The European Takeovers Directive - an overview

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FOREWORD

This memorandum gives an overview of the EU Takeovers Directive.

This memorandum is not intended to contain definitive legal advice, which should be sought as appropriate in relation to any particular matter.
## GLOSSARY

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tr>
<td>breakthrough rules</td>
<td>the provisions in the Takeovers Directive disapplying, during the period of a takeover bid, (i) restrictions on transfer of target securities in respect of acceptances of the bid and the bidder's market purchases and (ii) restrictions on voting and any multiple voting rights in relation to votes on frustrating action</td>
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<tr>
<td>frustrating action</td>
<td>action taken by the board of a target company to thwart a takeover bid either after the bid is made or when a bid is imminent</td>
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<tr>
<td>FSA</td>
<td>the Financial Services Authority</td>
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<tr>
<td>Member States</td>
<td>the member states of the European Union</td>
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<tr>
<td>national derogations system</td>
<td>the flexibility under the directive for a Member State to take national circumstances into account and implement less stringent rules than the &quot;minimum&quot; requirements set out in the Takeovers Directive</td>
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I. INTRODUCTION AND SUMMARY

1. Background

In December 2003, fourteen years after negotiations on a possible EU takeovers directive began, political agreement on the Takeovers Directive was finally reached by the European Parliament. The European Parliament approved the compromise text on 16 December 2003 and it was formally adopted by the Council on 21 April 2004 and published in the Official Journal on 30 April 2004. The directive came into force on 20 May 2004 and must be implemented in each Member State within two years.

As a result of the political compromises made to ensure that a directive in some form would be approved by the Member States, the Takeovers Directive has been significantly diluted from the Commission’s original proposal and will not deliver, in any meaningful sense, a level playing field of takeover regulation in the EU. This is a source of particular frustration to the Commission, with Commissioner Balkenstein commenting: "[I am not] going to be hypocritical by pretending that the version of the Directive [now] agreed … represents a step forward for EU competitiveness or for the integration of EU capital markets. There is a diplomatic delusion that any result is better than none. I do not share this delusion".

2. Basic scheme of the Takeovers Directive

(a) General principles and minimum requirements

The directive is based on, and recites, a number of general principles:

> equivalent treatment of shareholders and safeguarding the rights of minorities;

> target shareholders must be given sufficient time and information to be able to reach a properly informed decision on a bid;

> the target board must give its views on the effects of implementation of a bid, including on employment and on the locations of the target’s places of business;

> the target board must act in the interests of the company as a whole;

> the target board must not deny shareholders the opportunity to decide on the merits of a bid;

> false markets must not be created;

> a bidder should only announce a bid when it has the cash to implement it; and

> the target should not be subject to a bid for longer than is reasonable.
The directive also contains some more detailed rules setting the minimum requirements for achieving implementation of those general principles. The ability of Member States to impose more stringent measures is preserved. However, the level playing field purportedly created by the minimum requirements is undermined by the following two features of the directive:

- **Opt-outs system.** Member States have the ability to opt out of the provisions relating to frustrating action and multiple and restricted voting rights (the so-called "breakthrough rules") in respect of companies with their registered office in that Member State; and

- **National derogations system.** Member States will have a more general flexibility to implement rules that are less stringent than the "minimum" requirements in order to take account of circumstances determined at national level. The only qualification to this flexibility is that the rules implemented must respect the general principles of the directive.

**b) Competent Authority**

Each Member State must designate a competent authority to supervise takeovers. In general, a target company will be subject to regulation in the Member State in which it has its registered office if it has transferable voting securities listed in that territory. Otherwise it will be regulated by the Member State in which it is listed. There are tie-breaker provisions dealing with companies with multiple listings and companies which are listed in jurisdictions other than the Member State in which it has its registered office. However, certain key provisions of the Directive will be supervised by the competent authority of the Member State in which the target has its registered office, irrespective of where it is listed - thus, there are a number of situations - principally dual-headed structures and companies with a registered office in one jurisdiction and its listing in another - where jurisdiction is shared in a way that is likely to give rise to significant uncertainty.

