 634.

³⁹² Frank Woodridge, 'Some important provisions, and implementation, and the Takeover Directive' (2007) 28 Co Law 293, 295.

³⁹³ European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007) 10.

while permitting very valuable cross-border merger activity.³⁹⁴ Germany's approach of opting out of Article 9 breeds economic nationalism, the result of which is to confine hostile bids to history.

5.2.2 Comparison of German and UK structures

Unlike in the UK, the complex governance structure in Germany makes the implementation of Articles 9, 11 and 12 more difficult. In English law the board of directors is but one entity, which combines both managerial and supervisory functions in the affairs of the company. In German law,³⁹⁵ the functions of management and supervision are kept separate from each other, in that there are two separate organs: the management board (Vorstand) and the supervisory board (Aufsichtsrat). The supervisory board is appointed by the General Assembly of Shareholders (Hauptversammlung) under § 101 Aktiengesetz 1965. However, where codetermination applies, certain of the directors are not appointed by the General Assembly of Shareholders, but by representatives of the employees. In turn, the management board is appointed by the supervisory board (§ 84 Aktiengesetz 1965) and may be revoked only by the supervisory board. Both members of the management and supervisory boards must be natural persons, and not companies or corporations (§ 100 Aktiengesetz 1965). Whilst the former manages the business of the company, the latter supervises the activities of the former (§ 111 Aktiengesetz 1965). In managing the undertakings of the company, the management board does so independently of the wishes of the general meeting, and the company's statutes cannot restrict the independence of the board. As in the UK, directors' duties are owed to the company as an entity and not to the shareholders personally.

Unlike English company law, which requires only the board to have regard to the interests of employees,³⁹⁶ German law provides a more secure protection

³⁹⁴ J N Gordon, 'American experience and EU perspectives' in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 541, 546.

³⁹⁵ P Mantysaari, *Comparative corporate governance: shareholders as a rule-maker* (Springer, Berlin 2005) 252-270.

³⁹⁶ Section 309 of the CA 1985 required Directors to have regard to the interests of employees – a duty owed to the company and the company alone; this has since been replaced by

for employees. In German law, employees of the company are represented on the supervisory board, especially in companies engaged in the mining and steel industries (these mining industries are somewhat in decline). Employees themselves appoint their own representatives on the supervisory board (certain rules such as codetermination rules, may apply). At least one-third of the membership of the supervisory board makes up the representative of the employees. Trade Unions play an active role in collective bargaining on behalf of the employees, and representatives of trade unions are often represented on the supervisory boards of companies. The involvement of employees in the supervisory aspects of the company does not extend to questions of management policy but is concerned with welfare matters (e.g. agreeing the social plan for closure of coal pits following a rationalisation scheme). To this extent, protecting the interests of employees in a takeover situation is unlikely to be a problem for German companies who are accustomed to having employee representatives on company boards. In the UK, the position remains unchanged, but, with the Code now forming part of company law, a duty is owed to employees in a takeover situation – albeit being limited to obliging the board to give information to employees.³⁹⁷

Unlike in the UK, until halfway into the 1990s, public takeover bids did not play an important role in Germany; there was no statutory regulation of public takeovers.³⁹⁸ It is suggested that the reason why Member States like Germany found it difficult to accept some of the provisions in the proposals leading to the Directive was because the regulation of takeovers was less significant given their corporate structures. In a study by Berglof and Burkart,³⁹⁹ it was

section 127(1) CA 2006, which still require directors to have regard only to the interests of employees.

³⁹⁷ Rule 25 of the Code, 8th edition 2005, deals with the requirement for the board to give information to employees regarding a takeover bid – implements Article 9(5) of the Directive.

³⁹⁸ C Elst and L Steen, 'Opportunities in the Merger and Acquisition Aftermarket: Squeezing Out and Selling Out' in G Gregoriou and L Renneboog (eds), *Corporate Governance and Regulatory Impact on Mergers and Acquisitions* (Academic Press, Massachusetts 2007) 191, 213-242.

³⁹⁹ Berglof and Burkart, 'European Takeover Regulation' (2003) 36 *Economic Policy* 179.

reported that 50 per cent of listed companies in Germany, Belgium, Austria and Italy had corporate structures that were composed of a single controlling block shareholding majority with voting rights. Comparing that with the UK, only 3 per cent of the listed companies had such a corporate structure. Thus, it could be argued that, with closely held share structures, Germany and similar States saw little need for regulation, if the object was to protect shareholders faced with a takeover bid. This follows from the premise that takeover regulation as a means of shareholder protection is more relevant to dispersed share structured corporations. Without the majority giving consent or losing control in closely held share structures, it is difficult for takeovers to take place in order to trigger a need for regulation that should protect shareholders. No wonder, it is here concluded, that the Commission found it difficult to encourage States like Germany to appreciate the need for a Directive.

5.3 *The regulatory approach in France: Articles 9, 11 and 12*

5.2.1 The state of implementation of the Directive in France

In France the Act of 31 March 2006 on takeover bids (*Loi sur les offres publiques d'acquisition*) implements the Takeover Directive, of which details of the takeover code are left to the General Regulation of the Financial Markets Authority (*Règlement Général de l'AMF*).⁴⁰⁰ The same approach is taken in the UK – under section 943 of the CA 2006, the Panel is given the power to make rules in relation to takeover regulation. The Act of 31 March 2006 (*Loi sur les offres publiques*) was supplemented by amendment of the general regulations of the Financial Markets Authority (*Autorité des Marchés Financiers*) (AMF) published on 18 September 2006, and France has opted in

⁴⁰⁰ C Elst and L Steen, 'Opportunities in the Merger and Acquisition Aftermarket: Squeezing Out and Selling Out' in G Gregoriou and L Renneboog (eds), *Corporate Governance and Regulatory Impact on Mergers and Acquisitions* (Academic Press, Massachusetts 2007) 191, 211.

to Article 9 and out of Article 11.⁴⁰¹ The same options have been taken by the UK.

However, unlike the UK, France has introduced the reciprocity exception under Article 12(3) of the Directive. In its February 2007 report,⁴⁰² the Commission found that, by a Member State opting for a reciprocity rule, the management boards which, before the implementation of the Directive had been required to abstain from taking any measures likely to frustrate the takeover bid during the bid period without the approval of shareholders, are now either permitted to do so under certain circumstances or the powers of shareholders have been significantly restricted in this regard. Thus, in effect, France has increased the managements' power to take frustrating measures without the approval of shareholders on the proposed measure during the bid period. The Commission lamented that, 'this development will very likely hold back the emergence of an open takeover market, rather than promote it'. As rightly observed by Wooldridge, 'the use of the reciprocity rule is likely to encourage protectionism' – indeed, 'a number of Member States have implemented the Directive in a protectionist way'.⁴⁰³ For France, the protectionist spirit is not new.⁴⁰⁴

In addition, it may be difficult to reconcile the reciprocity provision with the freedom of establishment and free movement of capital, which do not allow the imposition of any condition on the party wishing to enjoy rights under national company laws other than having the registered office or central administration

⁴⁰¹ A Kay and Others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39, 41 <<http://www.practicallaw.com/crossborder>> accessed 07 August 2007.

⁴⁰² European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007).

⁴⁰³ Frank Wooldridge, 'Some important provisions and implementation of the Takeover Directive' (2007) 28 *Co Law* 293, 295.

⁴⁰⁴ For example, in 2005, in a takeover bid by a United States company PepsiCo for a French company Danone, the French Government openly sought to protect its companies against foreign takeovers – on the basis that foreign takeovers 'carries risks for employment and for our industrial strength' – see AP 'President Chirac seeks to protect French companies' *USA Today* 27 July 2005, available at <http://www.usatoday.com/money/world/2005-07-27-french-protects-companies_x.htm> accessed 27 February 2008.

in a Member State.⁴⁰⁵ For the reciprocity rule to breach free movement of capital under Article 56 of the Treaty,⁴⁰⁶ it must be: a state measure; a restriction on the movement of capital; and unjustifiable restriction.⁴⁰⁷ By its very nature, a reciprocity rule is a restriction, and unjustified restriction.⁴⁰⁸ Similar to the Italian Gas laws which were found to be restrictive, the French reciprocity approach ‘has the effect of dissuading public undertakings established in other Member States, in particular, from acquiring shares in [French] undertakings’.⁴⁰⁹ That being a correct analysis of the restriction issue, the analysis here then turns on whether it is a state measure in the first place.

A closer look at the reciprocity rule reveals that it is capable of being a ‘state’ measure breaching Article 56 of the EC Treaty. The basic operation of the reciprocity rule under Article 12(3) of the Directive has two limbs. First, once a Member State has opted in to Articles 9 and/or 11, the companies have no right to opt out of Articles 9 and/or 11, unless the Member State has discretionally allowed its companies to opt out if dealing with a bidder who is not subject to the same rules. Secondly, where a Member State has opted out of Articles 9 and/or 11 it has no right to restrict its companies – it must provide its companies the right to opt in to Articles 9 and/or 11, if the companies wish to do so. However, once a company has opted in to Articles 9 and/or 11, the Member State has the discretion to allow the company to opt out again when dealing with a bidder who is not subject to the same rules; otherwise the company cannot discriminate against bidders.

⁴⁰⁵ Blanaid Clarke, ‘Articles 9 and 11 of the Takeover Directive (2004/25) and the market for corporate control’ (2006) JBL 355, 373.

⁴⁰⁶ Article 56 EC Treaty provides, in part, that ‘all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited’.

⁴⁰⁷ Peter Werdmuller, ‘Compatibility of the EU Takeover Bid Directive reciprocity rule with EU free movement rules’ (2006) 27 BLRev 64, 66.

⁴⁰⁸ These assertions follow the interpretation of ECJ case law: Case C-367/98 *Commission v Italy* [2002] ECR I-4731; Case C-483/99 *Commission v France* [2002] I-4781; Case C-503/99 *Commission v Belgium* [2002] ECR I-4809; and Case C-463/00 *Commission v Spain* [2003] ECR I-4581 – see Peter Werdmuller, ‘Compatibility of the EU Takeover Bid Directive reciprocity rule with EU free movement rules’ (2006) 27 BLRev 64.

⁴⁰⁹ Case C-174/04 *Commission v Italy* [2005] ECR I-4933 para 30.

In both limbs of the reciprocity rule, the discriminatory aspect of the rule will only have effect if the Member State has used its discretion to allow its companies to discriminate against bidders – to this extent, the reciprocity rule becomes a restrictive ‘state’ measure in the meaning of Article 56 of the EC Treaty. That the Directive allows a Member State to apply such discretion, which has the effect of incompatibility with Treaty provisions, is unlikely to be a defence for a Member State – if all Community secondary provisions, including the Directive, should be interpreted to conform to the Treaty. Moreover, the reciprocity rule only involves the taking of economic measures of which ‘it is settled case law that economic grounds can never serve as justification for obstacles prohibited by the Treaty’.⁴¹⁰ After assessing the reciprocity rule as being based on fairness (‘thou shalt not enjoy the rights in a bid on another company that thou denies to others in a bid on thyself’), Winter, has rightly concluded that the reciprocity rule ‘may be difficult to reconcile with the freedom of establishment and free movement of capital’.⁴¹¹ As such, the French use of its discretion to allow a reciprocity rule is likely to have the effect of a restriction on the free movement of capital that is prohibited under Article 56 of the EC Treaty. Unlike the UK, the jury is still out on France for the reciprocity option.

5.3.2 A comparison of France and UK – effect of reciprocity provision

Both the UK and France have applied the board neutrality rule to prior and in implementing the Directive. Unlike the UK, France has opted to allow its companies to apply the reciprocity rule. Although France is applying the reciprocity rule, given that both the UK and France have opted out of Article 11, a UK bidder attempting a takeover in France would not be affected by the implementation approach in France. The French reciprocity rule, indeed as it operates, only becomes effective if a bidder is not subject to the same options – both UK and France have opted in to Article 9 and out of Article 11. Thus,

⁴¹⁰ Case C367/98 *Commission v Portugal* [2002] ECR I-4731, paragraph 52.

⁴¹¹ Jaap Winter, ‘EU Company Law at the Crossroads’ in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 18-19.

between France and the UK, cross-border takeovers appear to be adequately facilitated, and the French reciprocity option is unlikely to affect a UK bidder.

5.4 *The regulatory approach in Belgium: Articles 9, 11 and 12*

5.4.1 The state of implementation of the Directive in Belgium

Almost a year after the deadline for implementing the Directive, Belgium finally implemented it on 1 April 2007. The question to ask: did late implementation affect investors and would they have a cause of action against the Belgian regulator? This depends on the legal framework of the Belgian implementing legislation. At EU level, and in particular in relation to Articles 9 and 11, it is doubtful – as these controversial provisions are optional, it is difficult to criticise a Member State unless its approach on whether or not to opt out is made known. That uncertainty in itself defeats the rights of investors in a Directive not implemented. Now that Belgium has opted out of both Articles 9 and 11 of the Directive,⁴¹² whether or not barriers negatively affected investors in the period before the implementation, remains academic – these barriers have now been legitimised. As if to further distance itself from the scourge of the Directive, Belgium has also allowed its companies to apply the reciprocity exception – more for sake of the Commission’s statistics of states reluctant to remove takeover barriers.

