HOUSE OF LORDS SESSION 2002–03
28th REPORT

SELECT COMMITTEE ON
THE EUROPEAN UNION

IF AT FIRST YOU DON'T SUCCEED … TAKEOVER BIDS AGAIN

WITH EVIDENCE

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TWENTY-EIGHTH REPORT

24 JUNE 2003

By the Select Committee appointed to consider European Union documents and other matters relating to the European Union.

ORDERED TO REPORT

IF AT FIRST YOU DON'T SUCCEED … TAKEOVER BIDS AGAIN

12846/02	Proposal for a Directive of the European Parliament and of the Council on takeover bids
Un-numbered	Council Presidency compromise proposal for a Directive of the European Parliament and of the Council of 14 February 2003 concerning takeover bids
Un-numbered	Council Presidency compromise proposal for a Directive of the European Parliament and of the Council (OTNYR) of 28 April 2003 concerning takeover bids

SUMMARY

The Takeovers Directive lays down general principles to be applied, basic procedures to be followed and standards to be met in the conduct of takeovers in the Union. The Directive is an important element of the Financial Services Action Plan agreed at the Lisbon Summit in March 2000 and scheduled for completion by 2005.

From the narrow viewpoint of the domestic impact of the Directive on the conduct of bids in the UK, there seems to be little, if any, advantage to be gained from the Directive. The UK has, in the Takeover Panel and City Code, an efficient and effective system. The Directive would not necessary lead to any significant improvements. But it would require the Panel and the Code to be put on a statutory footing. This could provide more opportunities for legal challenge, which could be used tactically to obstruct a bid.

The Committee's analysis of the Directive also reveals serious defects or shortcomings. The Committee recommends that:

(1) there should be a common minimum threshold for triggering a mandatory bid (Article 5);

(2) the rules on jurisdiction be simplified (Article 4); and

(3) the "breakthrough" rule be amended (Article 11).

On the other hand, the Committee finds that the Directive would introduce a significant measure of harmonisation, with the potential for increasing shareholder protection and opening up markets in other Member States for UK companies.

The Directive requires a difficult judgement to be made, balancing the potential advantages that would be available for UK companies/investors in Europe against potential disadvantages with the risk of increased litigation in the UK.

The Committee concludes that if the balance of advantage is to tilt in favour of the Directive, some important changes need to be made and certain key provisions must not be given up or weakened.

CHAPTER 1: INTRODUCTION

1. Takeovers are a common feature of corporate and commercial life. They occur when one company acquires control over another, usually by the purchase of a sufficient number of shares. Takeovers of public companies in the UK have since 1968 been subject to an extra-statutory system of control by the Takeover Panel which has formulated, interpreted and enforced a body of rules, the City Code.[1] Those rules have sought to secure the fair treatment of all shareholders in the target company and the orderly conduct of takeover bids on the securities markets. In particular the Panel will police any hostilities between the companies where the bid is not agreed and is a hostile one (*ie* not recommended for acceptance by the board of the target company). The UK system is generally considered to have operated most effectively notwithstanding that it has no "visible means of legal support".[2]

2. The proposal for an EC Takeovers Directive (the Directive) would establish a framework for the protection of shareholders throughout the Union and provide minimum guidelines on the conduct of takeover bids. It would apply to all companies traded on a regulated market. The Directive would lay down common rules and principles providing for equal treatment for shareholders in the same situation, full information about the offer, institution of a mandatory bid,[3] and control by supervisory authorities. The Directive would fundamentally change the position in the UK by requiring the City Code and its enforcement to be put on a statutory footing. There would be less freedom for the Panel to amend the Code. Consistency with the Directive would be required. There would be increased opportunities for legal challenges. There is a risk that litigation, tactical or otherwise, would increase.

3. This is not our first Report on this subject. The proposal for an EC Takeovers Directive has a long history. The matter has proven to be an exceptionally difficult and controversial one and is of considerable interest to a number of Member States including, because of the implications, described above, the UK.

4. The Commission first put forward a draft in 1989.[4] It was over detailed and ran into substantial opposition. Following consultation with the Member States a revised text was published in 1996. This was the subject of detailed inquiry and Report by the Select Committee.[5] Following extensive negotiations a compromise was, in 2001, eventually hammered out between the Council and the European Parliament. This produced the so-called Conciliation text. Success appeared to be within grasp. But the text had to be put to the vote in the European Parliament and, by the narrowest of margins (just one vote), the proposal fell.

5. However, a Takeovers Directive remained high on the list of priorities in the Financial Services Action Plan (FSAP) agreed to by Heads of State and Government at the Lisbon Summit in March 2000: the FSAP has the aim of creating an integrated financial market within the EU and is scheduled for completion by 2005. The Commission, having first sought the views of a "High Level Group of Company Law Experts" and after a brief consultation, has brought forward a revised text. It adopts some of the ideas of the High Level Group by providing, for example, for general pre-bid information on listed companies to be published and for a "breakthrough" procedure.[6] The new text also responds to some of the concerns expressed by the European Parliament. Notably, it provides a definition of the "equitable price" to be offered by the mandatory bid. It also contains harmonised rules for two procedures that might be needed after a successful takeover: first, a "squeeze out" right, allowing the new majority shareholder to require the remaining minority shareholders to sell their shares to him; and, second, a "sell-out" right, enabling minority shareholders to require the new majority shareholder to buy their shares. Technically the Directive is a new proposal but because it bears many of the features of the Compromise text and contains the main changes described above it is to be hoped that it will have a speedy path through the legislative process. But there remain a number of important issues to resolve. We refer to these in Part 3 of this Report.

6. In our 1996 Report we were far from enthusiastic about the notion that there should be a European Takeover Directive. We doubted whether any directive on takeover bids was necessary. The

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1 For a more detailed account of the supervision of takeover bids in the UK and the role of the Takeover Panel and the City Code, the reader is referred to Part 2 of our earlier report, *Takeover Bids* (13th Report, 1995-96, HL Paper 100).

2 As Lord Donaldson of Lymington described the situation in the leading case on the position of the Panel: *R v Panel on Takeovers and Mergers, ex.p. Datafin plc* [1987] Q.B. 815.

3 An obligation on the offeror, when he has reached a certain level of shareholding, to bid for all the remaining shares.

4 Proposal for a Thirteenth General Directive on company law concerning takeover and other general bids. [1989] OJ C 64/8.

5 *Takeover Bids*, 13th Report, 1995-96, HL Paper 100.

6 This would enable the takeover bidder having acquired 75 per cent or more of the risk-bearing capital of the target company to override any defence structures that prevented it exercising control of the company (for instance, the right to dismiss the board of directors).

UK has a sophisticated and highly effective system of control of takeovers and a directive would inevitably change the fundamental nature of the control regime, bringing with it an increased risk of disruptive tactical litigation. We have therefore approached this current proposal with a particularly critical eye. We wish to be sure that there would be real benefits for the Union and its Member States, and especially the UK, in harmonisation by directive and that the Directive as adopted would be likely to deliver them. This has been our starting point and the focus of the questions put to our witnesses in this brief inquiry.

7. Sub-Committee E (Law and Institutions), whose members are listed in Appendix 1, carried out the inquiry into the issues raised by the Commission's revised text of the Takeovers Directive. We took evidence from Melanie Johnson MP, Parliamentary Under Secretary of State, Department of Trade and Industry, and from the Takeover Panel and the CBI. We are grateful for their assistance in this inquiry. The witnesses are listed in Appendix 2. The evidence, both written and oral, is printed with the Report.

CHAPTER 2: BACKGROUND TO PROPOSED DIRECTIVE AND SUMMARY OF ITS PROVISIONS

Brief history of the proposal

8. The history of the proposal can be traced back to 1985 when the Commission announced its intention, as part its programme for the completion of the Single Market, to bring forward a directive on takeover bids. A text was formally presented by the Commission in 1989. Both the Economic and Social Committee (ECOSOC) and the European Parliament gave it their general support, but a number of Member States, including the UK, had serious problems with what was being proposed. Not all Member States could accept the notion of a mandatory bid[7] required to be made when the offeror has reached a certain level of shareholding. The UK was concerned to safeguard its highly efficient self-regulatory system. Member States had differing views on the degree of prescription which the Directive should have and on the level of detail.