**c) Mandatory Provisions**

The following are the most important minimum requirements of the directive that, subject to the national derogations system, each Member State will be required to implement:

- **Mandatory Bids.** Where a person (or persons acting in concert) acquires a controlling stake in a target company it must make an offer to all other shareholders at the "equitable price". The level constituting "control" will be defined by the Member State in which the target company has its registered office.

  The "equitable price" is the highest price paid by the bidder during a period fixed by the competent authority. That period must be set so as to be between six and twelve months prior to the bid. A bidder who purchases shares during the offer period will trigger a requirement to increase the offer price if it is lower than the price for such market purchase. The competent authority also has power to increase or reduce the equitable price according to pre-determined criteria.
Consideration under a mandatory offer may consist of cash, securities or a combination of the two. However, a full cash alternative must be provided:

- where any consideration securities are not liquid securities listed on a regulated market;

- where the bidder has purchased in cash more than 5% of the voting shares of the target during the six to twelve month period fixed by the competent authority and the offer period; and

- in all mandatory bids, if the rules of the Member State so provide.

Offer Documents. An offer document, containing certain specified information, must be made public.

There is provision in the directive for offer documents approved by a competent authority in one Member State to be passported for use in other Member States. The availability of a passport depends on the competent authority in the target company’s Member State operating an approval system for offer documents. It remains to be seen whether such a system - compulsory or voluntary - will be introduced in the UK and there may well be resistance to the idea. Equally importantly, whether this passport can be used in the context of share-for-share takeover offers remains to be clarified by the Prospectus Directive.

Target companies must publish a document giving its board’s views on the bid, including its impact on employment and the locations of the company’s activities.

Employee involvement. Employees of both companies must be informed as soon as the bid has been made public. Employee representatives may submit for publication by the target board a separate opinion on the effects of the bid on employment. Any additional requirements of the Information and Consultation Directive (2002/14/EC), the European Works Council Directive (94/45/EC), the Collective Redundancies Directive (98/59/EC) and the Employee Involvement in European Companies Directive (2001/86/EC) continue to apply.

Offer Period. An offer, unless the competent authority agrees or provides otherwise, must remain open for acceptance for at least 2 weeks but (subject to certain permitted extensions) no longer than 10 weeks.

Squeeze-out. Each Member State is required to introduce a squeeze-out right to remove a minority post-bid. Either one of two types of right must be introduced:

- where a bidder holds 90% (or, at the option of the Member State, a higher percentage of up to 95%) of the target voting shares; or
where a bidder acquires 90% of the voting shares which are the subject of the offer.

The consideration offered on a squeeze-out must be the same as under the bid or be cash. Member States may also require that a cash alternative is made available. The directive also requires implementation of a reciprocal right entitling target shareholders to require a bidder which could exercise a squeeze-out to buy a target shareholder’s shares.

> Poison pills: disclosure. Where a company puts in place any of a specified list of poison pills (whether or not during an offer period) it must present an explanatory report to shareholders at each AGM and include details in annual reports.

(d) Optional Provisions: Opt Outs and Reversible Opt Ins

Member States may opt out of the frustrating action and breakthrough rules described in this section in respect of companies with their registered offices in that Member State. If a Member State does opt out, it must allow companies in its jurisdiction the opportunity to opt back in by shareholder resolution. A company opting back in will (if the rules of its Member State provide) be subject to disapplication of the opt-in (so that the frustrating action and/or breakthrough rules do not apply to it) if it is the subject of an offer from a company which itself does not apply the frustration action and/or breakthrough provisions to the same extent as the target company.

> Frustrating action. Target companies shall not take action to frustrate a bid without shareholder approval. The directive requires Member States to apply this prohibition from no later than the announcement of a bid, though they are permitted to apply the prohibition from an earlier stage such as when the target board becomes aware that a bid is imminent. In either case, the prohibition continues until the bid completes or lapses.