The approach taken by Belgium poses two difficulties under EU law. First, opting out of Article 9 of the Directive reflects a protectionist spirit, one that makes it difficult for nationals or companies of other Member States to launch hostile takeovers in Belgium. Although this does not directly restrict freedom of establishment, it makes such freedom illusory, and therefore likely to

⁴¹² See Steven De Schrijner and Others, ‘Belgium implements EU takeover directive’ (2007) *European Lawyear* 60.

constitute a restriction within the meaning of Article 43 of the EC Treaty.⁴¹³ Secondly, the opting out combined with the reciprocity exception is likely to substantially restrict the freedom of investors buying shares and taking over Belgian companies. The reciprocity exception is therefore likely to constitute a restriction to free movement of capital contrary to Article 56 of the EC Treaty. That the reciprocity exception is provided for in the Directive is no defence for Belgium, as it has to be interpreted to conform to Treaty provisions.

5.4.2 A comparison of Belgian and UK structures

In this comparison, information on the Belgian takeovers is drawn from the findings of De Schrijner.⁴¹⁴ The Belgian Banking, Finance and Insurance Commission (*Commissie voor Financiering en Assurantie* – the ‘BFIC’) is a body responsible for supervising takeovers. Unlike UK takeover regulation that dates back to the 1960s, Belgian takeover law only dates back to 1989 – which law was adopted after a hostile bid by Carlo de Benedetti on the ‘*Société Générale de Belgique*’ in November 1988. However, the UK regulation has continued without statutory basis until 20 May 2006, whilst Belgian regulation started off on a statutory footing in 1989. Since then, takeover regulation in Belgium has developed slowly. For instance, compared to the UK mandatory bid with a defined threshold of 30 per cent, Belgian law did not have a fixed threshold that triggered an obligation to launch a bid. Implementing the Directive has more significantly changed the regulatory environment in Belgium than it has done in the UK.

⁴¹³ Article 43 of EC Treaty provides in part that ‘restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited’.

⁴¹⁴ Steven De Schrijner and Others, ‘Belgium implements EU takeover directive’ (2007) Euro Law 60.

5.5 *The regulatory approach in The Netherlands: Articles 9, 11 and 12*

5.5.1 The state of implementation of the Directive in the Netherlands

In The Netherlands, the Directive was implemented by an interim legislation of 15 May 2006, the Temporary Exemption Regulation for Public Offers (*Tijdelijke vrijstellingsregeling overnamebiedingen*). This supplements other Dutch Civil Codes to the extent that it deals with those provisions of the Takeover Directive that have direct effect on takeovers and would otherwise lead to complications within the EU pending the full implementation of the Takeover Directive.⁴¹⁵ The Netherlands has opted out of both Articles 9 and 11, but will retain its restrictions such as granting veto rights in respect of a change to the articles of association to specific shareholders.⁴¹⁶ Opting out of Article 9 is not surprising, as The Netherlands had no such equivalent provision prior to the Directive. The Netherlands' approach is likely to create restrictions to free movement of capital and freedom of establishment contrary to the EC Treaty.

5.5.2 A comparison of the UK and The Netherlands markets

The main difference between The Netherlands and the UK lies in how their regulated markets have facilitated or hindered hostile takeovers. Article 9 of the Directive regulates the use of defensive measures that are designed to frustrate a takeover bid. In effect, Article 9 facilitates hostile takeovers, which are more facilitated in the UK than in The Netherlands. Right from the earlier draft Directive, both the UK and The Netherlands have had a difference of approach to Article 9. The 1996 proposal Directive was opposed by both the UK and The Netherlands, but for different reasons. The UK feared that the

⁴¹⁵ C Elst and L Steen, 'Opportunities in the Merger and Acquisition Aftermarket: Squeezing Out and Selling Out' in G Gregoriou and L Renneboog (eds) *Corporate Governance and Regulatory Impact on Mergers and Acquisitions* (Academic Press, Massachusetts 2007) 191, 215.

⁴¹⁶ A Kay and others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39, 43 <<http://www.practicallaw.com/crossborder>> accessed 7 August 2007.

Directive did not facilitate hostile takeovers, whilst the Netherlands feared that its companies would be subject to hostile takeovers under the proposed Directive.⁴¹⁷

These fears stemmed from the wording of Article 4(5) of the 1996 proposal, which gave room for parties to seek the intervention of the courts. The underlying issue, in the UK, was that the Code disallows defensive tactics that may frustrate a bid unless the board obtains authorisation from the general meeting of the shareholders. On the other spectrum, target companies in The Netherlands enjoy a number of defensive tactics for frustrating a hostile bid, and until recently, there has never been a successful hostile bid.⁴¹⁸ Given that The Netherlands has opted out of Article 9 of the Directive, a UK bidder would find it hard to launch a hostile takeover in The Netherlands. Given that the UK has opted in to Article 9 with no reciprocity rule, a Netherlands bidder is facilitated in launching a hostile takeover in the UK. The playing field between The Netherlands and the UK is not level, with the result that a UK bidder is hindered in successfully launching a takeover bid in The Netherlands.

5.6 The regulatory approach in Italy: articles 9, 11 and 12

5.6.1 The state of implementation of the Directive in Italy

A year after the deadline for implementing the Directive, Italy had not yet implemented it.⁴¹⁹ It is said that half of Italian listed companies have one shareholder controlling the ownership of at least 55 per cent of the votes.⁴²⁰ As companies with concentrated share structures tend to have little incentive for provisions like Article 9, it is perhaps the reason why the implementation of

⁴¹⁷ See KJ Hopt, 'Takeover regulation in Europe – The battle for the 13th directive on takeovers' (2002) 15 Aust JCL 1, 9.

⁴¹⁸ V Edwards, *EC Company Law* (OUP, Oxford 1999) 397.

⁴¹⁹ A Kay and others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39, 41 <<http://www.practicallaw.com/crossborder>> 07 August 2007.

⁴²⁰ Luca Enriques and Paolo Volpin, 'Corporate Governance Reforms in Continental Europe' (2007) 21 *Journal of Economic Perspectives* 117, 122.

the Directive was stalled. Whether late implementation has affected investors, and they would have cause of action against Italian regulators, is not investigated here. How Italy will implement Articles 9 and 11 of the Directive remains to be seen. This uncertainty as to how Italy will decide on the controversial and optional provisions only adds to uncertainty about the overall impact of the Directive. At the time of writing one fact is known: namely that the Italian supervisory authority is the National Commission for Companies and the Stock Exchange (*Commissione Nazionale per la Società e la Borsa*) (CONSOB)). It remains to be seen how implementing rules in Italy will affect UK's interests in cross-border takeovers.

5.2.2 Comparison of Italian and UK regulations

Unlike in the UK, takeover regulations in Italy have tended to be protectionist. More generally, Italian corporate law has historically provided poor protection for investors, while enforcement institutions, like the courts or the Italian CONSOB, have been unable to make up for the deficiencies of the law.⁴²¹ With this background, it would not be surprising if Italy decided to opt out of both Articles 9 and/or 11 of the Directive or to apply a reciprocity rule if it opts in. Unless Member States like Italy adopt a more liberal takeover approach (as in the UK) as opposed to a protectionist one, cross-border hostile takeovers will remain hindered.

5.7 Conclusion

In April 2004, following 15 years of debate and negotiation, the European Union adopted a much watered down version of the Takeover Bid Directive.⁴²² Its aim of establishing a level playing field for takeovers across Europe was hindered by the level of compromise involved in agreeing the provisions of the

⁴²¹ Luca Enriques and Paolo Volpin, 'Corporate Governance Reforms in Continental Europe' (2007) 21 *Journal of Economic Perspectives* 117, 128.

⁴²² Peter Werdmüller, 'Compatibility of the EU Takeover Bid Directive Reciprocity Rule with EU Free Movement Rules' (2006) *BLRev* 64.

Directive.⁴²³ The core provisions of the Directive, Articles 9 and 11, are made optional under Article 12 – making it difficult for hostile takeovers. Cranston was right in asserting that it is ‘not an unreasonable hypothesis that the takeover directive, when effective, will not radically change the environment of EC countries regarding hostile takeovers, at least not for the time being, since the institutional and cultural barriers will remain’.⁴²⁴ As predicted, the Directive is hardly a triumph in relation to cross-border takeovers.

The delay by some Member States (like Italy) in implementing the, in the light of the options such Member States are likely to take, creates a level of uncertainty for bidders as to which provisions will apply in any particular takeover bid. Where, as is the case with Germany, a Member State has opted out of Article 9 of the Directive, but has retained its pre-existing restrictions on defensive measures, it remains unclear whether these restrictions equate with Article 9 of the Directive and are therefore unlikely to infringe Article 56 of the EC Treaty. Where, as is the case with France, a Member State has opted out of Article 11 of the Directive, but has allowed its companies to apply the reciprocity rule, such that a company that opts in to Article 11 on a voluntary basis can immediately disapply the option as soon as it becomes a target, such ‘reversibility of the company’s decision may even create confusion on the market’.⁴²⁵ With the UK opting in to Article 9 and not applying a reciprocity rule, and the Netherlands taking an opposite approach, the playing field between the two states remain unlevelled – a Netherlands bidder is facilitated in launching a hostile takeover in the UK, whilst a UK bidder is hindered in successfully launching a takeover bid in Netherlands.

⁴²³ See A Kay and Others, ‘Takeovers Directive implementation and impact’ (2007) *Cross-border Quarterly*, April-June, 39, 39-40 <<http://www.practicallaw.com/crossborder>> accessed 07 August 2007.

⁴²⁴ R Cranston, ‘The Rise and Rise of the Hostile Takeover’ in Hopt and Wymeersch (eds), *European Takeovers* (Butterworths, London 1992) 77, 92.

⁴²⁵ European Commission, ‘Report on the implementation of the Directive on Takeover Bids’ (Brussels, 21 February 2007) 10.

Drawing from the Commission report of February 2007,⁴²⁶ it is not unreasonable to conclude that the whole project in respect of the Directive is disappointing for the Commission. In proposing the Directive, the Commission's aim was to promote integration of European capital markets by creating favourable conditions for the emergence of a European market for corporate control, namely: efficient takeover mechanisms; a common regulatory framework; and strong rights for shareholders, including minority shareholders. Two key provisions of the Directive — board neutrality and breakthrough — were considered to be particularly important in this respect. The final compromise on the Directive subjected the board neutrality and breakthrough rules to complex optional arrangements. Management boards which, before the implementation of the Directive had been required to abstain from taking any measures likely to frustrate the takeover bid during the bid period without the approval of shareholders, are now permitted to do so under certain circumstances. These Member States have increased the managements' power to take frustrating measures without the approval of shareholders on the proposed measure during the bid period. Some Member States, including France, have introduced the reciprocity exception, which may hold back the emergence of an active takeover market contrary to the original objective of the Directive.

The Directive is founded on the freedom of establishment enshrined in Article 44 of the EC Treaty. Where Member States have opted out of Article 9, such an option is likely to render illusory the freedom of establishment. It would also create defensive measures that are likely to be seen as being in breach of Article 56 of the Treaty. Although Article 12 of the Directive allows for a reciprocity provision, Member States like France that have opted to apply a reciprocity rule are at risk of being found in breach of their Treaty obligations under Article 56 of the Treaty. The likely reason for applying a reciprocity rule is the protection of economic interests, which the European

⁴²⁶ European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007).

Court of Justice has long ruled that ‘economic grounds can never serve as justification for obstacles prohibited by the Treaty’.⁴²⁷ In light of the European Court of Justice jurisprudence, that the Directive allows for the reciprocity provision is no guarantee that the ECJ would not rule against a Member State that applies it. With ‘the number of Member States implementing the Directive in a seemingly protectionist way [being] unexpectedly large’,⁴²⁸ it will require the Commission to proactively promote the Directive in the spirit of EC Treaty obligations, in order ‘to prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures’.⁴²⁹ This requires the reading down of Articles 9, 11 and 12 and the Directive’s aims of facilitating corporate restructuring through takeovers, to conform to EC Treaty obligations – freedom of establishment and free movement of capital.

⁴²⁷ Case C367/98 *Commission v Portugal* [2002] ECR I-4731, paragraph 52.

⁴²⁸ European Commission, ‘Report on the implementation of the Directive on Takeover Bids’ (Brussels, 21 February 2007) 9.

⁴²⁹ Recital 3 of the Directive.

Chapter 6: Harmonising Takeover Regulation in Europe

6.1 Introduction

It could be termed bravery for the then Chairman of the Panel to conclude that the Directive ‘is hardly a triumph for harmonisation since the contentious areas remain a matter for Member States to decide for themselves’,⁴³⁰ and equally so for Ferran to conclude that the Directive ‘is an embarrassment for the EU: as much time and effort was spent to achieve so little’.⁴³¹ For example, it is argued, quite rightly, that ‘the Directive’s failure to prescribe a uniform threshold of shareholding triggering the mandatory bid will limit its harmonising effect’.⁴³² But far from this merely being exaggeration, it is the obvious logical conclusion one can come to – and this writer concurs.