9. During the period 1992-95 the future of the Directive was extensively considered as part of a general review of proposals to be amended or withdrawn in application of the principle of subsidiarity. A majority of Member States took the view that some harmonisation on takeover bids was desirable and most of those thought that a framework directive would be the right approach. The Commission's 1996 text was the Commission's response.

The High Level Group

10. Following the narrow failure of the Takeover Bids Directive (*ie* the 1996 text as amended in the negotiations in and between the Council and Parliament) to be adopted in 2001, the Commission appointed a High Level Group of Company Law Experts[8] to look at three issues which the Commission identified as of concern to the European Parliament:

—the issue of the "level playing field" for shareholders (*ie* the problems created by the existence in Member States of differential voting and control structures, such as shares with multiple voting rights or restrictions on transfer of shares or voting rights);

—the definition of the "equitable price" to be paid to shareholders by a takeover bidder; and

—the right of a majority shareholder to buy out minority shareholders following a successful takeover.

11. To address the "level playing field" issue, the Group proposed[9]:

—rigorous disclosure provisions, so that differential voting and control structures were fully transparent to the market; and

—a "breakthrough" procedure, whereby any takeover bidder acquiring 75 per cent or more of the risk-bearing capital (in UK terms, the "equity" or "ordinary" shares) of a company would be able to override any defence structures that prevented it acquiring effective control of the target company (for instance, the right to dismiss the board of directors).

As will be seen, these proposals are developed in Articles 10 and 11 of the Directive respectively.

12. On the other two issues, the Group proposed that:

—a harmonised approach to equitable price be adopted across the EU based on the highest price paid by the bidder in a period of up to 12 months prior to the bid; and

—provisions be included to deal with the problems of, and for, residual minority shareholders following a bid ("squeeze-out" and "sell-out" rights).

These recommendations have formed the basis for Articles 5, 14 and 15 of the Commission's text.

The proposal in outline

13. Like the 1996 text, the current proposal is essentially a minimum standards/framework directive containing general principles but leaving considerable latitude for Member States and their takeover

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7 See footnote 3.

8 The group was chaired by Jaap Winter, Chief Legal Counsel of Unilever.

9 The High Level Group produced a report, "Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids," (the full text of which can be found at:

http://europa.eu.int/comm/internal_market/en/company/company/news/02-24.htm) on 10 January 2002.

supervisory authorities to deal with the detailed implementation of those principles. It builds upon the (2001) Conciliation Text, and includes a number of new measures which, whilst not adopting in their entirety the proposals of the High Level Group, reflect the issues considered and the solutions proposed by them.

The general principles

14. Article 3 would require Member States to ensure that their domestic regimes for regulating takeovers respect six "general principles":

—all shareholders in the same class are to afforded equivalent treatment;

—shareholders must have sufficient time and information to enable them to reach a properly informed decision on any takeover bid;

—the board of the target company is to act in the interests of the company as a whole and shareholders of the target company must be allowed to decide on the merits of the offer;

—a bid should not lead to the creation of false markets or the distortion of the normal functioning of the markets;

—a bidder should only announce a bid where proper steps have been taken to ensure the offer can be fulfilled in cash (where a cash offer is made) or all reasonable measures have been taken to secure the implementation of any other type of consideration; and

—target companies must not be hampered in carrying out their normal activities for longer than is reasonable.

15. The Greek Presidency has proposed the inclusion of a further "principle" which seeks to ensure that the Directive should not be impeded by Member States' laws.[10] But, in our view, it would add nothing and risks creating confusion.

The supervisory authority

16. Member States would be required to designate a supervisory authority to be responsible for supervising takeover bids, and for ensuring that parties to a bid comply with the Directive's requirements (Article 4). This would include a duty for parties to a bid to supply to the supervisory authority on request necessary information related to the bid (Article 6). The supervisory authority would be that of the Member State where the target company has its registered office if the company's shares are traded on a regulated market in that Member State (Article 4 (2)(a)).

Protection of shareholders—mandatory bid, equitable price

17. Article 5 requires Member States to adopt a "mandatory bid" rule. Where a party acquires a specified minimum percentage of a company's shares, thereby gaining control of the company, it would be required to make a bid to all the shareholders for all of their holdings at the equitable price.[11] The Directive leaves it to individual Member States to determine the percentage of voting rights which confers control of a company for this purpose. Generally, the "equitable price" will be the highest price paid by the bidder for the class of shares concerned within a period to be set by Member States but which may not be less than 6 months nor more than 12 months prior to the bid or during the bid (Article 5(4)).

Information and disclosure

18. The Directive specifies the minimum information to be included in the public offer document made available to the target company's shareholders (Article 6). This includes the terms of the bid (such as the consideration offered for each class of shares and all conditions to which the bid is subject) and also the offeror's intentions with regard to the future business of the company (including the likely impact upon employees).

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[10] The additional text proposed is as follows: "(g) the exercise of rights and the discharge of obligations as mandated by this Directive and whose content is clearly defined in this Directive should not be hindered by national law requirements related to this Directive whose content is defined by Member States such as the ones addressing compensation arrangements, ownership/control thresholds, timeframes and deadlines, derogations by supervisory authorities".

[11] The mandatory bid obligation would not, however, apply where a person had gone over the threshold as a result of a voluntary bid made to all shareholders for all of their shares (Article 5 (2)).

19. The bid must be made public in such a way as to avoid the creation of false markets in shares. Information and documents are to be made available to shareholders promptly (Article 8).

Defensive measures

20. The board of the target company would be prevented, once it had been notified of a bid, from taking action which could frustrate that bid, without the prior authorisation of its shareholders (Article 9).

21. The Directive also contains detailed provisions requiring companies to disclose their share structure and control systems so that the market can identify differential voting mechanisms and other control devices across the EU. Article 10 would require certain matters to be published in the company's annual report, including:

—capital structures and the rules governing amendments to the company's articles;

—rights and obligations attaching to different classes of shares;

—restrictions on voting rights and on the transfer of shares (including agreements between shareholders which might result in restrictions on voting rights or the transfer of shares);

—rules governing the appointment of board members, their powers and agreements between the company and its board members or employees which provide for compensation if they are made redundant following a takeover bid;

—significant shareholdings (including indirect holdings through intermediaries);

—the holders of shares with special control rights;

—the system of control of any employee share scheme (where the employees themselves do not directly exercise such control);

—significant agreements to which the company is a party taking effect, altering or concluding on the change of control of the company.

Article 10 also requires the board to present an explanatory report on the above matters to a meeting of shareholders every year.

Breakthrough

22. Under Article 11 any restrictions on the transfer of shares provided for in the company's articles of association or in contractual agreements between the target company and its shareholders or between shareholders of that company would be unenforceable against the bidder. Restrictions on voting rights would also cease to have effect at any meeting summoned to consider defensive measures in response to the bid. Where the bidder held the number of shares necessary under the applicable national law (in the United Kingdom, 75 per cent)[12] to make constitutional changes to the company, these restrictions on transfer of shares or voting rights would cease to apply at the first meeting following closure of a successful bid. The override procedure does not apply to shares without voting rights which carry specific pecuniary advantages (for example, in the UK, preference shares).

Employee rights

23. The Directive requires the prompt disclosure of the bid to representatives of the employees (Article 6 (1)) and requires the board of the target company to make public a document setting out its opinion on the effect of the bid on all the interests in the company, including employment. It also provides that, where the board of a target company receives in good time a separate opinion from the representatives of the employees, this should be appended to the document (Article 9(5)). Additionally, Article 13 specifically recognises employee rights and, in particular, those conferred under the directives on the European Works Council, Collective Redundancies and Information and Consultation.[13]

Protection of minorities—"squeeze-out" and "sell-out" rights

24. Member States would be required to put in place rules enabling a successful takeover bidder to acquire minority shareholdings (Article 14—"squeeze-out rights") and enabling minority shareholders

[12] The Greek Presidency has suggested that a 75 per cent threshold be inserted into Article 11. Doc 6064/1/03.

