Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Europe M&A: The Evolving Takeover Landscape

Law360, New York (February 25, 2013, 4:03 PM ET) -- The European and global economic crises have encouraged limited takeover activity in the past few years, providing little opportunity for the EU Directive on Takeover Bids (the Takeover Directive) to be fully tested outside of the United Kingdom. While the grounds for a takeover system are in place across Europe, it is apparent that substantial progress and adjustments need to be made now to continue the process of harmonization and to promote takeover activity.

Basic Principles of the Takeover Directive

The Takeover Directive was intended to harmonize EU takeover law and foster consolidation among EU companies through the adoption of a pan-European takeover code modeled after the U.K. Takeover Code.

The Takeover Directive establishes general principles that are common to most takeover systems worldwide: equal treatment of target shareholders, ability of target shareholders to make informed decisions on bids, and prohibition of market manipulation or abuse. It introduced a broad framework that is heavily reliant on the mandatory bid rule, effective involvement by national supervisory authorities and, in several cases, board passivity/neutrality.

At the same time, however, the Takeover Directive made the adoption of guiding principles on the ability of target boards to defend against takeover bids optional, allowing member states to choose whether to implement the following provisions:

- The board neutrality rule, which provides that, from the time a target board is informed of a bid until the end of the offer period, the target board may not take any "frustrating action" that might cause the offer to fail, other than seeking alternative bids, without obtaining prior shareholder approval; and

- The breakthrough rules, designed to render unenforceable clauses in the articles of association of target companies and agreements between targets and target shareholders, or among target shareholders, that could limit the ability of target shareholders to tender into a bid or vote at shareholders meetings.

Takeover Directive Implementation

Mandatory Bid Rule

The mandatory bid rule is the cornerstone of the European takeover regulation model. Intended to prevent creeping takeovers, the rule provides that when a person — acting

individually or in concert with other persons — acquires shares in a company above a specified percentage of voting rights in that company, giving him/her control of that company, such person is required to make a bid for the entire company and offer the same terms to all shareholders.

In many EU jurisdictions, the mandatory bid rule is the only statutory defense mechanism available to target companies. It is therefore crucial that the mandatory bid rule provide an effective defense against any form of acquisition of control that does not involve a full offer to all shareholders, particularly where the board neutrality principle has been adopted.

The system, however, is in need of adjustment:

- The threshold is too high. The threshold adopted by member states (between 30 percent and 33 percent) is set too high because, in many cases, shareholders are able to control a European company (and either block or have a nearly insurmountable advantage against other bidders) by accumulating ownership of shares just below the threshold. In most U.S. jurisdictions, mechanisms with similar objectives (e.g., poison pills or anti-takeover statutes) are triggered at far lower thresholds (between 15 percent and 20 percent), providing a more effective structural defense against creeping takeovers.

- The mandatory bid rule is flawed in several member states. As was proven by the coercive takeover of German construction company Hochtief AG by Spanish rival Grupo ACS a few years back, if the mandatory bid rule is not propped up by additional rules, including requiring (1) any voluntary tender offer to obtain a mandatory minimum acceptance threshold set at 50 percent or (2) additional mandatory tender offers upon further accumulation of stock after passing the mandatory bid threshold, the system can be gamed to the detriment of all shareholders.

- "Acting in concert." Another significant issue concerns the definition of "acting in concert" for the purpose of calculating the control threshold and determining whether two or more persons are subject to the mandatory bid rule. The definition of acting in concert is not harmonized among member states. Some jurisdictions (e.g., the U.K., the Netherlands and Italy) have adopted the Takeover Directive's definition, while others (e.g., France and Germany) have combined the Takeover Directive's definition with the more stringent definition contained in the EU Directive on Transparency. Moreover, each national supervisory authority has more or less developed its own interpretation of acting in concert, and several national supervisory authorities reserve the right to decide whether shareholders are engaging in this behavior on a case-by-case basis using a facts-and-circumstances analysis. This situation causes significant uncertainty and does not permit shareholders to adopt consistent strategies across jurisdictions in Europe. However, it allows sophisticated national supervisory authorities to prevent parties from acting together while circumventing the spirit of the law through strategies that fall outside strictly defined parameters for "acting in concert."

Optional Takeover Defense Rules (Portuguese Compromise)

Harmonization of the board neutrality and breakthrough rules remains the most serious obstacle to consolidating pan-European takeover rules and the establishment of a level playing field across member states.

The board neutrality rule has been adopted by 19 member states, including the U.K., France and Italy. Most of these states had a board neutrality principle in their preexisting legal framework before the Takeover Directive became effective. By contrast, eight member states (including Germany and the Netherlands) have opted out of the board neutrality rule — none of these countries had a board neutrality principle in their preexisting legal framework.

As for the breakthrough rules, they have been adopted (in full or in part) only in three member states.

Accordingly, the takeover landscape is widely inconsistent across Europe, including in the five jurisdictions where most of the takeovers have taken place historically (the U.K., Germany, France, Italy and the Netherlands).

Moreover, in the face of the economic crisis and the resulting weakness in the share price of many European companies, certain member states have made full use of the flexibility available under the Takeover Directive and changed their approach to board neutrality (in some cases multiple times) since the Takeover Directive's implementation to (1) provide shelter to their national champions, (2) safeguard employment and (3) protect strategic assets, even where such member states previously were staunch sup¬porters of systems that did not allow takeover defenses. Certain member states have changed national regulation to reduce board neutrality, introduce industry-specific or ad hoc protectionist legislation, or otherwise raise procedural obstacles for bidders.

While a discussion of the merits of board neutrality and breakthrough rules can be complex, we believe that Europe would benefit from a uniform set of rules in this area.