The opening recital and the preamble to the Directive leave no doubt as to its aim of harmonising takeover rules in accordance with Article 44(2)(g) of the Treaty – the Directive is to coordinate safeguards with a view to making such safeguards *equivalent throughout the Community*.⁴³³ This chapter looks at the wider question of how the implementation of the Directive affects the harmonisation process of takeover regulation and corporate law in Europe. It looks at the effect of allowing Member States to opt out or in of Articles 9 and 11, major articles of the Directive, and the effect of allowing Member States to apply rules different from those of other Member States and whether that would result in an unlevelled playing field in respect of takeovers in the EU. These options for individual Member States and companies create a level of uncertainty for bidders as to which provisions will apply in any particular target’s case. One example here is Germany, which has opted out of Article 9

⁴³⁰ P Scott, The Takeover Panel Report on the year ended 31 March 2004, 8.

⁴³¹ Eilís Ferran, *Building EU Securities Market* (Cambridge University Press, Cambridge 2004) 117.

⁴³² V Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’ (2004) 1 ECFLR 416, 439.

⁴³³ Recital 1 of the Directive – emphasis added.

but has retained its current restrictions on frustrating actions.⁴³⁴ These retained restrictions have the potential to confuse bidders as to which rules, whether national or the Directive, apply.

Just like the 1996 proposal, the Directive is ‘too general and leaves too much to the discretion of Member States’, and if it were not for ‘disagreement between Member States on so many issues in the takeover area, a more-detailed directive would be preferable’.⁴³⁵ Without detailed rules in the Directive, it is difficult to achieve legal harmonisation in Europe in the field of takeovers. Yet, legal harmonisation is vital in order to prevent individual Member States using their legal systems to erect or maintain barriers to market access with a view to protecting their own enterprises from takeovers.⁴³⁶ Its aim of establishing a level playing field for takeovers across Europe was hindered by the level of compromise involved in agreeing the provisions of the Directive; as such, it is not an ‘EU Takeover Code’, but instead ‘a framework directive’, establishing minimum standards for the regulation of takeovers.⁴³⁷

6.2 *Minimum regulatory standard versus detailed Directive*

What is meant by minimum and full harmonisation is explained by the setting of EU rules below or beyond which national rules are limited.⁴³⁸ Full harmonisation concerns situations where diverse national rules are replaced by a single EU rule, leaving no room for Member State action. Minimum harmonisation concerns situations where the EU sets rules below which

⁴³⁴ A Kay and Others, ‘Takeovers Directive implementation and impact’ (2007) *Cross-border Quarterly*, April-June, 39, 40 <<http://www.practicallaw.com/crossborder>> accessed 7 August 2007.

⁴³⁵ M Andenas, ‘European Directive and The City’ (1997) 18 *Co Law* 101, 104.

⁴³⁶ E Wymeersch, ‘Takeover Regulation in Europe: The Battle of the 13th Directive on Takeovers’ (2002) 15 *Aust JCL* 1, 8.

⁴³⁷ A Kay and Others, ‘Takeovers Directive implementation and impact’ (2007) *Cross-border Quarterly*, April-June, 39, 39-40 <<http://www.practicallaw.com/crossborder>> accessed 07 August 2007.

⁴³⁸ Catherine Barnard, *The substantive law of the EU: The four freedoms* (2nd edn OUP, Oxford 2007) 591, 600.

national law cannot fall, leaving discretion to Member States to impose higher rules. Minimum harmonisation is not appropriate for areas that are at the heart of the internal market.⁴³⁹ Takeover regulations is at the heart of the internal market and therefore its success requires full harmonisation.

European regulation is by definition supranational and hence harmonisation one of its *raisons d'être*.⁴⁴⁰ The preamble to the Directive confirms that the aim was to make takeover safeguards *equivalent throughout the Community*.⁴⁴¹ Since its implementation, it has become apparent that the ways in which Member States have approached its core provisions have hardly produced harmonised safeguards. Possibly due to its implementation outcome, some commentators have concluded that the Directive aims at a 'minimal harmonization' of takeover procedures.⁴⁴² But did the Directive ever aim at a 'minimum' harmonisation or has it simply found itself short of a full harmonisation? Or, does the Directive actually provide even a 'minimum' harmonisation? Elst accepts that the lack of any harmonisation in the legal framework, as seen in squeeze-out and sell-out rights, is a missed opportunity.⁴⁴³ Despite harmonisation being its *raison d'être*, the Directive hardly achieves any harmonisation.

With varied corporate structures, dispersed and concentrated share ownerships, it is difficult to have rules that will appeal to all Member States. For example, the mandatory bid rule impedes the takeover of a typical German

⁴³⁹ M Dougan, 'Minimum harmonisation and the internal market' (2000) 37 CMLRev 853, 860.

⁴⁴⁰ M Burkart and F Panunzi, 'Mandatory bids, squeeze-out and the dynamics of the tender offer process' in G Ferrarini and Others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 737, 744; – '*raisons d'être*' French phrase meaning 'reasons for being'.

⁴⁴¹ Recital 1 of the Directive – emphasis added.

⁴⁴² C Elst and others, 'Squeezing and Selling-out – a Patchwork of Rules in Five European Member States' (2007) 4 ECL 19, 22; C Elst and L Steen, 'Opportunities in the Merger and Acquisition Aftermarket: Squeezing Out and Selling Out' in G Gregoriou and L Renneboog (eds) *Corporate Governance and Regulatory Impact on Mergers and Acquisitions* (Academic Press, Massachusetts 2007) 191, 215.

⁴⁴³ C Elst and others, 'Squeezing and Selling-out – a Patchwork of Rules in Five European Member States' (2007) 4 ECL 19, 25.

firm with its controlling owner but not that of a typical UK firm with its dispersed ownership.⁴⁴⁴ The mandatory bid rule being mandatory in the Directive, but for its varied application, would have brought a gloss of harmonisation across Europe. In some countries, for instance in the Netherlands, mandatory offers have been introduced for the first time,⁴⁴⁵ which to that extent is an achievement. However, the Directive fails to harmonise even this mandatory rule – it is open to Member States to set their own threshold that triggers a mandatory bid.⁴⁴⁶ The varied corporate structures led to political compromises in the Directive, which saw its core provisions made optional – a recipe for disharmonisation. Possibly due to such compromises, commentators have concluded that ‘most EC corporate law rules can be categorised as optional, market-mimicking, unimportant or avoidable’.⁴⁴⁷ Indeed, to the disappointment of the Commission, a number of Member States have opted out of the core provisions.⁴⁴⁸

The concepts used to refer to the Directive include a ‘framework directive’ and a ‘minimum standards directive’.⁴⁴⁹ Both are but desperate attempts to explain the Directive’s failure to meet its original aim of promoting strong European market integration. Directives by their very nature are ‘framework’

⁴⁴⁴ M Burkart and F Panunzi, ‘Mandatory bids, squeeze-out and the dynamics of the tender offer process’ in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 737, 744.

⁴⁴⁵ A Kay and Others, ‘Takeovers Directive implementation and impact’ (2007) *Cross-border Quarterly*, April-June, 39, 43 <<http://www.practicallaw.com/crossborder>> accessed 7 August 2007.

⁴⁴⁶ Article 5(3) provides that ‘the percentage of voting rights which confers control for the purposes of [a mandatory bid] and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office’.

⁴⁴⁷ L Enriques, ‘EC company law Directives and Regulations: how trivial are they?’ (2005) ECGI Law Working Paper number 39, 5.

⁴⁴⁸ See European Commission, ‘Report on the implementation of the Directive on Takeover Bids’ (Brussels, 21 February 2007).

⁴⁴⁹ For example, and without criticism, many commentators have strained to explain that the Directive has been reduced by compromises to ‘a framework directive, establishing minimum standards for the regulation of takeovers’ – see A Kay and Others, ‘Takeovers Directive implementation and impact’ (2007) *Cross-border Quarterly*, April-June, 39, 39-40 <<http://www.practicallaw.com/crossborder>> accessed 7 August 2007.

measures;⁴⁵⁰ it is pointless to call them framework to justify their ‘soft’ effect. Justifying its ‘softness’, by calling it a minimum standards Directive, is equally pointless given that the EC Treaty already allows for a minimum standards measure. Commentators seem to be at pains to bluntly say that the Directive is a failure as far as harmonisation of takeover safeguards is concerned. But far from admitting failure, the Commission only needs to revisit the jurisprudence of the ECJ in interpreting all Community measures in the spirit of the EC Treaty. The so-called minimum standards Directive can still be enforced on Member States as a full harmonisation Directive. For example, opting out of Article 9 is likely to create takeover barriers and deter investors, which in turn can be challenged for breach of free movement of capital under Article 56 EC Treaty.⁴⁵¹

6.3 Joint regulatory responsibility between Member States

The Directive provides for joint regulatory responsibility between Member States under Article 4(2). Under this provision, a bid will be subject to control by the supervisory authority in the Member State where the offeree company has its registered office, if the company’s shares are traded on a regulated market in that Member State. If that is not the case, then the supervisory authority is that of the Member State on whose regulated market the shares are traded, while the company law obligations would remain to be governed by the law of the State of incorporation.

Much as the Directive provides categories to which supervisory jurisdiction would fall depending on incorporation and where the offeree company trades its securities, it does not provide for a mechanism for resolving jurisdictional disputes between supervisory authorities. Whereas it is unlikely that this would raise significant difficulties for the UK, it is likely to cause much delays

⁴⁵⁰ Article 189 of the EC Treaty envisages a Directive to be ‘binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities, the choice and form of methods’ – this is a ‘framework’.

⁴⁵¹ See further analysis of free movement of capital in Chapter 7 below.

of takeovers in other jurisdictions. This concept of shared jurisdiction has already raised questions in the Deutsche Börse and the New York Stock Exchange's battle for Paris-listed Euronext – a company incorporated in The Netherlands.⁴⁵² Another example is the Mittal Steel takeover battle for a rival steel company, Arcelor – a company incorporated and listed in Luxembourg, but also admitted on other regulated markets in France, Spain and Belgium, with over 90 per cent of its activities carried out in France. The regulators in all the four jurisdictions associated with Arcelor asserted jurisdiction on offer issues like advertising and disclosure. Although by the time of the Arcelor offer, none of the jurisdictions had implemented the Directive, the difficulties encountered are an indicator of the likely difficulties of shared jurisdiction.

As European integration progresses with the increase in freedom of establishment and free movement of capital, companies that are incorporated in other Member States and have their securities listed and traded only in the UK, are likely to increase. In those situations, Article 4(2)(e) provides that the Panel will supervise 'matters relating to the bid procedure' while a supervisor in the state where the company is incorporated supervises 'matters relating to company law'. If the company law in that other state is weak and does not provide adequate investor protection, such a situation is likely to cause delays in the takeover procedure and thereby affect the interests of a UK bidder who becomes subject to external regulators other than the UK's Panel.

Although harmonisation seem to be weak in this aspect of the Directive, as it would not be in the interest of other regulators or foreign companies not to cooperate with the Panel, it is unlikely that the split jurisdiction rule will cause any practical problem. All regulators have a duty to cooperate with one another.⁴⁵³ Nothing in the Directive prevents intervention by the Commission

⁴⁵² A Kay and Others, 'Takeovers Directive implementation and impact' (2007) *Cross-border Quarterly*, April-June, 39, 40 <<http://www.practicallaw.com/crossborder>> accessed 07 August 2007.

⁴⁵³ Recital 5 of the Directive.

if cooperation between regulators fails.⁴⁵⁴ Companies that engage in takeovers in the UK have a vested economic interest that they will not wish to jeopardise by not cooperating with the Panel. After all, takeovers are but financial transactions – the financial City in the UK is accustomed to listening to the Panel, and so companies that become subject to the Panel’s jurisdiction, be it that they are registered in other Member States, will either cooperate with the Panel or have City norms defeat their cause.

6.4 *Discretionary and national law issues in the Directive*

Commenting on the draft Directive of 1996, the UK Parliament observed that ‘the Directive would not meet the objective of providing a minimum standard of protection for shareholders as it allows for significant differences in the attitude towards such protection’.⁴⁵⁵ This prediction appears to have come to pass. The problem emanates from the resistance from Member States on the core provisions of the Directive. In The Netherlands, for instance, a company law adviser of The Netherlands Trade Union argued that Articles 5, 9 and 11 substantially interfere with the Member States’ corporate governance systems as embodied in their company laws.⁴⁵⁶ As a result of The Netherlands’ arguments and other resistance from Member States, political compromises were reached, which in turn gave Member States much discretion in applying the core provisions. As a result of this compromise, regulatory arbitrage and national protectionism could continue to be a characteristic of cross-border takeovers in Europe in the post-Takeover Directive environment.⁴⁵⁷ But the

⁴⁵⁴ Recital 29 of the Directive suggests a monitoring role for the Commission; alternatively, the Commission may, if necessary, take steps under Article 226 of the EC Treaty, as a last resort – which is unlikely.

