DIRECTIVE 2004/25/EC ON TAKEOVER BIDS

Article 9 (board neutrality)

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Abstract

This dissertation was written as part of the L.L.M. in Transnational and European Commercial Law, Mediation, Arbitration and Energy Law at the International Hellenic University.

This paper examines the article 9 of the Directive 2004/25/EC on Takeover Bids which refers to the board neutrality. First of all, there is a need to examine the Directive and its provisions generally in order to have a complete picture of what regulates. Ssubsequently analyzes the principles and rules which govern, including Article 9 on the board neutrality.
The Directive on Takeover Bids regulates the conduction of takeover bids by rules that apply to all cross border takeover bids, it gives legal certainty to the Member States and the companies generally and ensures safety in the course of trade. This safety increases competition and facilitates cross border takeover bids.
With regard to the board neutrality rule detailed in Article 9 of the Directive, this protects the bid and more specifically the frustration of the bid. That's why Bartman[1] believes that the term "non-frustration rule" fits better in Article 9 than the term "board neutrality rule". This rule requires the prior authorization of the general meeting of shareholders to the board before action.

Finally, it should be noted that the thesis is made under the supervision of Pr. Thomas Papadopoulos, Visiting Professor at the International Hellenic University (Thessaloniki, Greece), Lecturer in Commercial Law at the Department of Law of the University of Cyprus and with many awards in the field of Takeovers and Mergers.

Keywords:
- Takeover bid
- Offeror
- Offeree
- Securities
- Equitable price

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[1]S Bartman, "Analysis and consequences of the EC Directive on takeover bids" (2004) ECL 5,5

Preface

At this point of my thesis, I point out that my motivation for the selection of the issue was the course I chose at the International Hellenic University "mergers and acquisitions", who taught Mr. Thomas Papadopoulos, but mainly Mr. Papadopoulos himself with the way he taught us the lesson made me want to choose this lesson for my thesis.
I would also like to thank my fellow students for the help they gave me, my family for their support and finally my supervisor, Professor Thomas Papadopoulos, for his patience and encouragement during the supervision of my thesis.

<u>Contents</u>

Introduction

The Directive 2004/25/EC of 21 April 2004 was the result of years of negotiations and fruitless attempts. Discussions for a takeover directive begun in the mid-1970s when the first proposal was tabled. The different approaches of the Member States (legal and policy) contributed to adopt a text that was a compromise of the proposal of the European Commission. But by the adoption of this text (directive) the EU tried to offer legal certainty and protection to the shareholders with regard to cross-border takeover bids. More specifically, the directive contains some obligatory provisions such as the sell-out right or the mandatory bid rule and some optional provisions such as the non-frustration rule or the breakthrough rule. By these provisions *the Directive sets out to establish minimum guidelines for the conduct of takeover bids involving the securities of companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market; It also seeks to provide an adequate level of protection for holders of securities throughout the Community, by establishing a framework of common principles and general requirements which Member States are to implement through more detailed rules in accordance with their national systems and their cultural contexts*[2]. Moreover, the Directive adopts the reciprocity rule and freedom of establishment in order to achieve harmonization, minority investor' s protection, increasing efficiency and legal certainty in the course of trade. Additional objective was the protection of the minority shareholders by establishing common rules for all Member States which adapted the Member States always in conjunction with their national law.

[2]Thomas Papadopoulos, November 2007, academic analysis *The mandatory provisions of the EU Takeover Bid Directive and their deficiencies,* with reference to Europa Website, Activities of the European Union - Internal Market, SCADPLUS: Takeover Bids, http: // europa.eu/scadplus/leg/en/lvb/126012a.htm,accesed 21 May 2007.