> “Breakthrough” rules. During the period for acceptance of an offer:

- restrictions on transfers of shares, whether constitutional or in shareholder agreements, may not be applied vis-à-vis the bidder; and

- restrictions on voting rights and the use of multiple voting rights do not apply at any general meeting to approve any frustrating action.

Moreover, once a bidder has acquired 75% of the capital carrying voting rights in the target, any special arrangements for appointing board members cease to apply and multiple voting rights are ignored at the first general meeting called by the bidder following closure of the bid. Shareholders deprived of rights under these provisions are entitled to compensation on an equitable basis on terms to be determined by Member States. None of these requirements apply to state-held ‘golden shares’.
Has the Member State where the target has its registered office ("Home State") opted out of the breakthrough and/or frustrating action provisions?

- No
- Yes

Has the target opted back in to either breakthrough or frustrating action provisions?

- No
- Yes

Yes

Has the Home State permitted companies in its jurisdiction to reverse its opt-in where the bidder is not subject to the frustrating action and/or breakthrough provisions and, if so, has the target provided in its by-laws for this reversal?

- Yes
- No

Yes

Does the bidder apply the breakthrough and/or frustrating action provisions to the same extent as the target?

- No
- Yes

The breakthrough and/or frustrating action provisions do not apply
II. SCOPE OF DIRECTIVE, COMPETENT AUTHORITIES, CROSS-BORDER ISSUES AND JURISDICTION

1. Scope of the directive

The directive applies to takeover bids (however structured) for all or some of the transferable voting securities of a company governed by the laws of a Member State where all or some of those securities are admitted to trading on a regulated market in a Member State. The only exceptions are takeover bids for collective investment schemes and the central banks of Member States.

2. Cross-border and jurisdictional issues

Once the initial jurisdictional hurdle described in section 1 above is cleared, the directive contains a number of rules which determine the Member State (or Member States) whose national takeover rules will apply to regulate the takeover bid in question and whose competent authority will be responsible for supervising the bid.

(a) Basic position: supervision in the place of the target’s registered office

The starting position is that takeover bids will be supervised by the competent authority of the Member State in which the target company has its registered office provided that its securities are also admitted to trading on a regulated market in that state.

So far as the place of a company’s registered office is capable of change, a company which desires the maximum level of protection against a takeover bid could, in theory at least, “shop around” for that protection by moving its registered office to the Member State whose implementation of the directive affords the greatest such protection.

(b) More complicated situations: split supervision and tie breakers

Where a target company’s shares are not listed in the Member State where it has its registered office, the takeover bid will be within the jurisdiction of more than one Member State as determined by the following jurisdictional rules:

> The competent authority of the Member State in which the target company has its registered office (the “home authority”) will supervise the following aspects of the bid:

- the level of information to be provided to target company employees;
- the ability of the target board to take frustrating action; and
- matters relating to company law, in particular, the percentage of voting rights that confers “control” for the purposes of the national rules made under the directive, and any derogation from the obligation to launch a bid.

> The competent authority to supervise the “bid procedure” aspects (see below) of the bid is that of the Member State where the target company has its listing (the “host authority”).
If the target company’s shares are not listed in the Member State in which the target has its registered office, but are listed in more than one Member State, then the competent authority in the place of first listing will be the host authority. If those listings were obtained simultaneously prior to 20 May 2006, the competent authorities of the relevant Member States must agree which of them is to be the host authority. If the listings are obtained simultaneously after 20 May 2006, the target has to elect on its first day of trading which competent authority is to be its host authority.

all the above cases, the host authority only has responsibility for the “bid procedure” aspects of the bid. The directive provides that these include:

- the consideration offered, especially price; and
- matters relating to bid procedure, in particular: information on the bidder’s decision to make a bid, the contents of the offer document, and disclosure of the bid.