[13] Directives 94/45/EC, 98/59/EC and 2002/14/EC.

to require the takeover bidder to buy out their remaining shares in these circumstances (Article 15—"sell-out rights").

Other rules relating to the conduct of bids

25. Member States would also be required to put rules in place governing matters such as withdrawal or revision of bids, competing bids, disclosure of the results of bids, irrevocability of the bid, and conditions permitted (Article 12). The Directive does not stipulate the content of these rules.

CHAPTER 3: ANALYSIS OF PROPOSED DIRECTIVE

The new proposal

26. When the Committee looked at the 1996 proposal for a Takeovers Directive we queried whether any Directive was justified or necessary. Member States were already adopting rules to deal with takeovers. Driven by market forces a process of "soft harmonisation" was under way and, we were told, has continued. So, for example, the majority of Member States now have a mandatory bid provision. However, the current position across Europe is not uniform (Q 3).

27. We asked the Government whether it accepted that there was a case for action at Union level. The Minister said: "the balance at the moment, in our view, is that there is still a case for a Directive and that there would be gains to be had out of a Directive" (Q 58). She acknowledged that there would be no benefits in relation to takeovers of companies under the provisions of the City Code. It was, however, necessary to consider the wider European position. The Commission had put forward a two-fold justification for its proposal: the Single Market objective of providing a legal framework for takeovers across the EU and the need to provide adequate legal protection for shareholders. The Government supported both of these broad aims. The Minister said that there was a need to make the financial services markets work better across Europe. The Directive would play a key role in that process: it was an important part of the Financial Services Action Plan. The enhanced shareholder protection across Europe, especially the extension of the mandatory bid and the improved rule on equitable pricing, would be beneficial from a UK point of view. The Minister also believed that the Directive would have a general impact on good corporate governance and practice which would in turn bring increased investor confidence (p 33, QQ 58, 63, 95).

28. The Takeover Panel confirmed that the Directive would not bring about any improvements in the UK. Mr Remnant, the Panel's then Director General, said: "there is nothing in the Directive that I would say enhances the system of takeover regulation in the UK. We have the most sophisticated and developed system of takeover regulation in Europe, which has proved itself over the last thirty years or so and I do not think that it is in any way enhanced by the very basic requirements of the Directive, which is a minimum standards Directive. However, being a minimum standards Directive, it does enable Member States to have more detailed and more rigorous rules, which of course we have and which will mainly not be impacted by the Directive" (Q 2).

29. Witnesses agreed that it was necessary to look at the position in other Member States to see what benefits the Directive might provide for UK firms and investors. Mr Remnant said: "There are some provisions in the Directive—notably I would say the Article which deals with the requirement for mandatory bids, which is Article 5, and indeed Article 9 which deals with management not being able to take action which might frustrate a bid without the approval of shareholders—which are provisions which will be important in helping protect UK investors and UK companies in Europe" (Q 2). Mr Oliver, Chairman, CBI Companies Committee and Boots Company Secretary, said: "It is our view that the Directive is better than nothing, that there is a need for the Directive, that it achieves potential benefits for UK companies and for UK investors, UK companies wishing to make bids in Europe and all those who do invest in Europe already and have minority shareholdings" (Q 5). Mr Oliver identified the need to extend the opportunities for cross-European takeover activity. He said: "In some ways we are almost at a disadvantage in as much as EU firms which are not incorporated and subject to the Panel can make an easy bid within the UK but we do not have the ability because we have a level playing field in this country and so our market is open. UK firms wishing to invest in other Member States sometimes do not have the same advantage. So we have an open market, others do not, and we prefer to see the open market across the Union" (Q 49).

30. **The Directive would not bring any potential benefits to companies or shareholders in the UK but could confer benefits for them outside the UK. The procedures and rules operated under the City Code have been worked out over years and generally at a higher level of protection than is proposed in the Directive. But even though the UK position is, we believe, satisfactory, there is a UK interest in having good arrangements working in all Member States. It must be in the interest of UK companies and UK investors in other European markets that there are strong and efficient regulatory regimes in those jurisdictions, in particular so that they can have confidence in, and take the fullest advantage of, the Single Market. There is also the wider interest mentioned by the Minister that the Directive is one part in a Financial Services package designed to open up the financial services markets across Europe. We accept therefore that there is a good case for having a directive regulating takeover bids in Member States, though as we explain below, any such directive must be clearly of a sufficient minimum standard as to secure those benefits while not prejudicing unnecessarily the well-established position of the Takeover Panel and the City Code in the UK**.

The future of the Panel and the Code

31. The Directive will require changes to be made in the UK. In order to implement the Directive, the regulation of takeovers would have to be placed within a statutory framework. Legislation would designate a supervisory body. The Directive makes clear that a private body, such as the Takeover Panel, could be designated (Article 4(1)). The Government envisages that, in addition, some aspects of the Directive's proposed regulatory framework currently in the Code may have to be incorporated into legislation. The Directive refers to the need for Member States to ensure that rules are in force which satisfy certain requirements, but recognises such rules may include "codes of practice or other arrangements". The Government believes that the Takeover Panel could continue to perform its function of drawing up the detailed rules contained in the City Code, although in future that would be done under a statutory framework (p 28).

32. We asked how, in broad terms, the City Code and the Takeover Panel would be affected by the Directive. The Government held the view that the main elements of the proposal were covered by the Code. There were no significant requirements in the Directive in relation to the takeover bid process that go beyond the requirements of the Code, though it was accepted that some of the rules in the Code might need amendment. (There would, however, be more substantial company law changes, in particular in implementing the Directive's requirements (Article 11) for disclosure of company information (see paragraph 21 above) and also the breakthrough procedure (see paragraph 22). The Takeover Panel took a similar overall view of the Directive. The Panel nevertheless had a number of specific concerns with the text (QQ 4, 10).

33. **It is important that the Takeover Panel and the City Code should be able to continue to police takeover bids in the UK. That would be possible under the Directive, though they would have to operate under a statutory umbrella (we consider the implications of this below). As to the detail of the rules being proposed, there is no evidence that the current UK system falls in any way below the Directive's standards. Though there are provisions in the Directive which need to be improved, we are satisfied that the Directive as it presently stands would not have any major negative impact on the provisions of the Code. It is also important that the Directive should not impede unnecessarily the ability of the Panel to amend and update the Code in response to commercial and legislative developments**.

Tactical litigation

34. In our 1996 Report we expressed concern that the Directive, which would require our current procedures to be given a statutory basis, would open up the way for tactical litigation. The effect of the Court of Appeal's decision in *Datafin*[14] has been to discourage such litigation. Panel decisions are subject to judicial review but the courts would expect to intervene only after the event, not during the bid, and usually only by way of declaration as to what some provision in the Code means. The scope for tactical obstructive litigation is thus limited.

Article 4(6)

This Directive shall not affect the power of the Member States to designate judicial or other authorities responsible for dealing with disputes and for deciding on irregularities committed during the bid procedure or the power of Member States to regulate whether and under which circumstances parties to a bid are entitled to bring administrative or judicial proceedings. In particular, this Directive shall not affect the power which courts 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.

35. Article 4(6) has been specifically designed to allow individual Member States to prevent tactical litigation which might frustrate or delay a takeover bid. The Minister was confident that "the wording retained from the Conciliation text would be sufficient to safeguard the benefits of the existing UK system of takeover regulation and minimises the scope for tactical litigation to be imported" (p 29). Mr Remnant, for the Takeover Panel, accepted that Article 4(6) was "probably as good as one is ever going to get" (Q 53). The Minister was clear that the only way to avoid any risk of increased litigation would be to have no directive (Q 98).

[14] *R v Panel on Takeovers and Mergers, ex.p. Datafin plc* [1987] Q.B. 815.

36. The Minister acknowledged that it would be essential to implement Article 4 (6) "properly". The Government "intended to make the maximum use of the flexibility provided by Article 4(6)". The aim would be to maintain as far as possible the present legal position established by the courts (QQ 59, 61, 62, 97). The Takeover Panel envisaged the need for detailed implementing provisions. Mr Remnant said: "We do think that it is going to be very important that the implementing legislation in the UK specifically takes account of what is in Article 4(6) to make sure that, to the extent there is the possibility of litigation, it is very much a defined procedure with defined safeguards including time limits in order to limit as far as possible the amount of litigation" (Q 15).