Historical Background

Starting from 1989, Professor Robert Pennington presented a draft Directive for takeover bids on request from the European Commission. But the draft he presented although protected the shareholders more than any other regulation, was highly influenced by the UK Takeover Code. On the other hand, the Commission's proposal in 1989 created disappointment to all and especially in Germany. And this because the German Takeover Code (adopted by the Borsensachverstaendigenkommision[3]) protected the minority shareholders in Germany and there was no need, in their opinion, for a unified takeover system. So, in 1996, the Commission presented a new proposal, which included the principle of subsidiarity, because of the adoption of the Maastricht Treaty, and this proposal was wider and better than the previous one[4]. But this time, the new proposal created disappointment to the UK Government because they found the proposal unlawful and without compliance with the principles of subsidiarity and proportionality. Amendments were necessary in order to satisfy the British concerns with the most important amendment this of article 9. Under this article the shareholders have the right to decide upon the bid without the board's intervention. Without the prior shareholder approval the bid could be canceled. The European Parliament was not consistent with the prior shareholder approval. The Commission was not consistent with the amendment. But Germany ultimately claimed that it was a good idea for shareholders to consult. And although Germany supported the common Position, from this point onwards change its position and this fact disappointed the rest of the Member States. On 5 June 2001, the Council and Parliament, after negotiations and conciliation, agreed on a compromise and retain article 9 as had. The only prediction added was that Member States could postpone its application for one year after the deadline for implementation of the directive[5]. What remained was the approval of the Parliament at first and then the approval of the Council. Unexpectedly, the proposal was rejected (273 votes against and the same in favor). The harmonization of takeover bids in Europe remained primary objective of the Commission. So a new proposal was presented in 2002. The new proposal did not differ with the previous one at the basic principles and article 9 maintained unamended but optional (with the right to adopt it if an individual company wished to). The reciprocity rule that proposed and the opt in and opt out provisions led to the adoption of the proposal in 27 November 2003. The European Parliament approved the proposal in 16 December 2003 and Member States had to adopt the Directive until 20 May 2006.

[3]Thomas Papadopoulos , The European Union Directive on Takeover Bids: Directive 2004/25/EC p. 19 with reference n. 34 to C. Kirchner and RW Painter *Takeover Defenses Under Delaware Law, the Proposed Thirteenth EU Directive ad the New German Takeover Law: Comparison and Recommendations for reform* (2002) 50 An. JComp.L. 451,463.
[4]V. Edwards *The Directive on Takeover Bids – Not worth the paper it's written on (2004)* 4 ECFR 421.
[5]V. Edwards *The Directive on Takeover Bids – Not worth the paper it's written on (2004) 4 ECFR 426.*

SCOPE OF DIRECTIVE

The Directive sets out to provide the maximum protection for shareholders and generally to establish the basic principles that all Member States follow in the field of the internal market and especially in the field of takeover bids. The measures that Directive provides such as codes of practice, regulations etc. must be rejected by all Member States.
The general principles that EU Member States must be complied with are:

- Equal treatment : equal treatment must be given to all shareholders
- Sufficient time and information: sufficient time and information must be given to the shareholders in order to make a properly decision on the takeover offer.
- Board acts in the interests of the company: the board should treat the company as a whole and must act only in the interests of the company even if this means that the shareholders will decide on the merits of the bid.
- False markets forbidden: if false markets are created in the securities of an offeree company then a rise or fall in their prices leads to artificial and false results and this is forbidden.
- Be sure before announce a bid: an offer in order to announce a bid, must be sure that he can fulfill any type of consideration, even cash.
- Reasonable time for conduct of affairs: the target company must not be affected by a bid and must conduct its affairs at a reasonable time.

The Takeover Directive applies to takeover offers, for securities of companies where these securities or some of them *are admitted to trading on a regulated market (within the meaning of Directive 2004/39/EC, repealing Directive 93/22/EEC) in one or more EU Member States*[6].
But the Takeover Directive does not apply to takeover bids for securities issued by companies (eg the target company itself) aimed at collective investment of capital and does not also apply to public offers for securities issued by the Member State's central banks.

WHAT REGULATES

In order to understand what the Directive regulates, we must explain what takeover bid is. Starting from the term *takeover* we have to say that a takeover takes place when a person wants to become the owner of a company or when a group of persons (natural or legal) want to control the management of a company[7].

[6]European Directive Takeover Guide, Contact Christian Cascante and Jochen Tyrolt, Gleis Lutz, Germany

[7]MA Weinberg, MV Blank and AL Greystoke *Takeovers and Mergers (4th edn Sweet & Maxwell, London 1979, 3)*

A takeover may be effected either by an agreement or by a takeover bid. The agreement is signed by the person that acquires control of the company and by the holders of the majority of the share capital of the company the person acquires. The takeover bid is a procedure where the person that acquires control of a company, buys all the shares of that company or a voting majority of the shares so the offeree company becomes a subsidiary of the other. This means that the acquiring company controls the situation and takes decisions because it owns the majority shareholding[8].
Furthermore, a takeover bid constitutes a way for merger. Merger is a procedure where two companies of similar size decide to exchange their shares. The difference from the takeover is that in merger we have a combined enterprise and the shareholding is spread between the shareholders of the two companies. In a takeover, the control of the shares is on the hands of the acquirer.
From all the above, we realize that there was a need for common rules and principles in the course of trade and especially rules that apply to all cross border takeover bids in order to create legal certainty to the Member States and the necessary safety and this is what the Directive regulates.