⁴⁵⁵ House of Commons, European Legislation - Twelfth Report, London, 14 January 1998.

⁴⁵⁶ Joan Bloemarts, ‘European Parliament Committee on Legal Affairs and Internal Market: Public hearing on the Proposal for a Directive on Takeover Bids’ (COM (2002) 534, Brussels 2003) <<http://www.europarl.europa.eu/hearings/20030128/juri/bloemarts.pdf>> accessed 3 September 2007.

⁴⁵⁷ Scott V Simpson, ‘EU Directive fails to harmonise takeovers’ (2005) A Special IFLR Supplement 15 <<http://www.iflr.com>> accessed 3 July 2007.

reality is, without these compromises, the Directive would not have been passed. However, the price to be paid as a result of this political compromise is likely to be a lack of an EU-wide harmonization of rules relating to takeover defences.⁴⁵⁸

6.5 *General implementation and regulatory impact*

The deadline for implementing the Directive was 20 May 2006. Out of by then 25 EU Member States, only 13 had implemented the 13th Directive on time. At the time of writing, Italy has yet to implement the Directive. It is therefore too early to assess the full impact of the Directive. A partial impact assessment, which can be deduced from the Commission's report of February 2007,⁴⁵⁹ suggests that the Directive fails to meet its objective of facilitating corporate restructuring by removing takeover barriers. In its report, the Commission concluded that a large number of Member States have implemented the Directive in a protectionist manner. The report also states that there is a risk that the board neutrality rule, Article 9 of the Directive, as implemented in Member States where most of whom have opted out, will hold back the emergence of a European market for corporate control rather than facilitate it. In its final remarks, the Commission intimated the possibility of revising the Directive before the due date of 2011. Charlie McCreevy, Internal Market and Services Commissioner, summarises this partial impact as follows:

Too many Member States are reluctant to lift existing barriers, and some are even giving companies yet more power to thwart bids. The protectionist attitude of a few seems to have had a knock-on effect on others. If this trend continues, then there is a real risk that companies launching a takeover bid will face more barriers, not fewer. That goes completely against the whole idea of the Directive.⁴⁶⁰

⁴⁵⁸ Scott V Simpson, 'EU Directive fails to harmonise takeovers' (2005) A Special IFLR Supplement 15 <<http://www.iflr.com>> accessed 3 July 2007.

⁴⁵⁹ <http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf> accessed 30 August 2007.

⁴⁶⁰ Commission Press Release 251 (Brussels, 27 February 2007).

In aiming at removing barriers to takeovers, the Directive would have liberalised the market for corporate control. However, given the range of exemptions available and the current antipathy to hostile takeover activity in continental Europe, it is unlikely to be successful in liberalising the market for corporate control.⁴⁶¹

In regard to its objectives of making takeover safeguards *equivalent throughout the Community*,⁴⁶² and preventing patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures,⁴⁶³ one cannot help but think that, by making its core provisions (Articles 9 and 11), optional, the Directive was doomed *ab initio* to fail in achieving those objectives.

Clearly, the Directive's harmonising effect was ruined by compromises that made the core provisions optional. Expressing dissatisfaction at the contemplation of such compromise, Commissioner Frits Bolkestein said that such Directive 'without Articles 9 and 11, would not be worth the paper it was written on'.⁴⁶⁴ Indeed, when the Directive was being enacted, Member States officially agreed that 'the directive represented little progress towards a genuine level playing field on takeovers in the EU', and they accepted the *rapporteur's* position that 'half a loaf is better than none' and that it was time to 'put an end to this never-ending story'.⁴⁶⁵ To that end, Ferran concluded that the takeover directive in its final form is an embarrassment for the EU: as much time and effort was spent to achieve so little.⁴⁶⁶ With this background,

⁴⁶¹ Niamh Moloney, 'Financial Market Regulation in the Post-Financial Services Action Plan era' (2006) 55 ICLQ 982, 983.

⁴⁶² Recital 1 of the Directive – emphasis added.

⁴⁶³ Recital 3 of the Directive.

⁴⁶⁴ Commission Memo 113 (Brussels, 21 May 2003).

⁴⁶⁵ K Lehne, European Parliament - legislative opinion, 1st reading or single reading (16/12/2003), <<http://www.europarl.eu.int/oeil/FindByProcnum.do?lang=2&procnum=COD/2002/0240>> accessed 31 August 2007.

⁴⁶⁶ Eilís Ferran, *Building EU Securities Market* (CUP, Cambridge 2004) 117.

given the Commission report of February 2007, it is neither inapt nor unreasonable to conclude that the Directive fails in its objective of harmonising takeover rules in Europe.

6.6 *Optionality and reciprocity provisions*

Article 12 of the Directive allows Member States to opt in/out of Articles 9 and 11 – optionality provisions. This creates differential application across the EU, as Member States can opt out of Articles 9 or 11 and in to the other, or opt in or out of both – removing or creating obstacles to takeovers. According to Gatti, such an ‘optionality device ends up setting forth (or, better, tolerating) a Babel-like system for takeover defences around the various national legislations’.⁴⁶⁷ Further, Article 12 allows companies whose Member States have opted in/out of Articles 9 and 11 to reverse the optionality when faced with a bidder who is not subject to the same rules – reciprocity provision. This increases the ‘Babel-like’ situation, and hardly helps the harmonising effect of the Directive.

Taking advantage of the optionality and reciprocity provisions, some Member States have implemented the Directive in a protectionist manner. France, for example, will give companies facing a hostile bid the right to issue warrants convertible into shares at a discounted price to existing shareholders – a move that would make any takeover more expensive.⁴⁶⁸ To say that such a move by France violates the spirit of the Directive is an incorrect statement, for the Directive allows optionality and reciprocity. However, the creation of obstacles to takeovers undermines the free movement of capital. Member States have an obligation under the EC Treaty to refrain from adopting measures infringing free movement of capital. That the Directive allows for the creation of obstacles to takeovers under the optionality and reciprocity

⁴⁶⁷ Matteo Gatti, ‘Optionality Arrangements and Reciprocity in the European Takeover Directive’ (2005) 6 EBOLR 553, 567.

⁴⁶⁸ Tobias Buck, ‘Setback for EU as members opt out of takeover rules’ *Financial Times*, 02 March 2006, Brussels.

provisions is unlikely to serve as a defence for breach of an EC Treaty obligation.

6.7 Conclusion

It may well be academically inapt to conclude that the Directive fails to meet its objective of harmonising takeover regulation in Europe. It may be safer to state that it is too early to make any conclusions. But with the research evidence analysed above, it is difficult to avoid a blunt statement that the Directive hardly achieves any harmonisation. First, ‘the Directive’s failure to prescribe a uniform threshold of shareholding triggering the mandatory bid [limits] its harmonising effect’.⁴⁶⁹ By leaving it open to Member States to set their own threshold that triggers a mandatory bid, the Directive fails to harmonise the mandatory rule.

Secondly, by allowing Member States to opt in and out of the core provisions, Articles 9 and 11, the Directive fails to achieve a ‘harmonising of the regime of takeover defences’.⁴⁷⁰ At the last minute in adopting the Directive, Articles 9 and 11 were compromised under Article 12, which renders them optional. The price paid as a result of this political compromise is likely to be the lack of an EU-wide harmonization of rules relating to

⁴⁶⁹ V Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’ (2004) 1 ECFLR 416, 439.

⁴⁷⁰ Matteo Gatti, ‘Optionality Arrangements and Reciprocity in the European Takeover Directive’ (2005) 6 EBOLR 553, 579.

takeover defences.⁴⁷¹ Takeover barriers remain in many Member States, due to the manner in which the Directive has been implemented, which effectively avoids the application of Articles 9 and 11. Again, other than avoiding being somewhat direct, Bolkestein's words that 'without Articles 9 and 11, [the Directive is] not worth the paper [it's] written on' may live to be reiterated.⁴⁷²

⁴⁷¹ Scott V Simpson, 'EU Directive fails to harmonise takeovers' (2005) A Special IFLR Supplement 15 <<http://www.iflr.com>> accessed 3 July 2007.

⁴⁷² Commission Memo 113, Brussels, 21 May 2003 – said by Commissioner Frits Bolkestein.

Chapter 7: EU Capital markets and Takeover Regulation

7.1 Introduction

As part of the company law harmonisation process, the Directive seeks to regulate an important element of the functioning of capital markets: the public bid for all the shares of a company.⁴⁷³ The Directive deals with the regulation of listed companies with securities traded on a regulated market. This raises the question whether takeovers should be discussed as a matter of securities regulation or company law. Whereas takeover bids would be considered to belong to securities regulation in most Member States, the EU deals with it from the – apparent – angle of company law.⁴⁷⁴ This raises a further question of whether ‘strict-law’ that dominates company law should be applied or rather the ‘soft-law’ approach generally seen in securities market regulation. In particular reference to takeovers, the Directive having been reduced to optional provisions, is hardly a ‘strict-law’ measure. If discussed under securities regulation, then, as stated by Winter, the Directive’s optional system ‘can be made to work and, compared to having no directive at all, would offer benefits in terms of setting a clear benchmark with market incentives to move into the direction of the benchmark’.⁴⁷⁵ If discussed under company law, the Directive may require an EC Treaty interpretation to bring it into line with the rigours of the ‘strict-law’ nature of company law – a suggested approach in this thesis.

It will be recalled that the Directive’s core provisions, Articles 9 and 11, which were meant to remove technical and structural barriers to takeover activities, were compromised and made optional under Article 12. Prima facie, Member States seem to be free to opt to restrict takeovers under Article 12 of the Directive. Many commentators have concluded that on that basis, the

⁴⁷³ Jaap Winter, ‘EU Company Law at the cross-roads’ in Guido Ferrarini (ed) *Reforming company and takeover law in Europe* (OUP, Oxford 2004) 12.

⁴⁷⁴ Eddy Wymeersch, ‘About techniques of regulating companies in the EU’ in Guido Ferrarini (ed) *Reforming company and takeover law in Europe* (OUP, Oxford 2004) 150.

⁴⁷⁵ Jaap Winter, ‘EU Company Law at the cross-roads’ in Guido Ferrarini (ed) *Reforming company and takeover law in Europe* (OUP, Oxford 2004) 17.

Directive is hardly a triumph and at worst a failure.⁴⁷⁶ In this chapter it is argued that such restriction by Member States is likely to be contrary to the free movement of capital under Article 56 of the EC Treaty. To the extent that the Directive is read to conform to the EC Treaty, it is likely that the Directive would be revived to fulfil its driving force of removing technical and structural barriers to takeover activities. Whether the Commission would opt to take this legalistic approach, to revive the Directive amid a rather politically versatile regulatory framework of takeovers, remains debatable.

7.2 Difficulties inherent in capital markets and takeovers

One of the difficulties inherent in capital markets and takeover regulation is the conflict between, on the one hand the need for legal certainty, espoused by Community interests, and on the other hand the need for economic freedom, espoused by national interests. In the words of Commissioner Charlie McCreevy,⁴⁷⁷ on the one hand, ‘without legal certainty, without reliable information, without clear framework rules markets cannot work for long’, and on the other hand, it ‘is economic freedom that lets markets best play their role – legislation has to help, not hinder, this process’. Company laws tend to take the former approach, whilst securities regulation takes the latter. The rapidity and deterrent characteristics of takeovers require economic considerations to be taken into account when considering legal intervention: this contingency explains the UK’s protracted reluctance to consider legal intervention. At the EU level, one either has to ignore this conflict or face it bluntly by espousing a legal-certainty approach to the regulation of capital markets.

On the other hand, there is the difficulty of lack of political will and reluctance of states to actively support the capital markets integration process in Europe. The history leading to the adoption of the Directive has been remarkably tainted with political struggles among Member States and the

⁴⁷⁶ See discussion under Chapter 6.1 above.

implementation of the Directive has been marred with economic protectionism. Yet this should not have been a difficult legislative process, considering that the Directive is anchored (or supposed to be) on the pillar of one of the fundamental freedoms of the EC Treaty – the free movement of capital.

One other example of the difficulties in regulating capital is the link between capital and taxation, which creates protectionism. Capital is directly linked with tax policy which is another means for the Member States to regulate their national economy – every country remains cautious about giving up sovereignty in this context.⁴⁷⁸ This probably explains why a Directive, that was meant to free up capital movement through takeovers, was reduced to unsatisfactory Directive.

Furthermore, it is difficult to build a strong regulatory framework for takeovers across nations with varied corporate structures. For example, Germany with its highly concentrated share-ownership structures would find no room for a takeover rule in Article 9 of the Directive. Indeed, Germany surprised its counterpart Member States when it opposed the draft Directive in 2001 by suddenly threatening not to back the directive ‘unless shareholder approval for frustrating action were eliminated from Article 9 or the entire article were removed from the Directive’.⁴⁷⁹ In a 273-273-tie vote on 4 July 2001 a German MEPs-led coalition rejected a text that was heavily influenced by the British City Code on Takeovers and Mergers.⁴⁸⁰ In a comparative study Dignam argues,⁴⁸¹ and rightly so, that by the EU simply introducing shareholder-oriented takeover regulation it is unlikely to exert a transforming effect in the face of much stronger influences, as concentrated ownership

⁴⁷⁷ Charlie McCreevy, ‘The Commission’s Financial Services Policy 2005-2010’, Exchange of Views on Financial Services Policy 2005-2010 Conference, Brussels, 18 July 2005.