37. We asked the Minister how she envisaged implementing Article 4(6). We assumed that some detailed preparatory work had already been done, else the Government could not be so confident that Article 4(6) would have the sought-after effect. The Minister confirmed that some thought has been given to the issues, including the question of compatibility with Article 6 ECHR. Furthermore, the Government intended to consult widely in due course. But only "a small resource" was devoted to the Directive. The Minister said: "It is very effective in terms of the negotiation but it will not be very effective if we spend too long worrying about the detail of implementation" (QQ 92, 96). She accepted, however, that there was a need for detailed work to be done (Q 100).

38. **Putting the Code onto a statutory footing will inevitably increase the scope for litigation. Article 4(6) is well intentioned and very broadly drafted. But we do not believe that a Member State could, for example, make it impossible to question before a court whether the local law complied with the basic provisions of the Directive. Further, it would not be possible, especially if there is to be compatibility with the ECHR, to exclude some degree of judicial supervisory jurisdiction. There is a strong public interest in ensuring compliance with Article 6 ECHR here as elsewhere. We emphasise the need for clear thinking about the measures that the Government uses to take maximum advantage of Article 4(6). It is important that there should be wide consultation and that that should not be delayed. If there are likely to be problems then it is better to know them now than later when the Directive has been adopted. There may be resource restraints within the DTI but that is a matter which Ministers can speedily address. Ministers should be aware of the consequences of getting the Directive, and Article 4(6) in particular, wrong**.

A minimum standards directive

39. As mentioned above, one of the grounds on which the original (1989) text of the Directive was opposed by Member States was that it was too detailed and prescriptive. A framework Directive setting minimum standards should benefit the UK. As Mr Remnant, for the Takeover Panel, said, such a Directive would have "the advantage of enabling the UK to preserve its own very effective takeover regulation: it does allow more scope for the UK to keep the detailed rules which are tried and tested, which otherwise might not be the case" (Q 14). On the other hand, as we pointed out in our 1996 Report, the Directive should have sufficient clarity and require a sufficient measure of harmonisation in the interest of companies wishing to take advantage of the Single Market and in the interest of minority shareholders.[15] We remain of that view. Two Articles are particularly relevant in this context: Article 5 (mandatory bids), Article 9 (defensive measures).

Mandatory bid—minimum threshold

40. Article 5 is a significant improvement on the 1996 text. Member States would have to have a mandatory bid rule, requiring the bidder to make a bid for all the shares of the minority shareholders. Article 5 also provides for a minimum equitable price. We note that it now deals with concert parties.[16] But in the Takeover Panel's view it remains a weak provision because it does not actually define a common threshold for control (Q 2).

[15] *Takeover Bids,* 13th Report, 1995-96, HL Paper 100, at para 97.

[16] *ie.* dealings by offerors and persons acting in concert with them. The City Code recognises that parties often "act in concert" in connection with takeover offers and that rules which only apply to an offeror could easily be circumvented by that offeror arranging with another person to acquire shares (or take other actions) on its behalf. We commented on the omission of concert parties from the 1966 text in our earlier Report (13th Report, 1995-96, HL Paper 100) at para 113.

Article 5(1)–(4)

(1) Where a natural or legal person who, as a result of his own acquisition by persons acting in concert with him, holds securities of a company referred to in Article 1(1) which added to any existing holdings and the holdings of persons acting in concert with him, directly or indirectly, give him a specified percentage of voting rights in that company, conferring on him, the control of that company, Member States shall ensure that this person is required to make a bid as a means of protecting the minority shareholders of that company. This bid shall be addressed at the earliest opportunity to all holders of securities for all their holdings at the equitable price as defined in paragraph 4.

(2) Where control has been obtained following a voluntary bid made in accordance with this Directive to all holders of securities for all their holdings, the obligation to launch a bid laid down in paragraph 1 shall no longer apply.

(3) The percentage of voting rights which confers control for the purpose of paragraph 1 and the method of its calculation shall be determined by the rules of the Member Sates in which the company has its registered office.

(4) The highest price paid for the same securities by the offeror, or by persons acting in concert with him, over a period of between six and twelve months prior to the bid referred to in paragraph 1 or during the bid itself shall be regarded as the equitable price. If after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him purchases securities at above the offer price, the offeror shall increase his offer to not less than the highest price paid for the securities so acquired.

Member States may authorise their supervisory authorities to adjust the price referred to in the first subparagraph in circumstances and according to criteria that are clearly determined. To that end, they may draw up a list of circumstances in which the highest price may be adjusted either upwards or downwards, for example where the highest price was set by agreement between the purchaser and a seller, where the market prices of the securities in question have been manipulated, where market prices in general or certain market prices in particular have been affected by exceptional occurrences, or in order to enable a firm in difficulty to be rescued. They may also determine the criteria to be applied in such cases, for example the average market value over a particular period, the break-up of value of the company or other objective valuation criteria generally used in financial analysis.

Any decision by a supervisory authority to adjust the equitable price shall be substantiated and made public.

41. The Minister accepted that setting the mandatory bid threshold was of key importance. And it was a relevant factor in balancing the advantages and disadvantages of the Directive. But she said that it was necessary "to be realistic about what can be achieved on a European front". There had been long drawn out fruitless discussions in the past on the issue of a common threshold. She was prepared to accept that the Directive would not go as far as UK takeover provisions did (Q 64).

42. **Article 5 should be strengthened. The present text of the Directive does not prescribe a threshold at which a mandatory bid has to be tabled and accordingly it would be open to Member States to set a high threshold and thus limit the protection which shareholders should have. Without an effective mandatory bid requirement shareholders might have no right of exit from the company. We recommend therefore that a minimum threshold should be set down in Article 5 (1). Member States would be free to set a lower threshold but the Directive would stipulate a minimum level of shareholder protection across Europe**.

Mandatory bid—cash consideration

43. The Takeover Panel argued that that it should be obligatory to offer minority shareholders a cash consideration. Minority shareholders should be offered the opportunity of a clean exit for cash from a company where control has already passed (QQ 10-11).

Article 5(5)

The offeror may offer as consideration securities, cash or a combination of both.

However, where the consideration offered by the offeror does not consist of liquid securities admitted to trading on a regulated market, such consideration has to include a cash alternative.

In any event, the offeror shall offer a cash consideration at least as an alternative where he or the persons acting in concert with him, over a period beginning at the same time as the period decided by the Member State in accordance with paragraph 4 and ending when the offer closes for acceptance, he has purchased in cash securities carrying 5% or more of the voting rights of the offeree company.

Member States may provide that a cash consideration shall be offered, at least as an alternative, in all cases.

44. Article 4(5), in the Presidency's proposed text, states that Member States may provide that there must be a cash consideration offered in all cases. In the Minister's view, the text was satisfactory as it would permit Member States to require a cash consideration. The existing UK rule could therefore be maintained. (Q 67).

45. The text does not go as far as making it compulsory that there should be a cash consideration offered to all shareholders. The Minister did not think this was negotiable. The latest text was, in her view, a marked improvement. She said: "It may not be perfect and we would certainly continue to work if we thought that there was more to be gained on it but we have worked very hard to achieve the position that we have currently achieved" (Q 68).

46. **There is a strong case for saying that it is essential that shareholders who want to leave the company should be able to do so on cash terms. We agree with Government that the present text is satisfactory in that it safeguards the position in the UK. It is, however, regrettable that the Directive does not establish, as a minimum standard to be applicable in all Member States, the right of all shareholders to be offered a cash consideration for their shares. "Liquid securities" are the next best thing, but it is difficult to see why there should not be a requirement for cash**.

Article 9—defensive measures

47. As we pointed out in our 1996 Report, Article 9 (formerly Article 8) is another key provision of the Directive. All forms of action which might frustrate a bid would be prohibited. Defensive measures would not be in the hands of the directors of the target company. Article 9 retains the principle that it is for the shareholders to decide on defensive measures once a bid has been made public.