OBLIGATORY PROVISIONS

THE MANDATORY BID RULE (Article 5)

One of the obligatory provisions of the Directive is the mandatory bid rule that article 5 states.
According to this article Member States have the possibility to decide when the Mandatory Bid Rule applies or not depending on the special circumstances, case by case, but always with the precondition that article 3 (1) is respected. Otherwise, equivalent protection that must be provided for the protection of the minority shareholders. The main problem with article 5 is exactly this, that it gives discretion to the Member States so there are derogations from the safeguards of the Directive. More specifically, article 5 (4) states:
Provided that the general principles laid down in Article 3 (1) are respected, Member States may provide in the rules that they make or introduce pursuant to this Directive for derogations from those rules: (1) by including such derogations in their national rules, in order to take account of circumstances determined at national level and/or (2) by granting their supervisory authorities, where they are competent, powers to waive such national rules, to take account of the circumstances referred to in (1) or in other specific circumstances, in which case a reasoned decision must be requires.
Although the derogation provision has been justified for flexibility reasons (from the Commission), nevertheless, constitutes an issue that saw considerable debate. Mainly, because the directive does not particularize the voting rights that must have somebody to control the company or the share of capital needed. Generally, the article 5 is not fully comprehensive.

[8]LS Sealy *The Draft Thirteenth Directive on Take-overs* in S Kenyon – Slade and M Andenas (eds), EC Financial Market Regulation and Company Law (Sweet & Maxwell, London 1973), 135.

THE SQUEEZE-OUT RIGHT (Article 15)

According to article 15 (2) of the Directive *Member States shall ensure that an offeror is able to require all the holders of the remaining securities to sell him/her those securities at a fair price.* This article reflects the squeeze-out right with additional target the protection of investors and the promotion of freedom of establishment.

THE SELL-OUT RIGHT (Article 16)

Here the holder of remaining shares is entitled to require the bidder to buy these securities at a fair price. The aim of this provision is to protect the shareholders (the remaining shareholders) by offering a way of exit to them[9].

OPTIONAL PROVISIONS OF THE DIRECTIVE

THE BREAKTHROUGH RULE (Article 11)

The breakthrough rule is a rule that aims at the promotion of takeover bids and their facilitation and does not allow the any obstruction of takeover activity. Moreover, it requires the exercise of rights in order to achieve freedom of shareholders. The meaning of the rule is that the shareholders which have large proportion of shares in a company should have a dominant role in the control of that company.

THE RECIPROCITY RULE (Article 12)

According to Article 12 par. 3 *Member States may, under the conditions determined by national law, exempt companies which apply Article 9 (2) and (3) and/or Article 11 from applying Article 9 (2) and (3) and/or Article 11 if they become the subject of an offer launched by a company which does not apply the same Articles as they do or by a company controlled, directly or indirectly, by the latter, pursuant to Article 1 of Directive 83/349/EEC.*

This is a rule that is common in European law and also found in other European Directives. But the Takeover Bid Directive does not indicate clearly the context in which the rule of the reciprocity is applied. This implies many times to apply the companies different provisions to reciprocate and the situation becomes complicated.

[9]J Grant *Takeover Regulation and the Balancing of Interests* and E Bonans and C Demoulin *Acting in Concert – first conclusions drawn from two recent Takeovers and the Takeover Directive* in J Grant (ed), European Takeovers: the Art of Acquisition (1st 6dn Euromoney Books, London 2005), 50.

This complicated situation leads in turn to problems concerning the interpretation, the practical effect of the reciprocity rule and the issue if partial implementation of the two key provisions is allowed.

THE NON-FRUSTATION RULE (Article 9)

Article 9

Obligations of the board of the offeree company

1. *Member States shall ensure that the rules laid down in paragraphs 2 to 5 are complied with.*

2. *During the period referred to in the second subparagraph, the board of the offeree company shall obtain the prior authorization of the general meeting of shareholders given for this purpose before taking any action, other than seeking alternative bids, which may result in the frustration of the bid and in particular before issuing any shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company.*

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

3. *As regards decisions taken before the beginning of the period referred to in the second subparagraph of paragraph 2 and not yet partly or fully implemented, the general meeting of shareholders shall approve or confirm any decision which does not form part of the normal course of the company's business and the implementation of which may result in the frustration of the bid.*