⁴⁷⁸ Mads Andenas and Others, ‘Free movement of capital and national company law’ (2005) EBLR 757, 758.

⁴⁷⁹ KJ Hopt, ‘Takeover regulation in Europe – The battle for the 13th directive on takeovers’ (2002) 15 Aust JCL 1, 10.

⁴⁸⁰ Matteo Gatti, ‘Optionality Arrangements and Reciprocity in the European Takeover Directive’ (2005) 6 EBOLR 553, 561.

structures which are present in abundance in most of the EU social market systems.

The problem with concentrated ownership markets is that takeovers hardly thrive in such markets. In concentrated ownership markets, management often hold a close relationship with shareholders or are of a substantial shareholding, by means of which it is easy to influence shareholders against tendering their shares. As a result, Hahn observes that management would be likely to seek for large stable shareholders who would promise not to tender their shares to outside bidders.⁴⁸² As observed by Hahn, Germany, France and Italy are concentrated ownership markets, with less developed equity markets – of which financing of their businesses is based more on bank financing than public equity offerings.⁴⁸³ In contrast, as Hahn rightly points out, the UK relies on a well-developed liquid equity market with more corporations listed per capita than any other country.⁴⁸⁴ With this diverse equity market structure, it is no wonder that exporting UK takeover culture to the rest of Europe is an upheaval.

One way of curbing the above difficulties is to appeal to the jurisprudence of the European Court of Justice. On the broader jurisprudence, the ECJ regards the Treaties as having the effect of limiting Member States' 'sovereign rights' and creating 'a body of law which binds' Member States and 'their nationals'.⁴⁸⁵ On the specific jurisprudence of takeovers, the ECJ has shown through the golden shares cases that certain measures in share dealings can be a restriction to free movement of capital under the EC Treaty.⁴⁸⁶ This calls for

⁴⁸¹ Alan Dignam, 'Transplanting UK takeover culture: The EU takeovers directive and the Australian experience' (2007) IJDG 148.

⁴⁸² David Hahn, 'Concentrated ownership and control of corporate reorganisations' (2004) JCLS 117, 129.

⁴⁸³ David Hahn, 'Concentrated ownership and control of corporate reorganisations' (2004) JCLS 117, 132.

⁴⁸⁴ David Hahn, 'Concentrated ownership and control of corporate reorganisations' (2004) JCLS 117, 134.

⁴⁸⁵ Case 6/64 *Flaminio Costa v ENEL* [1964] ECR 585.

⁴⁸⁶ See discussion under 7.4 below.

an analysis of how opting out of certain provisions of the Directive can be interpreted as a restriction on free movement of capital and a breach of Article 56 EC Treaty.

7.3 *The scope and application of free movement of capital*

Free movement of capital is one of the fundamental freedoms laid down in the EC Treaty.⁴⁸⁷ Articles 3(1)(c) and 14(2) EC Treaty envisage an internal market without internal frontiers, in which free movement of goods, persons, services and capital is ensured. Article 56 EC Treaty, in particular, prohibits ‘all restrictions on the movement of capital between Member States and between Member States and third countries’. Article 56 EC Treaty has direct effect.

When considering the effect of the earlier version of Article 56 EC Treaty on free movement of capital (Article 67 EEC), the court ruled that Article 67 was only effective ‘to the extent necessary to ensure the proper functioning of the common market’;⁴⁸⁸ making the Article not directly effective. Moreover, Article 67 had not abolished all restrictions to free movement of capital. It was left to secondary EU legislation to introduce prohibitions; most significant secondary legislation was Directive 88/361.⁴⁸⁹ The Treaty on European Union amended the EC Treaty to include most of the provisions in Directive 88/361, and brought in what is now Article 56 EC Treaty. The court has since ruled that Article 56 EC is directly effective.⁴⁹⁰

⁴⁸⁷ For a detailed discussion see P Oliver and W-H Roth ‘The internal market and the four freedoms’ (2004) 41 CMLRev 407; also, see Case C-463/00 *Commission v Spain* [2003] ECR I-4581 para 68; L Flynn, ‘Coming of age: The free movement of capital case law 1993-2002’ (2002) 39 CMLRev 773, 776.

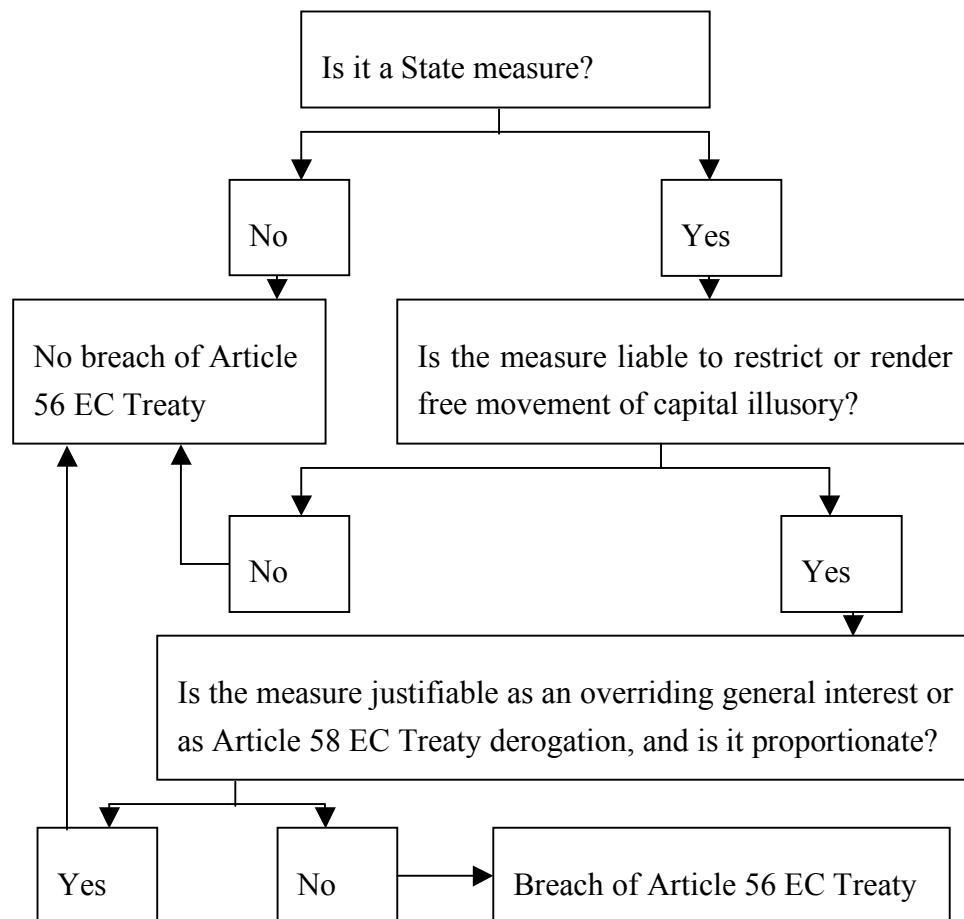
⁴⁸⁸ Case 203/80 *Casati* [1981] ECR 2595 para 10.

⁴⁸⁹ [1988] OJ L178/5.

⁴⁹⁰ Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 41; Joined Cases C-358/93 and C-416/93 *Aldo Bordessa and Others* [1995] ECR I-361 para 33.

To the extent that Article 56 EC Treaty has direct effect, it is invoked and applied independently without *per se* a need to refer to the Directive. As such, a measure that is allowed in secondary legislation, the Directive, can be found to be in violation of Article 56 EC Treaty. Following a ‘restrictive model’, it will be a breach of Article 56 EC Treaty, if the application of any provision in the Directive (a) is a State measure, which (b) restricts or renders illusory free movement of capital, and (c) the State has no justification generally or under Article 58 EC Treaty. In order to establish whether a measure is a breach of Article 56 EC Treaty, the European Court employs an approach to restrictions based on the model shown in the chart below.

Restrictive Model – finding Article 56 EC Treaty breach:



The EC Treaty does not define what amounts to ‘movement of capital’. The movement of capital is not defined literally – filing a car with money and

driving it outside the country is not capital movement.⁴⁹¹ The annex to Directive 88/361 contained a definition of what is capital. The court adopts and refers to this annex to define what is capital. As such, the court has ruled that the acquisition of shares on the capital market for the purpose of a financial investment is movement of capital.⁴⁹² Also, a resale of shares to the issuing company has been ruled as movement of capital.⁴⁹³

The scope of Article 56 EC Treaty is very broad – it applies to all cross-border transactions: ‘it makes no distinction between import and export, it covers all kinds of investments by both natural and legal persons, and includes shares or any form of share capital’.⁴⁹⁴ The Directive seeks to reinforce the Treaty by outlawing internal frontiers and obstacles to free movement of capital by facilitating investment through takeovers. To that extent, implementation of the Directive by Member States has to conform to the fundamental freedoms. Regardless of optional provisions in the Directive, it is for Member States to adopt measures that effectively safeguard the fundamental freedoms.⁴⁹⁵

In finding whether there is a breach of Article 56 EC Treaty, two models are usually advanced, the ‘non-discrimination model’ and the ‘no-restriction model’;⁴⁹⁶ the later is preferred herein, as shown above. The analysis of the non-discrimination model is difficult to defend, as it either violates the no-

⁴⁹¹ Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 33.

⁴⁹² Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-000 para 19.

⁴⁹³ Case C-265/04 *Bouanich v Skatteverket* [2006] ECR I-923 para 29.

⁴⁹⁴ See Mads Andenas and Others, ‘Free movement of capital and national company law’ (2005) EBLR 757, 766.

⁴⁹⁵ For example, in Case C-265/95 *Commission v France* [1997] ECR I-6959, a case concerning free movement of goods, the court said that whereas it is ‘not for the Community institutions to act in place of the Member States and to prescribe for them the measures which they must adopt in order to safeguard the free movement of goods’, the court would verify ‘whether the Member State concerned has adopted appropriate measures for ensuring free movement of goods’ – paras 33-35.

⁴⁹⁶ See Catherine Barnard, *The substantive law of the EU: The four freedoms* (2nd edn OUP, Oxford 2007) 532-563.

restriction model by justifying a restriction if it is not ‘substantial’ or adopts the approach sometimes taken by the court in relation to other freedoms. The court has made it clear in a number of decisions that breach of Article 56 EC Treaty does not depend on discrimination.⁴⁹⁷ Article 56 EC prohibits, not only discriminatory or particularly restrictive treatment of nationals of other Member States, but every restriction of cross-border transfer of capital.⁴⁹⁸ The requirement of the free movement of capital is infringed if the measure applies equally but dissuades investors from other Member States.⁴⁹⁹ As such, it would appear that the court applies the non-restrictive model in finding whether there is a breach of Article 56 EC Treaty.

Article 12 of the Directive provides room for Member States to restrict free movement of capital by opting out of Article 9 and applying defensive measures to defeat takeover bids. The question is whether such provision in EU secondary legislation gives a defence to Member States for failure to conform to the fundamental EC Treaty freedoms. In a number of cases,⁵⁰⁰ the ECJ ruled that secondary legislation must be in conformity with the limitations of the freedoms. As such, the Directive must be read down to conform to the EC Treaty provisions, or to the extent it does not conform, be disregarded. Like any other form of Treaty freedoms,⁵⁰¹ free movement of capital is directly applicable.⁵⁰² As such, private parties affected by how Member States have implemented the Directive need not seek legal redress by virtue of the Directive but could invoke the Treaty provision directly.

⁴⁹⁷ Cases C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 44-45; C-174/04 *Commission v Italy* [2005] ECR I-4933 para 12.

⁴⁹⁸ Mads Andenas and Others, ‘Free movement of capital and national company law’ (2005) EBLR 757, 769.

⁴⁹⁹ Cases C-250/94 *Sanz de Lera and Others* [1995] ECR I-4821 para 25; C-302/97 *Klaus Konle v Republik Oesterreich* [1999] ECR I-3099 para 44.

⁵⁰⁰ Cases C-80 and C-81/77 *Commissionaires Reunies and Fils de Henri Ramel* [1978] ECR 927; Case C-341/95 *Bettati* [1998] ECR I-4355.

⁵⁰¹ For instance, free movement of goods, see C-74/76 *Ianelli & Volpi/Meroni* [1977] ECR I-557 para 13; free movement of workers, see C-48/75 *Royer* [1976] ECR I-497 para 19/23; freedom of establishment, see C-2/74 *Reyners* [1974] ECR I-631 para 29/31; and free movement of services, see C-33/74 *Van Binsbergen* [1974] ECR I-1299.

⁵⁰² See C-358/93 *Aldo Bordessa* [1995] I-0361 para 17.