Article 9(2)

During the period referred to in the second subparagraph, the board of the offeree company must obtain the prior authorisation of the general meeting of shareholders given for this purpose before taking any action other than seeking alternative bids which may result in a lasting impediment to the offeror in obtaining control over the offeree company.

Such authorisation shall be mandatory at least from the time the board of the offeree company receives the information concerning the bid referred to in the first sentence of Article 6(1) and until the result of the bid is made public or the bid lapses. Member States may stipulate that such authorisation is to be obtained at an earlier stage, for example from the time when the board of the offeree company becomes aware that the bid is imminent.

48. The Minister said: "Article 9 … is a highly important Article simply because it does enshrine the principle of management not interfering in the process of a bid and gives shareholders the right ultimately to decide on the merits of a bid at any given time. We recognise the importance that the City and business attach to that. We rate that as a very high priority in terms of Article 9" (Q 65). Both the Takeover Panel and CBI considered Article 9 to be fundamental to investor protection and would be opposed to any directive on takeover bids without such a provision (Q 27).

49. We requested clarification of the Government's position from the Minister because there was a suggestion that if it proved impossible to reach agreement on Article 11 (in particular to provide for the overriding of multiple voting rights—we return to this at paragraph 62 below) and it had to be

dropped from the Directive then, as a *quid pro quo*, Article 9 might also be dropped. The Government has denied that it has accepted that position.[17] **Whatever the outcome on Article 11 the Government should stand firm on Article 9. The requirement that the board of the target company should, without shareholder approval, be prohibited from taking action which could frustrate the bid, is an indispensable provision of any directive on takeover bids**.

Split jurisdiction

50. Under Article 4 the basic rule is that a bid will be subject to control by the supervisory authority in the State where the target 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 and employee information obligations would remain to be governed by the law of the State of incorporation.

Article 4(2)

(a) The authority competent for supervising the bid shall be that of the Member State in which the offeree company has its registered office if the securities of that company are admitted to trading on a regulated market in that Member State.

(b) If the securities of the offeree company are not admitted to trading on a regulated market in the Member State in which the company has its registered office, the authority competent for supervising the bid shall be that of the Member State on whose regulated market the securities of the company are admitted to trading.

If the securities of the company are admitted to trading on regulated markets in more than one Member State, the authority competent for supervising the bid shall be that of the Member State on whose regulated market the securities were first admitted.

(c) If the securities of the offeree company are first admitted to trading on regulated markets within more than one Member State simultaneously, the offeree company shall determine which of the supervisory authorities of those Member States is the competent authority for supervising the bid by notifying these regulated markets and their supervisory authorities on the first trading day.

If the securities of the offeree company are already admitted to trading on regulated markets in more than one Member State at the date referred to in Article 20(1) and were admitted simultaneously, the supervisory authorities of these Member States shall agree on which one of them is to be the competent authority for supervising the bid within four weeks of the date mentioned in Article 20(1). Otherwise, the offeree company shall determine which of these authorities is to be the competent authority on the first trading day following the expiry of the period of time mentioned in the first sentence.

(d) Member States shall ensure that the decisions referred to in (c) are made public.

(e) In the cases referred to in (b) and (c), matters relating to the consideration offered in the case of a bid, in particular the price, and matters relating to the bid procedure, in particular the information on the offeror's decision to make a bid, the contents of the offer document and the disclosure of the bid, shall be dealt with in accordance with the rules of the Member State of the competent authority. In matters relating to the information to be provided to the employees of the offeree company and in matters relating to company law, in particular the percentage of voting rights which confers control and any derogation from the obligation to launch a bid, as well as the conditions under which the board of the offeree company may undertake any action which might result in the frustration of the bid, the applicable rules and the competent authority shall be those of the Member State in which the offeree company has its registered office.

51. Under the Code the Panel has jurisdiction where the offeree/target company is incorporated within the UK and has its place of central management within the UK. Where its shares are traded is not a relevant criterion. Mr Remnant was critical of the approach being proposed in the Directive. He said: "Although there are some examples given in the Directive as to which falls into which category, they are only examples and there are many issues on which it would be unclear as to whether they fell

[17] In his letter of 29 May 2003, Alan Johnson MP, Minister of State for Employment Relations, Industry and the Regions denied the allegation in *The Times* of 19 May that the UK had opposed the adoption of the Takeovers Directive and sought to "wreck the Agency Workers Directive". The correspondence is printed with this Report, at pp 35-36.

into one category or the other. Further, there is no mechanism for resolving jurisdictional disputes between supervisory authorities and we think it is inevitable that this will cause delay, potential litigation and frankly is a recipe for regulatory chaos" (Q 31).

52. The Government's preference was for the supervisory authority always to be that where the target company was incorporated (p 29). But they believed that the Directive's shared/split jurisdiction rule would only be applicable rarely (Q 75). While the proposed rules were not what the Government would advocate the Minister believed that the Directive "would at least lay down a rule, albeit one that we would not prefer, where there is presently no EU wide rule on jurisdiction at all" (Q 74). The views of Member States differed on the issue and Mr Edbury, Assistant Director, Company Law and Investigations, DTI, said: "Aside from those Member States who are actually against us on this point, there is a number who, for fairly understandable reasons, are reluctant to unpick the text of the conciliation Directive after all those years of negotiation" (Q 77). In the Minister's view, there seemed to be little scope to reopen this issue and if it were to be, there would a risk that the result might be something less attractive (Q 79).

53. **We agree with the Government and other witnesses that it is not desirable to have split jurisdiction and that in all cases supervision should be the responsibility of the authorities of the State of incorporation. In many cases the jurisdiction of the Panel will not be affected under the rules currently proposed in the Directive. This is because in most cases a company will have its registered office and its shares traded in the Member State where it is incorporated. But there will be cases where under the proposed rules a takeover bid will simultaneously be subject to two regimes. We have great difficulty in seeing how the split regime as proposed by the Directive will work in practice. The Government have judged it something which they can accept and appear reluctant to reopen the issue. But for those closest to the present UK system it remains a potentially serious problem. We therefore urge the Government to reconsider the position.**

The breakthrough/override procedure—golden shares

54. In her Explanatory Memorandum, the Minister identified two "potentially significant consequences for the UK" in relation to the proposed override procedure in Article 11; (a) golden shares, and (b) contractual arrangements between shareholders. As regards the former, only a small number of UK listed companies was involved. There was, however, some disagreement with the Commission as to whether Article 11 applied. The Minister made clear that the Government would seek to preserve the key public interests (including the confidentiality and integrity of defence manufacture and research, preserving the continuity of fuel and power supply) currently secured by golden shares in the articles of the companies concerned (QQ 83-4).

Article 11

(1) Without prejudice to other rights and obligations laid down in Community law for companies referred to in Article 1(1), Member States shall ensure that the provisions referred to in paragraphs 2 to 6 apply when a bid has been made public.

(2) Any restrictions on the transfer of securities provided for in the articles of association of the offeree company shall be unenforceable against the offeror during the period for acceptance of the bid laid down in Article 7(1).

Any restrictions on the transfer of securities provided for in contractual agreements between the offeree company and holders of its securities or between holders of securities of the offeree company shall be unenforceable against the offeror during the period for acceptance of the bid laid down in Article 7(1).

(3) Restrictions on voting rights provided for in the articles of association of the offeree company shall not have effect at the general meeting which decides on any defensive measures in accordance with Article 9.

Restrictions on voting rights provided for in contractual agreements between the offeree company and holders of its securities or between holders of securities of the offeree company shall not have effect at the general meeting which decides on any defensive measures in accordance with Article 9.

Multiple voting securities shall carry one vote only at the general meeting which decides on any defensive measures in accordance with Article 9.

(4) Where, following a bid, the offeror holds 75% of the capital carrying voting rights, any restrictions on the transfer of securities and on voting rights referred to in paragraphs 2 and 3 and any special rights of shareholders concerning the appointment or removal of board members shall not apply and multiple voting securities shall carry one vote only at the first general meeting following the closure of the bid, called by the offeror in order to amend the articles of association or to remove or appoint board members.