4. *For the purpose of obtaining the prior authorization, approval or confirmation of the holders of securities referred to in paragraphs 2 and 3, Member States may adopt rules allowing a general meeting of shareholders to be called at short notice, provided that the meeting does not take place within two weeks of notification's being given.*

5. *The board of the offeree company shall draw up and make public a document setting out its opinion of the bid and the reasons on which it is based, including its views on the effects of implementation of the bid on all the company's interests and specifically employment, and on the offeror's strategic plans for the offeree company and their likely repercussions on employment and the locations of the company's places of business as set out in the offer document in*

accordance with Article 6(3)(i). The board of the offeree company shall at the same time communicate that opinion to the representatives of its employees or, where there are no such representatives, to the employees themselves. Where the board of the offeree company receives in good time a separate opinion from the representatives of its employees on the effects of the bid on employment, that opinion shall be appended to the document.

6. *For the purposes of paragraph 2, where a company has a two-tier board structure 'board' shall mean both the management board and the supervisory board.*

According to article 9 of the Directive the prior authorization of the general meeting of shareholders is necessary before any decision taken from the target' s board. This authorization may lead to the frustration of the bid, but since the aim is to protect the interests of shareholders, the only thing that the board can do is to search for alternative bids so the shareholders can choose the most appropriate for the company. It is important to refer that it is up to the shareholders to decide on defensive measures, if necessary[10].
The board on the other hand, can express its opinion for the bid by a document, which analyzes the board's opinion, the justification of its opinion etc. (Article 9 paragraph 5 of the Directive).
It is often mentioned, in association with the non-frustration rule, the term *white knights.* As I mentioned above, during the bid period the board can search for alternative bids so the shareholders can choose the most appropriate for company. The potential alternative bidder is called *white knight.* And this procedure consists an exception from the non-frustration rule and regards non-coercive alternative bids. There are however the coercive bids which are the result of a high pressure brought to shareholders to accept a bid that it is not so attractive than another bid offered. This pressure derives from the fact that there is no coordination between the shareholders about the decisions taken and shareholders do accept the bid fearing that if they do not accept the bid they will stay with underpriced shares. The mandatory bid rule protects the shareholders from this pressure to accept a bid that is not attractive.
As the Explanatory Memorandum of the Commission's 2002 proposal says:
Where control of the offeree company is at stake, it is important to ensure that its fate is decided by its shareholders. The authorization of the general meeting must therefore be given explicitly with a view to responding to a specific bid.
Moreover, the aim of the legal basis of Article 50 (2) g TFEU must be fulfilled.
There is an issue about those shares that was decided upon before the launch of the bid. Paragraph 3 of article 9 applies and the general meeting of shareholders must approve actions that do not form part of the normal course of the company's business. The interpretation of the article above states that the new shares during the bid period consist a defensive measure.

[10]R. Skog *The takeover Directive - an endless Saga (2002) 13, EBLR, 307*

There is also an issue about the partial bids and the two-tier bids.

- Partial bids: the shareholders hold the average value of the price offered and their aim is to tender.
- Two-tier bids: there is a *front-end* offer at a high price and there is a promise for a second *back-end* offer for the rest shares at a lower price. What is important is the difference between the *front-end* and the *back-end* price because *the greater is the potential loss for non-tendering shareholders the more shareholders are forced to tender*[11]*.*

In more detail, objective of the directive with the introduction of Article 9 is to protect those companies holding titles, the harmonization, and transparency and simultaneously to protect the interests of third parties[12].

Quite useful for the interpretation of the Directive were the findings of the Winter Committee on which was based the proposal of 2002. The assumptions of the Winter report were many. Firstly, the success of a share offer depends on factors which distinguish in general economic factors and corporate factors. The first category, the general economic factors can be self-financing, long term loans etc. The second category, the corporate factors can be non-voting shares, multiple voting shares, administration rights etc. shaping each one either the pre-bid structure either the post-bid structure[13]. The problem that the Winter report faced was that Member States had adopted different factors (general or corporate) so the share offers had different approach at each Member State (*lack of a level playing field).* Moreover, the Winter report remarked that the share offers are not always beneficial for the companies or the shareholders. That's why it stressed how important was the harmonization based on the principle of *shareholder decision-making* and the principle of *proportionality* between risk bearing and control. Article 9 of the Directive serve this purpose, the harmonization. First it introduces the principle of neutrality of the board (of course with exceptions). Obligation of the board of the offeree company is to have previously received authorization from the general meeting of shareholders to do so.