Takeovers facilitate capital movement within the EU. Apart from Article 9 being optional, the Directive aims at removing all obstacles to takeovers. Article 56 EC Treaty refers to ‘restrictions’ as opposed to ‘obstacles’ referred to in the Directive. The ECJ refers to and uses both terms interchangeably – for instance, in *Commission v Netherlands*,⁵⁰³ the court referred to both ‘restrictions’ and ‘obstacles’ to free movement of capital, whilst it referred to an ‘obstacle to the movement of capital’ in *Sandoz*.⁵⁰⁴ As such, any ‘obstacle’ to takeovers will amount to a ‘restriction’ contrary to Article 56 EC Treaty. The restriction to movement of capital does not have to be substantial – it is enough that the measure ‘dissuades investors in other Member States from investing’, and it is irrelevant that the measure does ‘not give rise to unequal treatment’.⁵⁰⁵

Even if a measure is restrictive, it may nonetheless not be a breach of Article 56, if it is justifiable under Article 58 EC Treaty. In *Commission v Portugal*,⁵⁰⁶ the court said that a restriction to free movement of capital can be justified if: (a) overriding requirements of general interest apply; or (b) express derogations in Article 58 EC Treaty apply, and the measure accords with the principle of proportionality. Article 58 EC Treaty derogations are essentially on the basis of taxation and public policy or security. These are difficult to invoke when a Member State wishes to restrict free movement of capital. The court interprets these derogations very strictly.⁵⁰⁷ In the case of derogations affecting takeovers, the ostensible ground for any derogation would take the form of economic protection. The court has ruled that these derogations cannot be applied to serve purely economic ends.⁵⁰⁸ In *Commission v Portugal*

⁵⁰³ Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-000 para 20.

⁵⁰⁴ Case C-439/97 *Sandoz GmbH v Finanzlandesdirektion für Wien, Niederösterreich und Burgenland* [1999] ECR I-7041 para 20.

⁵⁰⁵ Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 45.

⁵⁰⁶ Case C-367/98 *Commission v Portugal* [2002] ECR I-4731.

⁵⁰⁷ see Case 36/75 *Rutili v Minister of the Interior* [1975] ECR 1219 para 26/27.

⁵⁰⁸ Case 36/75 *Rutili v Minister of the Interior* [1975] ECR 1219 para 30.

the court said that ‘economic grounds can never serve as justification for obstacles prohibited by the Treaty’.⁵⁰⁹

The application of Article 56 is very wide. In ECJ jurisprudence, any measure that either renders unattractive the acquisition of shares in undertakings or impedes the acquisition of shares in the undertakings concerned or dissuades investors in other Member States from investing in the capital of those undertakings is contrary to Article 56 EC Treaty and is prohibited.⁵¹⁰ It is irrelevant that the measure applies equally to domestic and to foreign investors. In the view of the ECJ, such measures are liable to render free movement of capital illusory, which may make the investment in (or into) the company less attractive, and thus constitute an infringement of Article 56. Where a Member State has opted out of Article 9 of the Directive, ‘if the management uses defensive mechanisms this could be either a direct barrier to the acquisition of shares but also a restriction of shareholder rights which make the investment into the company less attractive’,⁵¹¹ might be better which Article 56 EC Treaty prohibits.

It should be remembered that the Commission initially resisted making Articles 9 and 11 of the Directive optional. However, having met resistance from Member States, a compromise was reached that left the core Articles optional under Article 12 of the Directive. In the above analysis it would be contrary to Article 56 EC Treaty for Member States to invoke Article 12 of the Directive. The Commission would be within its legal rights to insist that Member States refrain from breaching their Treaty obligations under Article 56 EC Treaty by implementing the Directive in a manner that creates obstacles to takeovers. Such an approach by the Commission is likely, however, to be seen as removing Article 12 of the Directive through the ‘back door’, and is likely

⁵⁰⁹ Case C-367/98 [2002] ECR I-4731 para 52.

⁵¹⁰ See Cases C-163/94 *Sanz de Lera* [1995] ECR I-4821 para 26/27; C-302/97 *Klaus v Republik Oesterreich* [1999] ECR I-3099; C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 56; C-483/99 *Commission v France* [2002] ECR I-4781 para 56; C-98/01 *Commission v UK* [2003] ECR I-04641.

to be met with resentment from Member States. As long as a State remains a Member of the EU, it is bound by EC Treaty provisions regardless of any contrary provisions in the Directive or any other secondary legislation.

7.4 Golden share cases and free movement of capital

Whether opting out of the optional provisions in the Directive would amount to a restriction contrary to Article 56 EC on free movement of capital can be assessed in the light of the ECJ case law on ‘golden share’ cases. A ‘golden share’ is a term used to denote a special share held by the state in a privatised company, which is usually held for the purpose of protecting the company from being subject to a takeover. Ordinarily, the golden share gives the state power to restrict acquisition of shares and disposal of assets in the company. It is to the extent of this restrictive power that golden shares have been objected to by the Commission as being contrary to freedom of establishment (Article 52 EC Treaty) and free movement of capital (Article 56 EC Treaty). In a number of cases brought before the ECJ, it has been ruled that golden share arrangements are contrary to EC Treaty obligations. A few of these cases merit a comparative analysis with the optional provisions in the Directive.

In two golden share cases, *Commission v Spain*,⁵¹² and *Commission v United Kingdom*,⁵¹³ the court found that the golden share arrangements applicable to the undertakings in Spanish companies (Repsol, Telefónica, Argentaria, Tabacalera, Endesa) and a British company (British Airports Authority (BAA)) were contrary to the principle of free movement of capital under Article 56 EC Treaty. In the Spanish companies, the golden share meant that the State had power to restrict and approve certain decisions, including merger or change of corporate objects or the disposal of certain assets or shareholdings, in those companies. In the British company, BAA, the golden

⁵¹¹ Mads Andenas and Others, ‘Free movement of capital and national company law’ (2005) EBLR 757, 778.

⁵¹² Case C-463/00 *Commission v Spain* [2003] ECR I-4581.

shares created power for the State to restrict and approve certain decisions, including disposal of an airport and the acquisition of more than 15 per cent of the voting shares in the company.

The court restated that Article 56 EC Treaty prohibits all restrictions on the movement of capital between Member States and between Member States and third countries. Investments in the form of participations, in the court's view, constituted movements of capital under the Community legislation. On that basis, the court found that both the Spanish and the UK golden share rules entailed restrictions on the free movement of capital between Member States. Although Member States can justify restrictions in limited circumstances under the Treaty, the court found that the restrictions failed the test of proportionality – the restrictions went beyond what was necessary in order to attain the objective they pursued.

Similar rulings of the court had been made in the earlier cases of *Commission v Portugal*,⁵¹⁴ and *Commission v France*.⁵¹⁵ In these cases, the court found the French and Portuguese golden share arrangements to be unlawful and contrary to Article 56 EC Treaty. In the Portuguese companies, the golden shareholding accorded the State power to limit participation by non-nationals and to establish a procedure for the grant of prior authorisation by the Minister of Finance once the interest of a person acquiring shares in a privatised company exceeded a ceiling of 10 per cent. In the French company (*Société Nationale Elf-Aquitaine*), the golden shareholding accorded the State power to approve in advance any acquisition of shares or rights that exceeded established limits on the holding of capital, and to oppose decisions to transfer shares or use them as security.

The court referred to Article 56 EC Treaty, which prohibits restrictions on free movement of capital between States. The court's ruling in both cases was uncompromising. It concluded that legislation, which is liable to impede the

⁵¹³ Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641.

⁵¹⁴ Case 367/98 *Commission v Portugal* [2002] ECR I-4731.

acquisition of shares in the undertakings concerned and to dissuade investors in other Member States from investing in the capital of those undertakings, may render the free movement of capital illusory, and thus constituted a restriction on movements of capital.

The foregoing illustrates, to some extent, that takeover rules that accord the board of directors the power to block a bid without giving shareholders a chance to decide on the merits of the bid are very likely to ‘dissuade investors’ from investing in the capital of those companies.⁵¹⁶ To that extent, such rules would be contrary to Article 56 EC Treaty, by which Member States have the obligation to ensure that companies under their jurisdiction comply with. As such, a Member State that has opted out of Article 9 of the Directive is very likely, in the light of the golden share cases, to be found wanting in its Treaty obligation. That the Directive allows a Member State to opt out of Article 9 is irrelevant to the breach of a Treaty obligation – the Directive, to the extent that it conflicts with Treaty provisions, would be inapplicable in order to comply with EC Treaty.

7.5 The Directive and free movement of capital

The Creation of an internal market and the abolition of obstacles to free movement of capital are fundamental aims of primary EU law.⁵¹⁷ Defensive measures in takeovers are obstacles to the free movement of capital and a counter-facilitation of the internal market. Whilst Article 56 of the EC Treaty (primary EU law) requires the abolition of obstacles to free movement of capital, Article 12 of the Directive (secondary EU law) makes the abolition of these obstacles optional for Member States. To facilitate a genuine internal market, any provision of secondary EU law that is in conflict with any

⁵¹⁵ Case C483/99 *Commission v France* [2002] ECR I-4781.

⁵¹⁶ See Case C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 41; and Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 45.

provision of primary EU law, must be set aside. This analysis is not made easy by the scholarship available (lack of available discussion is better than scholarship available) – most texts discuss supremacy of EU law as an issue between national law and EU law (without distinguishing between primary and secondary EU law), ignoring the need for secondary EU law to conform to primary EU law.

By Articles 9 and 11, the Directive provides a framework committed to giving effect to free movement of capital. But for being optional, these two provisions clearly remove obstacles to takeovers and facilitate free movement of capital. Opting out of Article 9 of the Directive is more likely to create obstacles to takeover than opting out of Article 11. Article 9 is directly linked to takeover obstacles, removal of which has been the driving force behind the Directive since its initial draft appeared in 1974. Article 9 promotes shareholder decision-making as advocated by the Winter Report. On the other hand, Article 11 is said to be an undue *ex post facto* intervention in contracts violating the very shareholder decision-making right that the Winter Group advocates.⁵¹⁸ However, the implications of Article 11 depends on the regulated market framework of a particular Member State.

Where the regulated market structure affords no listed company the possibility of having share restrictions, which Article 11 of the Directive seeks to outlaw, then opting out of Article 11 has no effect on the free movement of capital. For instance in the UK, listing rules prevent listed companies from having any restriction on shares.⁵¹⁹ The UK has opted in to Article 9 but opted out of Article 11. The latter has no effect on free movement of capital given that UK companies with their securities traded on the regulated market are

⁵¹⁷ Articles 3 and 56 EC Treaty; Case 270/80 *Polydor v Harlequin* [1982] ECR 329 para 16; Case 15/81 *Gaston Schul Douane Expeditie BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal* [1982] ECR 1409 para 33.

⁵¹⁸ M Burkart and F Panunzi, 'Mandatory bids, squeeze-out and the dynamics of the tender offer process' in G Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 737, 739 (n 6).

⁵¹⁹ See G Morse, *Charlesworth's Company Law* (17th edn Sweet & Maxwell, London 2005) 223.

usually free of restrictions outlawed by Article 11. Member States like France would find it difficult to escape a ‘whip’ from the Commission requiring them to honour their Treaty obligation under Article 56 EC Treaty. France has opted out of Article 9 and opted in to the reciprocity provision under Article 12(3) of the Directive – both of which approaches restrict takeovers to the extent of their ability to ‘dissuade investors in other Member States from investing in the capital of those undertakings’, thereby rendering ‘the free movement of capital illusory’, and thus constituting ‘a restriction on movements of capital’.⁵²⁰

Based on the analysis of the golden share cases, although the Directive was watered down by the political compromises that reduced its core provisions to optional ones, its legal force as an effective EU law can be salvaged by the jurisprudence of the ECJ. The ECJ is not obliged to have regard to underlying political compromises. Any implementation of the Directive in a manner that creates obstacles or restrictions to takeovers ought to be interpreted as being contrary to one of the fundamental Treaty freedoms – the free movement of capital. Such interpretation is not free from difficulties. First, the Directive itself allows the creation of such obstacles, as it gives Member States the discretion to opt in or out of the very core provisions designed to outlaw the obstacles. In principle, as the Directive is secondary legislation, it must comply with the Treaty – provisions that do not comply with the Treaty, ought to be disregarded. Alternatively, regardless of what the Directive provides, Member States are under a duty to implement it in a manner that complies with their Treaty obligations.

Second, as the Directive evolved, after years of political haggling, as a political compromise, insisting that some of its provisions cannot be applied or as being contrary to the Treaty risks alienating the political will that is vital in sustaining a steady trend towards the harmonisation efforts of capital markets regulation in Europe. One can only speculate that, had Member States that have opted out of Article 9 or opted for a reciprocity rule, known that Article

⁵²⁰ See Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 45.

56 EC Treaty would catch such optional provision in the Directive, they might have voted differently in 2004 – which may have seen a repeat of 2001 voting that defeated the adoption of the directive. Of course the Commission would be within its legal remit if it were to bring proceedings against Member States for a breach of Article 56 EC Treaty if they created takeover barriers by opting out of Articles 9 or 11 of the Directive. However, one would be naïve to disregard the likely adverse effect of such a legalistic approach to a rather politically volatile regulatory framework of takeovers.