To that end, the offeror shall; have the right to convene a general meeting at short notice, provided that the meeting does not take place within two weeks of notification.

(4a) Where rights are being removed on the basis of paragraph 4, equitable compensation must be provided for the loss incurred by the holders of these rights. The terms for determining such compensation and the modalities of its payment will be set by Member States.

(5) Paragraphs 3 and 4 shall not apply to securities where the absence or restrictions of voting rights are compensated for by specific pecuniary advantages.

(6) Member States may provide that paragraphs 2 to 5 shall not apply to companies referred to in Article 1(1) for a period of five years from the date of the first listing of the company's securities on a regulated market of a Member State.

(7) This article shall not apply to securities which are held by Member States in accordance with the Treaty for reasons of public security, defence or national security.

55. Since we met the Minister there have been two important developments affecting this Article. First, the text of Article 11 has been amended to afford protection to securities held by Member States on public security, defence and national security grounds. The new text is set out in the box above. This change has, in the Government's view, substantially reduced the impact of Article 11 on golden shares (p 31). Second, on 13 May, the Court of Justice handed down its judgment in the case brought by the Commission against the UK in respect of its golden share in British Airports Authority (BAA).[18] The Court reiterated that the EC Treaty prohibits all restrictions on the movement of capital between Member States and between Member States and third countries and that direct investments in the form of participation in an undertaking by means of shareholding or the acquisition of securities on the capital market constitute capital movements.[19] The Court rejected the UK Government's argument

[18] Case C-98/01 *Commission v United Kingdom*. Judgment of 13 May 2003. The Commission took issue with the rights attaching to the UK's special share in BAA plc. The Articles of Association of BAA, a privatised undertaking which owns a number of airports in the UK, create a special share held by the UK Government which requires the Government's consent to certain of the company's operations (winding-up, disposal of an airport). The Articles also prevent the acquisition of more than 15 per cent of the voting shares in the company.

[19] The Court regarded it as settled law that Directive 88/361, [1988] OJ L178/5], could be used for the purposes of defining what constitutes capital movement. Case C-98/01, judgment at para 39.

that the measures at in issue in relation to BAA were solely the application of private company law mechanisms. The Court declared that by maintaining in force the provisions limiting the possibility of acquiring voting shares in BAA as well as a procedure requiring consent to the disposal of the company's assets the UK had infringed Article 56 TEC.

56. It is clear, however, from the earlier "golden share" judgments[20] and the case brought against Spain[21] heard alongside that against the UK, that while golden shares may entail restrictions on the movement of capital between Member States Member States may be justified in having a degree of influence within undertakings that were initially public and subsequently privatised, where those undertakings are active in fields involving the provision of services in the public interest or of strategic services.[22] Such restrictions, when they apply without distinction to nationals of the Member State concerned and to other Community nationals, may be justified by overriding requirements of the general interest. To be justified in that way, the restrictions must also accord with the principle of proportionality.[23]

57. **We support the approach being taken by the Government. There should be no uncertainty as to the position of the UK's golden shares under Article 11**.

The breakthrough/override procedure—contractual arrangements

58. The effect of Article 11 would be to make restrictions on the transfer of shares and on voting rights unenforceable. The issue is a controversial one. The High Level Group looked at the question in some detail and could not come to a definitive view. They referred it back to the Commission and that has resulted in the contractual override provisions in the Commission proposal, which are still retained in the current text.[24]

59. Both the Takeover Panel and the CBI expressed concern over the potential implications for contractual arrangements between shareholders. It was difficult to see what was offensive about contractual agreements between shareholders to which neither management nor the company were a party. Further, the scope of Article 11 was so wide that it would encompass certain arrangements which actually facilitated takeovers.[25] The Panel believed that the Article would be achieving the opposite objective to that intended (Q 23). The CBI agreed (Q 25).

60. The Government believed that freely negotiated contractual arrangements should not be overridden by the Directive. Contractual provisions could assist takeover activity (Q 80). When asked whether the inclusion of contractual arrangements in Article 11 was a sticking point, the Minister relied: "I do not think that is something where we have come to a bottom line at the present time. We are certainly strongly arguing that these things should be taken out. We do think that the value of contractual arrangements is considerable and perfectly acceptable" (Q 81). The changes recently made to Article 11 have not alleviated the Government's concerns about the proposed override of contractual provisions (p 31).

61. **Article 11 would interfere, in our view unnecessarily, with freedom of contract and risks having the effect of striking down important and unobjectionable arrangements, some of which may be totally unrelated to the takeover bid and others which might, as the Takeover Panel indicated, be considered helpful. It has also been suggested that Article 11 could even interfere with normal market trading.[26] We agree with the Government that contractual rights should not be overridden and therefore that they should be taken out of Article 11**.

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[20] C-367/98 *Commission v Portugal*, C-483/99, *Commission v France*, and C-503/99, *Commission v Belgium*. Judgments of 4 June 2002.

[21] Case C-463/00 *Commission v Spain*. Judgment of 13 May 2003.

[22] In the BAA case, the UK Government expressly stated that it did not wish to rely on any justification based upon possible overriding requirements relating to the general interest. The Court therefore saw no need to examine the provisions in question ton see whether they could be justified on that basis. Case C-98/01, judgment at para 50.

[23] *ie.* they may not go beyond what is necessary in order to attain the objective which they pursue.

[24] Q 81.

[25] For example, if an offeror, who was also a shareholder, had sought and obtained from another shareholder an irrevocable undertaking to accept an offer and as part of that arrangement the person giving the irrevocable undertaking agreed not to sell his shares to another bidder, not to vote them or to vote them in a particular way, then that agreement, which was not uncommon in practice, would fall foul of Article 11 and be rendered unenforceable (Q 23).

[26] A commitment to sell shares to a third party or an agreed option or pre-emption right which was bought, and which in either case is uncompleted at the breakthrough date, might be avoided by a shareholder seeking to argue that this was a restriction on selling to the bidder. Submission of 5 March 2003 of City of London Law Society Company Law Sub-Committee and the Law Society of England & Wales' Standing Committee on Company Law to EC Commission and to the European Parliament Committee on Legal Affairs and the Internal Market.

Multiple voting rights

62. The override procedure, as originally set out in Article 11, would not have affected the rights of dual or multiple voting shares. It was reported that opponents of the Directive in Germany were unhappy that the Directive permitted multiple voting rights, which are illegal in Germany, but outlawed defence measures (poison pills) which are more common in that country. On the other hand, a number of Member States (in particular Sweden, Finland and Denmark) have multiple voting share arrangements. Other Member States have similar kinds of pre-bid defensive measures.[27]

63. The Minister acknowledged that there were conflicting views on the issue of multiple voting rights: "A wide variety of differential share structures are possible in the UK but I recognise that there are those in the UK who have argued cogently in favour of retaining the flexibilities of the existing system. I think it is fair to say that differential share structures have been generally been disapproved of by the markets, particularly the institutional investors, and such structures are now rare among our listed company community. Institutional investors have viewed positively the possible override of multiple voting rights and indeed on balance it is considered that the disadvantages resulting from the impact domestically through override of multiple voting rights are outweighed by the possible openings elsewhere in Europe for UK companies that will result" (Q 55).

64. The CBI considered that the breakthrough provision should extend to multiple voting rights. They recognised, however, that there were both political and practical difficulties in doing so. Mr Oliver said "there are some significant issues that are raised by abolishing multiple voting rights and principally the question of should people be compensated for the loss of those multiple voting rights" (Q 9). Mr Remnant, for the Takeover Panel, doubted whether it would be possible to reach agreement on the scope of Article 11 and was concerned that certain countries, especially Germany, would suggest Article 11 should be dispensed with entirely provided Article 9 (preventing management taking frustrating action without shareholder approval) were also deleted. The Panel considered Article 9 to be absolutely fundamental to investor protection and therefore to the protection of UK investors in European companies (Q 26).