The relevant period during which it should be authorized begins when the board of directors receives information about the offer.

What is also important is to respect the shareholder's pre-emption rights because intention of the board is the non-exercise of the pre-emption rights of the minority shareholders as this leads to capital increase and watering down control.

[11]Federico M. Mucciarelli, Bologna 15th June 2006 *White knights and black knights,* working paper, p. 6

[12]C. Kirchner, AG 1999, 485

[13] Adrianesis Anastasios, The position of the Management Board in public limited company shares market proposals, p. 91-92

Interaction of article 9 with article 12

Article 12 states that:

Optional arrangements
1. Member States may reserve the right not to require companies as referred to in Article 1(1) which have their registered offices within their territories to apply Article 9(2) and (3) and/or Article 11.
2. Where Member States make use of the option provided for in paragraph 1, they shall nevertheless grant companies which have their registered offices within their territories the option, which shall be reversible, of applying Article 9(2) and (3) and/or Article 11, without prejudice to Article 11(7).
The decision of the company shall be taken by the general meeting of shareholders, in accordance with the law of the Member State in which the company has its registered office in accordance with the rules applicable to amendment of the articles of association. The decision shall be communicated to the supervisory authority of the Member State in which the company has its registered office and to all the supervisory authorities of Member States in which its securities are admitted to trading on regulated markets or where such admission has been requested.
3. Member States may, under the conditions determined by national law, exempt companies which apply Article 9(2) and (3) and/or Article 11 from applying Article 9(2) and (3) and/or Article 11 if they become the subject of an offer launched by a company which does not apply the same Articles as they do, or by a company controlled, directly or indirectly, by the latter, pursuant to Article 1 of Directive 83/349/EEC.
4. Member States shall ensure that the provisions applicable to the respective companies are disclosed without delay.
5. Any measure applied in accordance with paragraph 3 shall be subject to the authorization of the general meeting of shareholders of the offeree company, which must be granted no earlier than 18 months before the bid was made public in accordance with Article 6(1).

As we see, article 12 states that the implementation of article 9 is optional. With this setting, the non-frustration rule loses its value. This is an unparalleled setting for the data of the European Community[14]. And undermines any attempt for harmonization since the application of article 9 par. 2 and article 9 par. 3 is left to the discretion of the Member States[15]. Here is clearly seen that the Directive is a compromise of competing interests (legislative and political interests). But if they didn't accept Article 12 with the optional application of article 9, the Directive would not exist (after many trials). On the other hand, if they had adopted the 2001 proposal the non-frustration rule would be obligatory and non-optional.

[14]D. Avgitidi, DEE 2006,268, B. Clarke, JBL 2006, 372
[15]D. Tuchinsky, NYL Sch. L. Rev. 2006-2007, 708

Defensive measures of the board

Defensive measures are those measures that are taken by the board to frustrate a bid[16]. It is a very broad meaning and practically can be any behavior that leads to the frustration of the bid. They may be predicted before the appearance of the public proposal (preventive measures[17]). This helps in advance the protection of the company[18]. Or after it (post-bid defenses) such as white knight, share buy-backs and special dividends, Pacman defenses, strategic acquisitions, poison pills, anti-trust litigation etc.

More specifically, the defensive measures are distinguished on the basis of their results. For example, there are those defensive measures that impede the exercise of control of the board such as the *staggered boards.* Or those that impede the exercise of control of the general assembly such as *golden shares* and *voting caps.* Also, those that impede the acquisition of shares of the company such as *ownership caps.* Those that impede the exercise of control in the company's assets e.g. *scorched earth* or *crown jewels.*

The individual defensive measures of the board

- Capital increase – issuance of convertible bonds

The procedure of capital increase and issuance of convertible bonds, lead to the increase of the cost of acquisition. This means that, the offeror, in order to control the company, must buy more shares. May even this measure be accompanied by exclusion of the right of existing shareholders.

- Litigation

The frustration of the bid is possible with the entry of a litigation. This is because the above procedure births procedural costs and delays even when it comes to application unfounded. The basis of the action may relate to the infringement of competition rules or the contamination of the environment. It is not necessary to affect public proposal.

[16]M. Tsibris, The public proposal, p. 240
[17]I. Anastasopoulou, Tribute to Andreas Loukopoulos, p. 226
[18]A. Gardner, ICCLR 1992, 94

- Substantial change in the assets and liabilities (*kamikaze strategy)*

Changes in the assets and liabilities of a company cause repulsion of the offeror because they reduce the productive capacity of the company and therefore its value. In these cases the board may sell its fixed assets (*scorched earth policy)* or to sell a part of the company (*crown jewel defense)* [19] or even to make leverage recapitalization. Even worse to commit corporate suicide such as the board of St. Joe Minerals company suggested when Seagram initiated a tender offer.