7.6 *Harmonisation of capital markets and company laws*

Taking a legalistic approach to finding Member States in breach of Article 56 EC Treaty for opting out of core provisions of the Directive risks slowing down the harmonisation of capital markets and company law. This is because such an approach, though legitimate, is likely to be seen as coercive and achieving by the ‘back door’ what failed to be achieved in the directive process. To that extent, a legalistic approach would be *tabula in naufragio*.⁵²¹ It is here suggested that the solution to the foregoing is for the Commission to adopt an intentional partial approach to the procedure in Article 226 EC Treaty, and to seek a revision of the Directive under Article 20 of the Directive.

First, where a Member State implements the Directive in a manner contrary to the free movement of capital, for the avoidance of defeating efforts of harmonisation, the Commission would elect to partially invoke Article 226 EC Treaty. In that regard, the Commission would, first ask the Member State to refrain from infringing Article 56 EC treaty. Secondly, the Commission would give its reasoned opinion, and if the Member State fails to comply, the Commission would intentionally not pursue the matter any further. Article 226 EC Treaty provides that the Commission ‘*shall*’ deliver a reasoned opinion and ‘*may*’ bring the matter before the Court of Justice – the latter suggests there is

⁵²¹ If English is preferred, ‘a plank in a shipwreck’.

discretion in having the matter litigated. According to Craig and De Burca, the language of paragraph 2 of Article 226 clearly suggests that, once it has issued a reasoned opinion indicating a breach by a Member State, the Commission has broad discretion whether or not to bring the matter before the ECJ.⁵²²

If the Commission applies its discretion not to bring the matter to the court, such discretion would be in line with the jurisprudence of the court, as the Commission would be justified in not commencing proceedings where ‘there is a major political crisis which could be aggravated if proceedings are commenced’ or where ‘there is a possibility that the Community provision in issue might be altered in the near future’.⁵²³ With the political will to eliminate takeover obstacles seemingly dim, a partial Article 226 EC Treaty approach would be sensible, or, as revision of the Directive is enshrined in the Directive,⁵²⁴ rather wait for a revision.

Second, in addition or alternatively, the Commission could seek an early revision of the Directive, or seek one in 2011, with the aim of removing Article 12 of the Directive, which allows core provisions to be optional. Either suggested option has the inherent ability to weaken rather than strengthen legal certainty in Europe’s market regulation. Securing economic exchange of capital between Member States by ‘strict-law’ as opposed to ‘soft-law’ ignores the inherent nature of capital markets – that of being free and liberal. With the major economies of Europe having concentrated shareholding structures that are usually unfavourable to takeovers, with many Member States implementing the Directive in a protectionist manner, and with capital regulation being difficult to harmonise, one would be naïve to disregard the fragility of takeover markets and the risk of losing political will that seems to be the sustaining force behind the compromise Directive.

⁵²² Paul Craig and Grainne De Burca, *EU Law: Text, Cases, and Materials* (4th edn OUP, Oxford 2008) 434.

⁵²³ Case 7/71 *Commission v France* [1971] ECR 1003 (Advocate-General Roemer).

⁵²⁴ Article 20 of the Directive.

7.7 Conclusion

The pessimistic view is that the Directive is ‘not worth the paper it’s written on’.⁵²⁵ This is because the Directive watered down its very core provisions by making them optional. Most Member States have taken advantage of the options and implemented the Directive in a protectionist way. It would seem, on the face of it, that the Directive has been ‘fatally wounded’ and could be seen as having failed to achieve its intended objectives. This is the view one would have if one only looks at the Directive in isolation from other Community harmonising law. When the seemingly failed Directive is put through the ‘magnifying glasses’ of the EC Treaty and ECJ jurisprudence, there emerges some hope for a ‘revived’ Directive. This ‘resuscitation’ of the Directive lies in the fundamental freedoms guaranteed in the EC Treaty. Regardless of what the Directive permits under its optional provisions, Member States must conform to the EC Treaty in implementing the Directive. If opting out of any of the Directive’s provisions restricts free movement of capital, then opting out is not an option open to a Member State seeking to remain in conformity with its EC Treaty obligations.

Where Member States have opted out of core provisions like Article 9 of the Directive, such an approach would create barriers to takeovers. Any barrier to takeovers is a restriction on free movement of capital and contrary to Article 56 EC Treaty. If the matter is referred to the ECJ, the court is likely to find the Member State in breach of its Treaty obligation, depending on the effect the application of Article 12 of the Directive has on free movement of capital. It may well be the case that the court’s finding of whether there is a breach of Treaty obligation in applying Article 12 of the Directive turns not on purely legal considerations, but on a broader view of what the orderly development of the Community requires. However, it is difficult to envisage

⁵²⁵ Comment made by Frits Bolkestein, Internal Market Commissioner, reported in *Bulletin Quotidien Europe*, 26 November 2003; see Vanessa Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’ (2004) ECFLR 416.

the court taking a 'soft' legal approach in the light of its 'strict' legal approach in the golden share cases.

Conclusion

Impact of the Directive on the UK

Against the background of the political history of the Directive, with many Member States yet to enact legislation implementing the Directive, it is hardly a last word any thesis can offer on takeover law in Europe. As such, this thesis provides an impetus for further research in this fast changing area of law.

Suffice to state that the Directive is unlikely to have any or significant impact on takeover regulation in the UK, given that much of the self-regulatory characteristics that prevailed prior to the implementation of the Directive seem to have been retained in the process that has brought the Panel and the Code within statutory regulation. The Panel and the Code have regulated takeovers in the UK since 1968. With the implementation of the Directive, the operation of the Panel and the Code has been put on a statutory footing for the first time. Provisions implementing the Directive, though refined to suit the requirements of the Directive, are but a reincarnation of the Code. In terms of content, nothing has changed since the Directive was implemented, although some of the Code's provisions now have Parliamentary approval.⁵²⁶

The Directive is meant to facilitate restructuring of companies through the provisions that seek to protect shareholders and those that seek to remove barriers that would frustrate free movement of capital. The UK regulatory system prior to the Directive has provided protection to shareholders at a level that surpasses the Directive's minimum standard requirements. When it comes to the removal of barriers that would hinder cross-border takeovers, the Directive was much needed.

⁵²⁶ Andrew Johnston, 'Takeover regulation: historical and theoretical perspectives on the City Code' (2007) 66 CLJ 422, 448.

In order to remove barriers to free movement of capital in takeovers, the Directive prohibits the use of defensive measures that may frustrate the bid,⁵²⁷ but at the same time gives Member States the leeway of opting out of the very prohibition.⁵²⁸ The effect of this option is twofold. First, where Article 9 is not applied, that creates the barriers the Directive aims at removing – the result of which is unequal implementation of the Directive throughout Europe. Secondly, the non-application of Article 9 would mean that hostile takeovers are not facilitated and cross-boarder takeovers would remain difficult. To that extent, the Directive makes no significant impact on how takeovers are regulated in the UK – it adds ‘very little of benefit to the UK system’.⁵²⁹

The fear that the Directive would increase litigation

The implementation of the Directive in the UK and its effect of creating a statutory regulatory framework were always feared for having the potential to create a culture of tactical litigation that would be detrimental to takeovers.⁵³⁰ The Panel got caught up in these fears and resisted the precursors of the Directive a number of times. Andenas rightly concluded that ‘there is no reason to fear that a take-over directive will lead to more litigation and undermine the City Code and the Takeover Panel’, as the ‘English case law is clear in this respect’.⁵³¹ This thesis has argued that the implementation of the Directive is unlikely to cause unwelcome legal scrutiny and tactical litigation in takeovers.

Arguably, the problem in implementing the Directive has never been so much the potential litigation chaos it was likely to cause the Panel, but with the fact that the Directive attempted to harmonise an activity that predominantly

⁵²⁷ Article 9 of the Directive.

⁵²⁸ Article 12(1) of the Directive.

⁵²⁹ R Murley, *The Takeover Panel Report on the year ended 31 March 2004*, 13.

⁵³⁰ See G Stedman, *Takeovers* (Longman, Harlow 1993) 55.

⁵³¹ Mads Andenas, ‘European Take-over Regulation and the City Code’ (1996) 17 *Co Law* 150, 152.

occurs within the UK and that it was likely to do so at the expense of the Panel's ability to control its business. Indeed, control is seemingly lost in the sense that the implementation of the Directive has resulted in the supremacy of EU law on all aspects of UK takeover regulations with the Panel having no option but to regulate the takeover industry within a legal framework. Silent on the fear of loss of control, the Panel throughout its hostility to the Directive has instead pointed at the fear of tactical litigation, notwithstanding that the UK market is accustomed to listening to the Panel and the courts have always been reluctant to intervene in takeovers.

As the UK market would suffer detriment if the impact of the Directive meant a litigation culture emerging, the consolation to the Panel is the provision under Article 4(6) that allows courts of Member States to decline to hear legal proceedings. To strengthen this provision, the UK has taken the approach of replicating, to the greatest extent possible, the Panel's previous jurisdiction, practices and procedures within a statutory framework, including giving the Panel power to make statutory rules, and only allowing courts a limited intervention by way of judicial review – making it difficult for a litigation culture to develop in UK takeovers.⁵³² With the Panel operating as it always has done under self-regulation, albeit with legal force, with market participants accustomed to resolving matters without resorting to the courts, and given that the CA 2006 limits the possibility of litigation, a notorious litigation culture is very unlikely to develop in the UK, and the Directive makes no difference to the takeover business in the UK.

The Directive and the protection of shareholders

This thesis has confronted the question whether the Directive provides any significant changes in the protection of shareholders during takeover bids. This question has been difficult to answer given the many facets of the protection package in the Directive, ranging from mandatory bid to squeeze-

⁵³² See CA 2006, sections 945, 951, 955, 956 and 961.

out rules. Suffice to state that it has been argued in this thesis that whilst the Directive does not provide significant changes in the protection of shareholders faced with a takeover bid, it is progression to have the protective provisions enshrined in UK statutes for the first time.

A major task in the Directive is to strike a balance between on the one hand the objective of protecting the interests of minority shareholders, and on the other hand the objective of facilitating the interests of investors in takeovers. Both Articles 9 and 11 of the Directive were meant to serve these dual conflicting objectives of takeover regulation. National political interests seem to have led to a compromise governing the applicability of these provisions. As such, shareholder protection remains in conflict with the need to facilitate investment through unrestricted takeover activities. Whilst the UK has, as it always has, opted to apply Article 9, many other Member States have, as they have always, opted out of Article 9. The likely result is weak facilitation of the interests of investors. However, the principles of equal treatment of shareholders and the mandatory bid rule, to an extent, promote the protection of shareholder interests.

The protection accorded to minority shareholders at common law has always been very weak.⁵³³ Takeover regulations predating the Directive have sought to vest decision-making powers in the hands of shareholders in a takeover situation. Article 9 of the Directive furthers this by seeking to promote shareholder supremacy. With all the difficulties for aggrieved minority shareholders of litigating against directors, the answer lies in promoting shareholder supremacy. Regrettably, the Directive makes Article 9 optional, such that Member States are free to allow management to make the ultimate decision – even to prevent a bid. If power to decide the outcome of a takeover bid is left in the hands of directors, who are often sophisticated professionals keen to promote the interests of the company provided it does not

⁵³³ See common law rules in cases *Percival v Wright* [1902] 2 Ch 421; and *Foss v Harbottle* (1843) 2 Hare 461.

endanger their existence and interest, minority shareholder protection, at least in Member States that opt out of Article 9, remains a myth.

The break-through rule contained in Article 11 of the Directive is optional, such that Member States may choose not to apply it.⁵³⁴ Possibly because of the perceived complication of the compensation requirement, the UK has opted not to apply the break-through rule. Although the UK has opted out of this provision, nevertheless, in implementing the Directive, the Act includes a right for any company to opt into the break-through provision of Article 11 pursuant to Article 12 of the Directive.⁵³⁵ In the UK, the dictates of the market for securities on a regulated market have reduced the number of companies with preferential share and voting structures that would be subject to a break-through rule – as such, whether or not a UK company should opt in to Article 11 of the Directive is therefore unlikely to be relevant in most cases.

However, if a UK company elects to opt in to Article 11, having fulfilled the conditions in the Companies Act 2006, there are uncertainties that may ensue in regard to compensation.⁵³⁶ It is not stated in the CA 2006 who is to pay (whether offeror or Offeree), how much is to be paid (whether the highest price paid for the shares has any relevance), and how the courts are to determine or calculate the amount to be paid. Rule 24.2(d)(xv) of the Code seems to suggest that the offeror is to pay for the compensation. This seems reasonable; after all, it is the offeror interested in the break-through of share structures in order to take control. However, that would defeat incentives for investors, as it would increase the costs of takeovers and make takeovers unattractive. Moreover, a UK company that opts in have no reciprocity safety-net if faced with an offeror who does not apply Article 11 of the Directive – the alternative

⁵³⁴ Article 12 of the Directive makes Article 11 (and Article 9) optional.