(c) Areas of uncertainty or ambiguity

Notwithstanding the split responsibility and tie breaker rules described above, neither a clear nor a satisfactory delineation of jurisdiction is achieved in the following situations:

Uncertain division of responsibility between home authority and host authority. The distinction between “bid procedure” matters supervised by the host authority and “company law” matters supervised by the home authority is not set with any great precision. There is therefore scope for uncertainty and potentially litigation as to which competent authority is responsible for a particular matter. It would, for instance, seem possible for competent authorities from different Member States to take differing views on whether a matter such as squeeze-out is a matter of company law or bid procedure.

Tie breaker where a target company is listed in two jurisdictions. It is not clear how the rules which seek to determine which competent authority is the host authority will operate where, prior to implementation of the directive, the target company was simultaneously listed in two or more Member States and those Member States each implement the directive on different dates.

Status of national takeover rules that cover areas not addressed by the directive. The directive only resolves jurisdictional disputes between Member States “for the purposes of rules made or introduced pursuant to” the directive. The possibility therefore remains that where a particular national rule on takeovers exists other than pursuant to the directive and does not conflict with the directive’s general principles, the relevant Member State may apply that rule to a takeover bid notwithstanding that its competent authority is not supervising the bid for the purposes of the directive.
(d) **Dual headed structures**

In general terms, the directive is very unlikely to change the place of regulation for dual-headed groups, i.e. groups with top listed companies in different jurisdictions linked by cross-shareholdings and/or equalisation arrangements. Each of the top listed companies will be subject to regulation for takeover purposes in its home jurisdiction if it is listed there. However, depending on the approach taken in the relevant Member States in implementing certain aspects of the directive, particularly the breakthrough rules, there may be serious implications for some dual headed structures in relation to their pooled voting mechanisms, their equalisation arrangements and provisions in their constitutional documents which effectively seek to ensure that any takeover bid is made for both sides of the group.
WHICH COMPETENT AUTHORITY REGULATES THE BID?

Is the target listed in its Home State?

- **Yes**: Home Authority regulates all aspects of the bid.
- **No**: Is the target listed in more than one Member State?

Is the target listed in more than one Member State?

- **Yes**: Were all the listings obtained simultaneously?
- **No**: The Host Authority is the Competent Authority of the Member State where the target was first listed.

Were all the listings obtained simultaneously?

- **Yes**: Home Authority regulates bid procedure. Host Authority regulates:
  - information to employees
  - frustrating action
  - derogations from mandatory bid obligations
  - definition of “control”

For listings obtained before 20.5.06, the Competent Authorities for the Member States where the target is listed determine which is to be the Host Authority. If after 20.5.06, the target determines

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**Home State** = Member State in which the target has its registered office

**Home Authority** = Competent Authority of the Home State

**Host Authority** = Competent Authority of the Member State in which it is listed (or where there is more than one listing, as determined above)
3. Cross-border offer documents and interaction with the Prospectus Directive

(a) Cross-border offer documents

The directive contains rules which provide for the recognition throughout the European Union of offer documents that have been approved by a competent authority in a particular Member State.

Where (but only where) the competent authority of the relevant Member State operates a system requiring offer documents to be approved by it before release, the offer document - translated, where necessary - may be used in all other Member States without change.

Where an offer document is to be used in other Member States, it may sometimes be required to deal with local issues, such as different methods of acceptance and any different tax consequences. Also, where the consideration includes bidder securities, the Prospectus Directive will also apply.

(b) Interaction with the Prospectus Directive

Where bidder securities form part of the consideration on a takeover bid, there will also be the question of whether a prospectus (or equivalent document) will be required in respect of the consideration securities.

The Prospectus Directive effectively provides that a bidder need not publish a prospectus where the shares are consideration shares on a takeover bid in circumstances where the offer document is regarded by the “competent authority” as containing information equivalent to that which would be required for a prospectus, taking into account the requirements of EU legislation. The “competent authority” for this purpose will be that identified in accordance with the Prospectus Directive (usually the bidder’s home state) which may not be the competent authority with jurisdiction over the takeover bid.

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