- Commitment of business policy

With the commitment of its business policy the company signs long term contracts e.g. with its suppliers or by a franchising. Thus the company loses the opportunity to meander. There is an issue about the so called *embedded defenses.* Basically they are clauses contained in contracts and they may lead to the frustration of the bid.

- Announcements

The board of a company may announce the public offer in order either to lure the shareholders to accept the offer either to lure the shareholders to refuse the offer. Great attention is needed to this procedure in order not to commit the offense of market manipulation.

- Defensive investment decisions

Defensive investment decisions are:

a) The acquisition of own shares e.g. stock buybacks
b) Circular shareholdings
c) Pacman defense (for capital companies only)
d) Antitrust defense

[19] N. Krause, Comp. Law 2002, 323

- Contractual agreements for shares

Usually, is agreed that the counterparty shareholder before selling the shares to a third person must offer his/her shares to the company and the shareholders under the same conditions and price and if nobody is interested then he/she can sell to a third person (preemption pact).

The application of the rule of neutrality in Greece

Since the Member States had to transpose the Directive 2004/25/EC into their national law, Greece adopted 3461/2006 law. Article 14 of 3461/2006 law refers to the obligations of the board of the offeree company, following article 9 of the Directive 2004/25/EC but with the difference that in the Greek Law (3461/2006) there is no use of discretion under Article 12 of the Directive for optional application of the neutrality rule. More specifically article 14 states that *the Board cannot take any actions outside the ordinary course of the Company and are likely to result in the frustration of the proposal.* And when we talk about *any actions* we mean any legal or physical operation. But it must be an unusual management operation which tenders result to the frustration of the bid.

With the conditions laid down by Greek law, the regulatory scope of the rule of neutrality shrinks. And this happens because the Directive does not include this limitation (for actions outside the ordinary course of the company). We only meet a similar limitation in the Directive at Article 9 par. 4 which refers to those decisions of the board dating before the entry into force of the rule of neutrality[29].

THE APPLICATION OF THE RULE OF NEUTRALLITY IN CYPRUS

Cyprus adopted the Takeover Directive by Law 41 (I)/ 2007. From the two main provisions of the Takeover Directive (this of article 9 *board neutrality rule,* and this of article 12 *the breakthrough rule)* Cyprus decided to adopt the first one of board neutrality as obligatory and the second one of breakthrough rule as optional.

More specifically, Article 34 of Law 41 (I)/ 2007 states that the board of the offeree company cannot take any action which may result to the frustration of the bid without prior authorization of the general meeting of shareholders (of course with exceptions). Moreover, decisions that does not form part of the normal course of the company must be approved by the general meeting of shareholders if they are taken by the board before the beginning of this period.

The adoption of the board neutrality rule (and even as mandatory) contributes to the strengthening of freedom of establishment such as Article 49 of the Treaty on the Functioning of the European Union (TFEU) states:

RIGHT OF ESTABLISHMENT

Article 49

(ex Article 43 TEC)

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

*Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, unde*r the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

And to gain control of a company by Takeover Bid is an exercise of the right of freedom of establishment. Case C – 251/98 C. Baars {2000} ECR I-02787 refers to exactly this conclusion:

The Court (5th Chamber) answer on the questions submitted by provision 8 July 1998 Gerechtschof te 's-Grevenhage, hereby rules:

The article 52 of the EC Treaty (now, after amendment, article 43 EC) prohibits tax legislation of Member States such as the question in lady trial, who, in case the *participation to the capital of a company provides in shares/shares holder to has undeniable influence in the company's decisions and to determine its activities,*

- *Allows resident domestic nationals of Member States overall or partial exemption from wealth tax in respect of assets invested in shares/corporate shares of the company,*

- *But makes that exception subject to the condition it participation in a company established in that Member State, so refuses that exception to shares/shares of companies holders established in other Member States.*

Aim of Cyprus legislation was to strengthen the internal market and the exercise of the freedom of establishment.

On the other hand, Cyprus decided to adopt the breakthrough rule as an optional one.