The Key Role of (National) Supervisory Authorities

The Takeover Directive establishes a system that, as opposed to the U.S. disclosure-based system, requires a significant amount of oversight and involvement by national supervisory authorities at every stage of the takeover process. Any material announcement made or document published by the bidder or target during a takeover process is subject to clearance by the supervisory authority, which also has a significant say on the actual terms and conditions of the bid. Accordingly, efficient regulation or ad hoc decisions by the supervisory authority are a significant factor affecting target shareholders' ability to maximize the value of their investment.

Where national takeover authorities are constituted by practitioners or career regulators highly experienced in takeover matters, the system can guarantee a smooth process and minimize the opportunity for litigation post-takeover (disclosure-based systems typically rely heavily on pre- or post-takeover judicial scrutiny). However, in member states where takeovers occur less often or even rarely — i.e., the vast majority — and where unsolicited offers are, at most, an annual or biannual occurrence, or have yet to occur under the current legislation, the reaction of national supervisory authorities to complex fact patterns is uncertain and can vary significantly from member state to member state.

Squeeze-Out Rules

The Takeover Directive requires member states to adopt a mechanism that allows bidders to "squeeze out" shareholders if the bidder reaches a certain ownership threshold (between 90 and 95 percent). France, Germany, the Netherlands and Italy opted for a 95 percent threshold, whereas the U.K. opted for 90 percent.

While the introduction of squeeze-out mechanisms has given bidders a tool to close takeover bids that previously was unavailable in many jurisdictions, it is the only practical

way of achieving full control of a target in the vast majority of cases.
The high threshold required to squeeze out minority shareholders in several member states, particularly those requiring 95 percent thresholds, poses a significant practical hurdle for bidders. We believe that the high threshold, coupled with the lack of alternatives to achieve full control, is one of the reasons takeover bids are not as frequent in certain member states.

The European Commission's Review

Review of the Takeover Directive is currently under way — five years after the transposition deadline of April 2006, the European Commission was due to examine the Takeover Directive in light of the experience gained in applying it and, if necessary, propose revisions. In June 2012, the European Commission published a report on the application of the Takeover Directive, identifying the following key areas where the Takeover Directive would benefit from review (all focused on the correct functioning of the mandatory tender offer system):

- The definition of acting in concert, viewed by the European Commission as too broad and potentially inconsistent, could be clarified to provide more legal certainty to investors as to the extent to which they can cooperate with each other without running the risk of triggering the mandatory bid rule;

- The wide range of national derogations to the mandatory bid rule gives rise to concerns as to whether this rule adequately protects minority shareholders in situations of change of control. Some clarifications are expected in the scope of application of national derogations to the rule and the interaction between these derogations and the existing mechanism to protect minority shareholders;

- In several markets it has been acknowledged that there is an increasing number of offerers obtaining de facto control of a target company without triggering the mandatory bid rule by acquiring a stake that remains just below the triggering threshold; and

- The exemption to the mandatory bid rule for situations where the control threshold has been exceeded following a voluntary bid for all shares of the company has created a potential loophole. This enables offerors to subvert the intention of the rule by acquiring a stake close to the mandatory bid threshold and then launching a voluntary bid for a low price (where the consideration consists of shares) to breach the threshold without being required to make a mandatory offer (and without giving shareholders a fair chance to exit the company). As mentioned earlier, such concerns were raised in the context of the bid by ACS for Hochtief. The European Commission has indicated it will take steps to discourage the use of this technique, such as through bilateral discussions with concerned member states or through commission recommendations. Possibilities to limit the use of this technique may include additional mandatory bid thresholds or minimum acceptance conditions to takeover offers.

A Missed Opportunity

The limited scope of review proposed by the European Commission does not address some

of the most critical shortcomings of the Takeover Directive.

- Harmonization of takeover defenses. Despite the political debate that inevitably would ensue, the European Commission should propose a system that harmonizes the approach to takeover defenses.

- Mandatory tender offer rule. The European Commission should consider additional rules proposed by certain member states to enable the mandatory bid rule to operate more effectively and supplement the Takeover Directive to reflect these provisions; the European Commission also should consider proposing a lower threshold — there is no apparent reason why shareholders should be able to accumulate 30 percent of a company's stock before making a tender offer.

- 95 percent squeeze-out threshold. Where squeeze-out thresholds are set at 95 percent, they should be lowered to 90 percent. Further, where a company reaches a dominating ownership through a tender offer that is lower than 90 percent but still delivers overwhelming majority, there should be an alternative mechanism to cash out minority shareholders (in several U.S. jurisdictions, for example, the alternative is the long-form cash merger).

- Enhanced disclosure rules. The European Commission should consider enhancing disclosure rules, including requiring a description of the process and negotiations leading to the bid.

- National supervisory authorities. The European Commission should consider a system that requires national supervisory authorities to coordinate their interpretations of takeover laws — at least on the principles that are common to all systems.

More progress is required to harmonize takeover law. Until the issues above are tackled head on, the system will remain fragmented.

--By Lorenzo Corte and Scott V. Simpson, Skadden Arps Slate Meagher & Flom LLP

Lorenzo Corte and Scott Simpson are both partners with Skadden in the firm's London office.

This article was originally published in 2013 Insights, Skadden's fifth annual collection of commentaries on the critical legal issues businesses will be facing in the coming year. To see additional articles from Insights, including discussions on capital markets, corporate restructuring, financial regulation, global litigation, global M&A, governance and regulatory issues, please visit this link: http://www.skadden.com/newsletters/Skadden_Insights_2013_011613_web.pdf.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.