65. The Greek Presidency has put forward proposals to address the issue of multiple voting rights in Article 11. The Minister believed that the approach to multiple voting rights now being proposed was "a positive development" (Q 57). The effects of the latest text would be greater in other Member States than in the UK because there were few UK listed companies with multiple voting rights. The Government believed that the override of multiple voting structures might increase the opportunities for UK companies to engage in takeover activity elsewhere in the Union. The Minister acknowledged that detailed consideration would need to be given to devising a workable compensation regime in implementing legislation (p 31). The CCBE (Council of the Bars and Law Societies of Europe) has argued that any dispute on the amount of compensation should not be allowed to frustrate the bid. There should be two separate legal phases, one concerning the bid and its completion and the other concerning the determination of fair value compensation.[28]

66. A number of objections have been raised concerning the treatment of multiple voting rights proposed by the Greek Presidency. The main objection is that the Directive would no longer be limited to regulating transactions and behaviour but would be extending its reach into property rights. It is argued that Article 44(2)(g) TEC, the legal basis for the Commission's proposal, cannot be used to modify property rights. Further, multiple votes are part of the "system of property ownership" which the Treaty cannot prejudice (Article 295 TEC). Economic and practical arguments have also been put forward.[29] Uniform governance structures are not a prerequisite for an open takeover market. Sweden, which permits multiple voting rights, has one of the highest proportions of foreign ownership of the capital of listed companies. Finally, it is argued that the abolition of multiple votes would not necessarily create a level playing field because other devices, such as pyramid ownership structures and non-voting shares, can also act as barriers to takeovers.[30]

67. **We agree with the Government that the Directive should provide for multiple voting rights to be overridden. But we aware of the sensitivity of this issue in some Member States, especially the Scandinavian countries, and the practical problems and delays which could arise in fixing appropriate compensation in a particular case. Most careful consideration needs to be**

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27 Q 56.

28 Comments by Hans-Jurgen Hellwig, Chairman of the Company Law Committee and First Vice President of the CCBE, at the public hearing on the Directive held by the European Parliament Committee on Legal Affairs and Internal Market. Brussels, 28 January 2003.

29 A summary of the economic arguments was presented by Professor Joseph A. McCarthy to the European Parliament at the public hearing on the Directive held by the European Parliament Committee on Legal Affairs and Internal Market. Brussels 28 January 2003.

30 Stefano Micossi, *Dangerous precedent could undo the takeover directive*, European Voice 15-21, May 2003.

given to the compensation issues raised. It is for consideration whether more should be said about compensation rights in the Directive. Ideally, the basic principles should be spelt out. In any event, the Directive should expressly provide that disputes over compensation should not be permitted to delay or frustrate the bid.

Employee representation

68. The 1996 draft Directive was amended in the European Parliament to give employees certain rights to information, including the prompt disclosure of the bid to representatives of the employees. This was perceived to be a potential problem when the Committee examined the original proposal. The Directive retains provisions from the Conciliation text requiring the prompt disclosure of the bid to employees' representatives (Article 6(1)) and requiring the board of the target company to make public a document setting out its opinion on the effect of the bid on all interests of the company including employment (Article 9(5)). Article 9(5) also provides that where the board of the target company receives in good time a separate opinion from the employees' representatives, this should be appended to the offer document. Further, the Directive expressly recognises employees' rights under the European Works Council Directive, the Collective Redundancies Directive and the Information and Consultation Directive[31] (Article 13).

69. The draft Directive has been criticised by those representing employees' interests on the grounds that Articles 6(1) and 9(5) only require representatives of employees to be informed; they are not required to be consulted. Further the references to the existing Directives, though welcome, needs strengthening. None of three Directives mentioned in Article 13 sets rules tailored specifically to takeover bids. Nor do they implicitly provide that representatives of the employees of the offeror and offeree companies have to be informed and consulted before decisive steps in the bidding process are taken. It has been suggested that Article 6(1) should impose an obligation for the offeror to inform and consult employees' representatives before a final decision to make a bid is taken. Article 9(5) should oblige the offeree company board to inform and consult the representatives of the employees on the position to be taken on the bid.[32]

70. We asked the Panel and the CBI whether they were content with what was now being proposed. Mr Remnant said: "We are happy with what is in the Directive at the moment because it basically confers rights of receipt of information on employees but it does not confer rights of consultation or decision making. We would not support extensions of the Directive into those areas and it is possible there will be various amendments proposed, especially from within the Parliament, in that regard. We think that it is unrealistic to seek to harmonise laws of Member States on such a sensitive topic as employee rights in a Directive on takeovers which is designed for the protection of minority shareholders not employees" (Q 16). The CBI was especially concerned that the Directive should not impose an obligation to consult before the bid was made public. They believed that the draft Directive (Article 6(2)) was not sufficiently clear on this (Q 16). The CBI also queried what practical effects the Information and Consultation Directive might have: "The issue relates to the timing of the requirement to inform the employees of the bid. There is significant concern that the provisions of the Information and Consultation Directive could require employees to be informed before the offeror is ready to go public and launch its bid. Issues of market abuse, insider information and false markets and the like arise" (p 13).

71. The Minister said that the Government supported both Article 6 (requiring the respective boards of the offeror and offeree companies to inform employees once the bid is made public) and Article 9 (enabling an employee statement to be annexed to the opinion of the board of the target company on the merits of the bid). In the Government's view, Article 13 gave no new rights but simply acknowledged the existing law. As regards the Information and Consultation Directive, the Minister said: "that Directive actually gives employees specific rights to be consulted about businesses they work for, including the prospects for employment. There are safeguards in relation to price-sensitive information not yet publicly disclosed, for obvious reasons. We think we should consider the necessary implementing measures, including the interaction with the takeover regime, and we are looking to publish a consultation document and draft legislation later on this year" (QQ 85, 88).

72. **We reiterate the view expressed in our earlier Report. Employee consultation provisions should not be allowed to frustrate the process of takeovers. Consultation of employees in advance is, we believe, impractical and would seriously jeopardise any necessity to keep negotiations secret. We note that the Government is to consult on the implementation of the**

[31] Directives 94/45/EC, 98/59/EC and 2002/14/EC.

[32] Proposal made by Joan Bloemarts, Netherlands Trade Union Confederation FNV, at the public hearing on the Directive held by the European Parliament Committee on Legal Affairs and Internal Market. Brussels 28 January 2003.

Information and Consultation Directive.[33] That should help to clarify the position. We do not believe that it can be right, however, that the Information Directive should be allowed to undermine the objectives of the Takeovers Directive.

Comitology

73. Article 17 of the draft Directive would establish a comitology committee and give the Commission the power to make detailed rules on the equitable price (Article 5(4)), cash consideration (Article 5(5)) and on the contents of the offer document (Article 6(3)). Both the Takeover Panel and the CBI queried the appropriateness and desirability of using a comitology committee to set such minimum standards. Mr Oliver, for the CBI, said: "If this is a minimum standard Directive that is what it should set. There is reason for there to be a review of the minimum standards to see if they are working properly but then amendments should be made to the Directive in the normal and proper course of making a Directive" (Q 45). Mr Remnant (Takeover Panel) said: "So our preference would be to go back to what was in the last draft, which was a Contact Committee which was responsible for proposing future amendments in the light of practical experience, but those amendments would go through the normal legislative procedure involving the Parliament and the Council" (Q 13). The CCBE could accept that arrangements for publishing the bid documents could be left to the European Securities Committee but not rules for determining an equitable price and the nature of the consideration. These matters had a "constitutional connotation (protection of ownership)".[34]

Article 17—Committee procedure

(1) The Commission shall be assisted by the European Securities Committee established by Commission Decision 2001/527/EC (hereinafter referred to as the "Committee").

(2) Where reference is made to this paragraph, Article 5 and 7 of Decision 1999/468/EC shall apply, having regard to Article 8 thereof, provided that the implementing measures adopted according to this procedure do not modify the essential provision of this Directive.

(3) The period referred to in Article 5(6) of Decision 1999/468/EC shall be three months.