Article 35 of Law 41 (I)/ 2007 states that the general meeting of shareholders may choose to adopt the breakthrough rule. This optional character of the breakthrough rule does creates some problems to takeover activity. First of all, it does not facilitate the exercise of the freedom of establishment. Secondly, it does not attract foreign potential bidders and generally it does not help to strengthen takeover bids, it constitutes protectionist provision.

The application of board neutrality rule in other jurisdictions

According to par. 7 of the 2012 Commission's Report on the application of the Directive 2004/25/EC on takeover bids word is the following:

Austria, Bulgaria, Cyprus, the Czech Republic, Estonia, Finland, France, Greece, Ireland, Italy, Latvia, Lithuania, Malta, Portugal, Romania, Slovenia, the Slovak Republic, Spain and the United Kingdom have transposed the board neutrality rule.

Estonia, Latvia and Lithuania have transposed the breakthrough rule.

In accordance with article 12 (3) of the Directive, about half of the Member States (Belgium, Denmark, France, Germany, Greece, Hungary, Italy, Luxembourg, the Netherlands, Poland, Portugal, Slovenia and Spain) allow companies who are subject to the board neutrality rule and/or breakthrough rule (by law or based on the articles of association of the company) not to apply the rule when they are confronted with a takeover bid by an offeror who is not subject to the same rule (reciprocity)[20].

THE APPLICATION OF THE RULE OF NEUTRALLITY IN FRANCE

In France, the implementation of the Takeover Directive generally, started with the Lepetit Report[21] in 2005 which was an advisory study by the government suggesting how to implement the Directive. The Report accepted the board neutrality rule and the reciprocity rule but rejected the breakthrough rule because, as it explains, causes limitation to the freedom of establishment. In contrast, proposed the application of the breakthrough rule in conjunction with cancellation of voting caps after a successful bid.

[20]Report from the Commission to the European Parliament, the Council, the European economic and social committee and the committee of the regions, Brussels 28.06.2012

[21]Jean-Francois Lepetit, Rapport Du Groupe De Travail Sur La Transposition De La Directive Concernant Les Offres Publiques D' Acquisition (2005) France .

Finally France voted the French Code de Commerce in order to implement the Takeover Directive, concluding the board neutrality rule but subject to reciprocity rule.

This means that the impact of the reciprocity rule is such that that shareholders are always involved in decisions about defensive measures. In France we also meet the BSAs (bons de souscription d' actions) which are warrants for the subscription of shares issued upon the general meeting. BSA' s remind us the poison pills of United States. Indeed they are similar as both can be used for negotiation with the bidder but differentiated at the procedure they follow because BSA's are issued only with the shareholder's authorization.

THE APPLICATION OF THE RULE OF NEUTRALLITY IN GERMANY

Germany also adopted the Takeover Directive in July 2006 (WpUG) but opted out of both board neutrality rule and the breakthrough rule[22]. As Guidi Ferrarini and Geoffrey P.Miller say[23] *the German government, which had supported the first drafts of the European Takeover Directive, switched positions and opposed the final ones after Mannesmann's* takeover[24]. The rejection of board neutrality rule in German Law was a result of politic and economic features.

[22]Thomas Schurrle Et Al, The European Takeover Directive: Status Of Implementation 6 (2006) available at http://www.debevoise.com/files/Publication/ac 744779-09e1-448c-aa35-003adb117040/Presentation/PublicationAttachment/b18d9b78-ab24-4a08-ab8c-0756baffa25c1/EuropeanTakeoverDirective.pdf.

[23]Guido Gerrarini, Geoffrey P.Miller, A Simple Theory of Takeover Regulation In the United States and Europe, Cornell International Law Journal, Vol.42, Issue 3 Fall 2009, Article 1.

[24]Curtis J. Milhaupt & Katharina Pistor, Law and Capitalism: What Corporate Crises Reveal About Legal Systems 80 (2008)

THE APPLICATION OF THE RULE OF NEUTRALLITY IN ITALY

In Italy the Takeover Directive was implemented gradually. Firstly, under the Prodi government the breakthrough rule and the neutrality rule were mandatory for the companies. Subsequently, the Berlusconi Government introduced the optional character of the above rules and the companies could choose to opt in into their effect in order to apply the. Today, under the Berlusconi Government (1st of July 2010) the board neutrality rule consists a default rule[25] but companies can choose to exclude it if they wish.

THE APPLICATION OF THE RULE OF NEUTRALLITY IN SPAIN

The Spain Law which adopted the Takeover Directive is Law No. 6 of April 12, 2007. Under this law the board neutrality rule is subject to reciprocity rule and the breakthrough rule is opted out. Pre-bid defenses and voting caps are permitted under Spanish Law and are used by the companies. The fact that the breakthrough rule is opted out does not affect the takeovers.