⁵³⁵ It is clear from the CA 2006 that Article 11 of the Directive is not to be applied in all cases of takeovers. In keeping with Article 12 of the Directive, sections 966 to 972 of the CA 2006 provide an option for listed companies to opt in to Article 11 should they wish to. These sections provide for conditions that have to be met if listed companies wish to opt in to Article 11 – broadly, a special resolution is required for both initial opting in and subsequent option out.

⁵³⁶ CA 2006, s 968.

is to opt out again altogether. It is doubtful that a UK company will want to opt in to Article 11 of the Directive.

The mandatory rule contained in Article 5 of the Directive has always been a feature of the Code. Much as it is meant to prevent arbitrary control if bidders would freely buy shares, the rule is arguably capable of escalating arbitrary control. An investor who may only want to raise his portfolio to, say, 35 per cent, leaving other shareholders in investment, is forced by the rule to bid for all remaining shares, causing a panic of sale by other shareholders who otherwise would have lived with a 35 per cent majority shareholder. The mandatory rule has the effect of accelerating arbitrary control in the company causing a squeeze-out of the minority, who may not have the means to invest elsewhere, thereby destabilising minority investment portfolios.

Where a minority shareholder is squeezed-out, the bidder will in turn hold 100 per cent shares, turning the share structure of the company in a concentrated share ownership, which makes it more difficult for future bidders. In concentrated share ownership, especially if shares are vested in a single shareholder after a bid, acquisition of shares depend on either the controller's consent or his loss of control. Hence, contrary to the Winter Report, favouring a bidder to squeeze-out a minority does not attract future bidders but rather repels them. It is, however, difficult to see a better way than by a mandatory rule and squeeze-out regulation. If it is left to the market forces of demand and supply, minority shareholders may not have even the remedy of selling their shares at a fair price.

Notwithstanding concerns about the optional nature of Articles 9 and 11, and the harsh effect of the squeeze-out provision, the Directive, as implemented by the rules contained in the Code, offers a greater protection to shareholders than accorded by mainstream company law. Although the Directive adds nothing in the matter of shareholders' protection to what is already contained in the Code, even prior to the current version of the Code, it is through the Directive that the Code acquired legal force, and to that extent,

the general statutory protection of shareholders is a progressive landmark in the UK in regard to takeovers.

The Directive and directors duties in takeovers

It has been argued in this thesis that the imposition by the Directive of certain obligations on directors for the benefit of employees and shareholders, as implemented by the Companies Act 2006, is unlikely to lead to radical changes in the corporate culture in regard to directors' duties. In general, directors owe their duties to the company. A duty can be owed to other interested parties – shareholders, employees and investors – if special factual relationship can be established in a particular case. In regard to takeovers, that special factual relationship can be established. Indeed, the Companies Act 2006, in codifying directors' duties at the same time codifying takeover rules to implement the Directive, creates a legal presumption that directors owe their duties to shareholders and other parties interested in takeover activities for which the company is involved. It has been argued in this thesis that the conflict created by this dual codification of directors' general duties and specific duties pertaining takeovers under the Code, can be resolved if directors' duties are treated as *sui generis* to stakeholders affected by actions of directors of a company involved in a takeover bid.

Although the statutory derivative action under Companies Act 2006 seem to expose directors to a greater risk, the difficulties of effecting a derivate action will still remain. The action will still be required to have a support of an independent majority within the aggrieved minority shareholders. The practicalities of financing shareholder litigation will remain a major obstacle. An effective remedy for an aggrieved shareholder may well lie in the mechanism of a fair share price on a takeover bid. Moreover, the range of rules on takeovers and the policing of the Panel make it unlikely that shareholders affected by directors' actions during a takeover bid, will need to invoke a derivative action or any breach of the statutory directors' duties. Even then, the policing of the Panel may only serves a purpose of a regulated

exit strategy for aggrieved shareholders – to sell their shares at a fair price and invest elsewhere.

Effect of how other Member States implement the Directive

One of the questions this thesis has sought to address is whether the manner in which other Member States have implemented the Directive would negatively affect cross-border takeovers contrary to the UK interests. This thesis has argued that the main benefit for the UK under the Directive has always been the facilitation of takeovers, as it was hoped that an EC regulatory framework would enhance the UK's business interests in cross-border takeovers. The UK was keen to promote its hostile takeover custom across the EU. Article 9 of the Directive, the equivalent of UK's Rule 21 of the Code, was crucial to achieving this facilitation of cross-border takeovers. A level playing field across the EU was desirable to this effect. The Directive's aim of establishing a level playing field for takeovers across the EU was hindered by the level of compromise involved in agreeing the provisions of the Directive. The core provisions of the Directive, Articles 9 and 11, are made optional under Article 12 – making it difficult for hostile takeovers. As observed by Woodridge, a number of Member States have implemented the Directive in a protectionist way.⁵³⁷ By opting out of Article 9, some Member States have retained barriers to takeovers. Cranston was right in asserting that it is 'not an unreasonable hypothesis that the takeover directive, when effective, will not radically change the environment of EC countries regarding hostile takeovers, at least not for the time being, since the institutional and cultural barriers will remain'.⁵³⁸ As predicted, the Directive is hardly a triumph in relation to cross-border takeovers.

⁵³⁷ Frank Wooldridge, 'Some important provisions and implementation of the Takeover Directive' (2007) 28 Co Law 293, 295; see also European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007).

Harmonisation of takeovers under the Directive

This thesis has assessed whether the Directive is likely to effectively achieve its objective of harmonising takeover regulations in Europe, given the discretion under Article 12 to opt out/or into the fundamental provisions of the Directive aimed at achieving this objective. At the heart of the harmonisation process is the aim of liberalising the market for corporate control in Europe in order to create an effective economy. In aiming at removing barriers to takeovers, the Directive would have liberalised the market for corporate control. As rightly observed by Moloney, given the range of exemptions available and the current antipathy to hostile takeover activity in continental Europe, the Directive is unlikely to be significantly successful in liberalising the market for corporate control.⁵³⁹

As asserted in this thesis, it is neither inapt nor unreasonable to conclude, quite bluntly, that the Directive hardly achieves any harmonisation. First, ‘the Directive’s failure to prescribe a uniform threshold of shareholding triggering the mandatory bid [limits] its harmonising effect’.⁵⁴⁰ By leaving it open to Member States to set their own threshold that triggers a mandatory bid, the Directive fails to harmonise the mandatory rule.

Secondly, by allowing Member States to opt in and out of the core provisions, Articles 9 and 11, the Directive fails to achieve a ‘harmonising of the regime of takeover defences’.⁵⁴¹ Optionalisation of Article 9 is difficult to reconcile with the acknowledged necessity to prevent patterns of corporate restructuring within the EU from being distorted by arbitrary differences in

⁵³⁸ R Cranston, ‘The Rise and Rise of the Hostile Takeover’ in Hopt and Wymeersch (eds), *European Takeovers* (Butterworths, London 1992) 77, 92.

⁵³⁹ Niamh Moloney, ‘Financial Market Regulation in the Post-Financial Services Action Plan era’ (2006) 55 ICLQ 982, 983.

⁵⁴⁰ Vanessa Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’ (2004) 1 ECFLR 416, 439.

⁵⁴¹ Matteo Gatti, ‘Optionality Arrangements and Reciprocity in the European Takeover Directive’ (2005) 6 EBOLR 553, 579.

governance and management cultures.⁵⁴² The price paid as a result of this political compromise is likely to be the lack of an EU-wide harmonisation of rules relating to takeover defences.⁵⁴³ The diverse approaches taken by Member States on the optional provisions, leaves the playing field unlevelled.

For example, with the UK opting in to Article 9 and not applying a reciprocity rule, and The Netherlands taking an opposite approach, the playing field between the two states remain unlevelled – a Netherlands bidder is facilitated in launching a hostile takeover in the UK, whilst a UK bidder is hindered in successfully launching a takeover bid in The Netherlands. In this thesis, it has been argued that Bolkestein's statement that 'without Articles 9 and 11, [the Directive is] not worth the paper [it's] written on,'⁵⁴⁴ may live to be repeated.

The future of the Directive and EC Treaty obligations

The future of the Directive may well depend on whether applying Article 12 in implementing the Directive would create a restriction to free movement of capital contrary to Article 56 of the EC Treaty. Broadly, the Directive seeks to regulate an important element of the functioning of capital markets: the public bid for all the shares of a company.⁵⁴⁵ One of the difficulties in regulating capital is the link between capital and taxation, which is another means by which the Member States can regulate their national economy – every country remains cautious about giving up sovereignty in this context.⁵⁴⁶ This probably

⁵⁴² Blanaid Clarke, 'Articles 9 and 11 of the Takeover Directive (2004/25) and the market for corporate control' (2006) JBL 355, 374.

⁵⁴³ Scott V Simpson, 'EU Directive fails to harmonise takeovers' (2005) A Special IFLR Supplement 15 <<http://www.iflr.com>> accessed 03 July 2007.

⁵⁴⁴ Commission Memo 113, Brussels, 21 May 2003 – said by Commissioner Frits Bolkestein.

⁵⁴⁵ Jaap Winter, 'EU Company Law at the cross-roads' in Guido Ferrarini (ed) *Reforming company and takeover law in Europe* (OUP, Oxford 2004) 12.

⁵⁴⁶ Mads Andenas and Others, 'Free movement of capital and national company law' (2005) EBLR 757, 758.

explains why a Directive that was meant to free up capital movement through takeovers was reduced to a compromise.

The pessimistic view is that the Directive is ‘not worth the paper it’s written on’.⁵⁴⁷ This is because the Directive watered down its very core provisions by making them optional. Most Member States have taken advantage of the options and implemented the Directive in a protectionist way. It would seem, on the face of it, that the Directive has been ‘fatally wounded’ and could be seen as having failed to achieve its intended objectives. This is the view one would have if one only looks at the Directive in isolation from other provisions of Community law. When the seemingly failed Directive is put through the ‘magnifying glasses’ of the EC Treaty and ECJ jurisprudence, there emerges some hope for a ‘revived’ Directive. This ‘resuscitation’ of the Directive lies in the fundamental freedoms guaranteed in the EC Treaty. Regardless of what the Directive permits under its optional provisions, Member States must conform to the EC Treaty in implementing the Directive. If opting out of any of the Directive’s provisions restricts free movement of capital, then opting out is not an option open to a Member State seeking to remain in conformity with its EC Treaty obligations.

Where Member States have opted out of core provisions like Article 9 of the Directive, such an approach would create barriers to takeovers. Any barrier to takeovers is a restriction on free movement of capital and contrary to Article 56 EC Treaty. If the matter is referred to the ECJ, the court is likely to find the Member State in breach of its Treaty obligations, depending on the effect the application of Article 12 of the Directive has on free movement of capital. It may well be the case that the court’s finding of whether there is a breach of Treaty obligations in applying Article 12 of the Directive turns not on purely legal considerations, but on a broader view of what the orderly development of the Community requires. However, it is difficult to envisage the court taking a

⁵⁴⁷ Comment made by Frits Bolkestein, Internal Market Commissioner, reported in *Bulletin Quotidien Europe*, 26 November 2003; Vanessa Edwards, ‘The Directive on Takeover Bids – Not Worth the Paper It’s Written On?’ (2004) ECFLR 416.

‘soft’ legal approach in the light of its ‘strict’ legal approach in the golden share cases.

However, taking a legalistic approach to finding Member States in breach of Article 56 EC Treaty for opting out of core provisions of the Directive risks a further slowing down of harmonisation of capital markets regulation. This is because such an approach, though legitimate, is likely to be seen as coercive and as removing Article 12 of the Directive through the ‘back door’, and is likely to raise resentment in Member States. It is here suggested that the solution to the foregoing is for the Commission to adopt an intentional partial approach to the procedure in Article 226 EC Treaty, and to seek a revision of the Directive under Article 20 of the Directive.

Where a Member State implements the Directive in a manner contrary to free movement of capital, for the avoidance of defeating efforts of harmonisation, the Commission could elect to partially invoke Article 226 EC Treaty. The Commission could give its reasoned opinion, and, if the Member State fails to comply, the Commission could intentionally apply its discretion not to pursue the matter any further.⁵⁴⁸

The Commission is entitled to apply its discretion not to bring the matter to the court, where ‘there is a major political crisis which could be aggravated if proceedings are commenced’ or where ‘there is a possibility that the Community provision in issue might be altered in the near future’.⁵⁴⁹ With the political will to eliminate takeover obstacles seemingly dim, a partial Article 226 EC Treaty approach would be sensible, or, as revision of the Directive is

⁵⁴⁸ Article 226: the Commission ‘*shall*’ deliver a reasoned opinion and ‘*may*’ bring the matter before the Court of Justice – the latter suggests discretion in having the matter litigated.

⁵⁴⁹ Case 7/71 *Commission v France* [1971] ECR 1003 (Advocate-General Roemer).

enshrined in the Directive,⁵⁵⁰ rather wait for a revision in 2011. Nonetheless, if the matter were brought to the ECJ, in the light of the golden share cases, the court is likely to find a breach of Article 56 EC Treaty where a Member State has taken full advantage of Article 12 of the Directive.

⁵⁵⁰ Article 20 of the Directive.

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