(4) Without prejudice to the implementing measures already adopted, on the expiry of a four-year period following the entry force of this Directive, the application of its provisions requiring the adoption of technical rules and decisions in accordance with paragraph 2 shall be suspended. On a proposal for the Commission, the European Parliament and the Council may amend the provisions concerned in accordance with the procedure laid down in Article 251 of the Treaty and, to that end, they shall review them prior to the expiry of the period referred to above.

74. The Government were also opposed to the inclusion of comitology provisions in the Directive. They did not consider that comitology had a role to play in the Directive. The Directive is concerned with minimum standards to be applied according to Member States' takeover rules. Member States had different perspectives on the Directive. Some saw it as relating to financial services, others as concerning company law. The Government was in the latter group, which saw no place for comitology in the Directive. The Government would be pressing for the deletion of the references to comitology (QQ 89, 90).

75. **Already the negotiations have led to the suggested deletion of Article 5 (6), which would have triggered the Article 17 comitology procedure for detailed rules on the equitable price (Article 5(4)) and on cash consideration (Article 5(5)). But Article 6(4), providing for the Commission to make detailed rules on the offer document, remains. Though this is the least troublesome of the three matters originally proposed for comitology committee procedure we share the view of our witnesses that the Directive is a minimum standards Directive and there should be no need for the Commission to be given the power to make further, more detailed, rules under the Directive and therefore no place for comitology here. We support the Government in pressing for the deletion of all references to comitology in the Directive**.

[33] A DTI Discussion Paper, *High Performance Workplaces: the Role of Employee Involvement in a Modern Economy*, was published in July 2002 preliminary to the Government presenting specific proposals for implementing the Information and Consultation Directive.

[34] Comments by Hans-Jurgen Hellwig, Chairman of the Company Law Committee and First Vice President of the CCBE, at the public hearing on the Directive held by the European Parliament Committee on Legal Affairs and Internal Market. Brussels, 28 January 2003.

CHAPTER 4: CONCLUSIONS

76. Since we last looked at the proposed Takeovers Directive it has undergone a number of changes. The Directive remains a minimum standards measure, laying down general principles to be applied, basic procedures to be followed and standards to be met. But in a number of respects it has been improved. For example, a mandatory bid rule is now obligatory. But we cannot yet give the Directive our unconditional support.

77. A major concern from the UK standpoint has been that the Takeover Panel should be able to carry on its role of enforcing the City Code as it has done, most effectively and successfully, for over thirty years. The Directive would allow the Panel to be appointed as the supervisory authority for the UK. The Takeover Panel was generally positive about this. Subject to a small number of changes (for example, the jurisdiction rule) the general principles and minimum rules in the Directive can be accommodated within the UK system of supervising takeover bids. Some amendments to our company law would also be needed, but the Government does not believe that these would be problematic.

78. However, in one major respect the Directive has not changed and remains a potential source of difficulty for the UK. The Takeover Panel and the City Code would have to be put on a statutory footing. That would inevitably increase the risks of litigation, including tactical litigation aimed at disrupting a takeover bid. The Government has negotiated a special provision (Article 4(6)) designed to enable it to maintain, so far as is possible, the present position when implementing the Directive in UK law. It is generally agreed that there must be minimal scope for litigation. Article 4(6) is helpful, but is only part of solution. Any lack of clarity in the Directive and in its subsequent implementation may also lead to litigation.

79. Looked at from the narrow view of the domestic impact of the Directive on the conduct of bids in the UK, there seems to be little, if any, advantage to be gained from the Directive. We already have an efficient and effective system. The Directive would not necessary lead to any significant improvements. Indeed it could simply provide more opportunities for tactical obstructive litigation. There is, however, a wider UK interest to consider.

80. There is, we believe, a clear UK interest in the Directive improving the position in other Member States, and in particular opening up markets for UK companies and making more secure the position of UK investors in Europe. Accordingly in assessing the balance of advantages in relation to the Directive one must look outside the UK and towards the rest of Europe to try to ascertain whether the Directive would introduce certain minimum standards which are not currently observed in some other Member States which are important markets. All our witnesses believed that the Directive could have some positive and beneficial effects. It would introduce a significant measure of harmonisation, with the potential for increasing shareholder protection and opening up markets in other Member States for UK companies. But that support for the Directive was not unqualified. Some provisions of the Directive need to be improved. Others must not be diluted.

81. There are three places where we believe the Directive contains serious defects or shortcomings. There should be a common minimum threshold for triggering a mandatory bid (Article 5). The rules on jurisdiction need simplifying, giving precedence in all cases to supervisory authorities in the State of incorporation of the target company (Article 4). Contractual arrangements between shareholders should not be overridden and thus should be excluded from Article 11 (the breakthrough rule). The present provision overriding multiple voting rights needs to be retained, but with the addition of common rules on compensation (Article 11).

82. There is no doubt the successful negotiation of the Directive is going to be difficult, not least in relation to those matters listed in the previous paragraph. It has been reported that when the Directive was discussed at the recent Competitiveness Council no agreement could be reached.[35] A number of Member States indicated readiness to accept the latest text with the omission of Articles 9 (shareholder control of defensive measures) and 11 (the breakthrough rule). Other countries considered that the notion of common rules would be lost without the inclusion of those Articles. We agree with those countries and hoped that the UK Government will be arguing most strongly for the retention (and indeed strengthening) of both Articles 9 and 11. If these provisions are not included the UK should firmly reject the proposal.

83. In summary, the Directive requires a difficult judgement to be made, balancing the potential advantages that would be derived from UK companies/investors in Europe against potential disadvantages with the risk of increased litigation in the UK. If that balance is to tilt in favour of the

[35] *EUobserver.com*, 20 May 2003.

Directive, there are some important changes which need to be made. Further, key provisions, such as Articles 9 and 11, must not be given up or weakened.

Summary of detailed conclusions and recommendations

84. Our detailed conclusions and recommendations are as follows:

—It is important that the Takeover Panel and the City Code should be able to continue to police takeover bids in the UK (para 33).

—It is not possible to remove [entirely] the risk of tactical litigation. Consultation on implementation of Article 4(6) should not be delayed (para 38).

—Article 5(1) should set down a minimum threshold for mandatory bids. Member States would be free to set a lower threshold but the Directive would stipulate a minimum level of shareholder protection across Europe (para 42).

—It is regrettable that the Directive does not establish, as a minimum standard to be applicable in all Member States, the right of all shareholders to be offered a cash consideration (para 46).

—The Government should stand firm on Article 9. The requirement that the board of the target company should, without shareholder approval, be prohibited from taking action which could frustrate the bid, is an indispensable provision of any directive on takeover bids (para 49).

—It is not desirable to have split jurisdiction. Supervision should be the responsibility of the authorities of the State of incorporation (para 53).

—There should be no uncertainty as to the position of the UK's golden shares under Article 11 (para 57).

—We agree with the Government that contractual rights should not be overridden and therefore that they should be taken out of Article 11 (para 61).

—The Directive should provide for multiple voting rights to be overridden. It is for consideration whether more should be said about compensation rights in the Directive. Ideally, the basic principles should be spelt out. The Directive should expressly provide that disputes over compensation should not be permitted to delay or frustrate the bid (para 67).

—Employee consultation provisions should not be allowed to frustrate the process of takeovers. Consultation of employees in advance is, we believe, impractical and would seriously jeopardise any necessity to keep negotiations secret (para 72).

—There is no place for a comitology committee in this Directive (para 75).

Recommendation

85. The Committee considers that the Commission's proposal for a Directive on takeover bids raises important questions to which the attention of the House should be drawn, and recommends the Report to the House for debate.

APPENDIX 1

Sub-Committee E (Law and Institutions)

The members of the Sub-Committee which conducted this inquiry were:

Lord Brennan
Lord Fraser of Carmyllie
Lord Grabiner
Lord Henley
Lord Lester of Herne Hill
Lord Mayhew of Twysden
Lord Neill of Bladen
Lord Plant of Highfield
Lord Scott of Foscote (Chairman)
Baroness Thomas of Walliswood
Lord Thomson of Monifieth

APPENDIX 2

List of Witnesses

The following witnesses gave evidence. Those marked * gave oral evidence.

* CBI (Confederation of British Industry)
* Department of Trade and Industry
* The Takeover Panel