[25]Decree-Law No. 146, art. 1 (3), Sept. 25, 2009, Gazz. Uff. No. 246, Oct. 10,2009

THE APPLICATION OF THE RULE OF NEUTRALLITY IN UNITED KINGDOM

The City Code of United Kingdom includes takeovers. There was an issue if the Takeover Directive could be implemented by a City Code. Well, since the Directive states that *has to be transposed in the Member States through laws, regulations and administrative provisions,* the City Code is permitted[26]. Under the City Code the board neutrality rule was provided for in Article 21 but no reciprocity was allowed and the breakthrough rule was not adopted.

[26]Brian E. Rosenzweig, Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls, 18 Duke J. Comp. & Int' L 213, 227 (2007)

Comparison of the choice of neutrality by the EU Directive with the American approach on this matter

There is a distinction between the European approach and the U.S. approach to takeovers. Although at first sight we meet many similarities between the two approaches such as the equal treatment of the shareholders, the quick announcement of the bids by the bidders, the appropriate disclosures, the offer of the highest bid price and the reveal of information to the shareholders in order to make the appropriate decisions for the company, however the differences are many and substantive. The Directive puts certain conditions on which America breaches. As Susie Choi says in the US *the function of protecting minority shareholders against majority oppression is principally vested in state corporate law*[27]. Under the U.S. Law the board has the choice to decide about a bid and to refuse an unwanted takeover and *poison pills* are often used to deter takeovers. Indeed, this procedure has been approved by Delaware Courts (Air Prods. & Chems., Inc. v. Airgas, Inc. 16A 3d 48, 129 Del. Ch. 2011)[28]. Also, under the U.S. Law the board can use its defensive measures while the Directive tries to give the competence of decision making only to the shareholders. Generally, the U.S. Law does not regulate the takeovers, does not protect the shareholders and it is to the discretion of the board to decide about them or to Delaware Judges.

[27,28]Susie Choi, An Evaluation of the EU Takeover Directive (Thirteenth Directive) Through the Lens of the Harmonization Process, European Union Law Working Papers, No. 12, Stanford – Vienna, footnote 99

DISCLOSURE OF INFORMATION

According to this principle the target companies have the obligation to reveal any information that could lead to the frustration of the bid. That's why is one of the most important principles that the Directive sets in force. More specifically, the obligation to reveal any information is important for the shareholders in order to take a decision about the bid. It is met in article 10 of the Directive and refers to the obligation of the target companies to reveal whatever could influence the bid. It is also met in article 6 of the Directive and refers to the obligation of the bidder to reveal any information concerning to the bid. This obligation to provide information achieve transparency and protection of shareholders. The companies usually reveal their structures meaning their defensive measures. And this happens by a report (an explanatory report) which is presented every year to the general meeting of shareholders as article 10 par. 3 of the Directive states.

Article 10 par. 1 of the Directive obliges the disclosure of information of the rights and of shares and the percentage of total share capital (a), of any restrictions of the transfer of securities (b), of significant direct and indirect shareholdings(c), of the special control rights (d), of the system of control of any employee share scheme (where the control rights are not exercised directly by the employees) (e), of any restrictions on voting rights (f), of any agreements between shareholders which are known to the company (g), of the rules governing the appointment and replacement of board members and the amendment of the articles of association (h), of the powers of board members (i), of any significant agreements to which the company is a party and which take effect, alter or terminate upon a change of control of the company following a takeover bid (j) and of any agreements between the company and its board members or employees providing for compensation if they resign or are made redundant without valid reason or if their employment ceases because of a takeover bid (k). If all this information is disclosed the potential bidder will be more careful before launching a bid.

Article 6 on the other hand, refers to the obligation of information from the perspective of the bidder. Here, the disclosure of information is made by an offer document which must be approved in advance by the supervisory authority and must contain what par. 3 of article 6 of the Directive states i.e. (a) the terms of the bid, (b) the identity of the offeror and, where the offeror is a company, the type, name and registered office of that company, (c) the securities or, where appropriate, the class or classes of securities for which the bid is made, (d) the consideration offered for each security or class of securities and, in the case of a mandatory bid, the method employed in determining it, with particulars of the way in which that consideration is to be paid, (e) the compensation offered for the rights which might be removed as a result of the breakthrough rule laid down in Article 11(4), with particulars of the way in which that compensation is to be paid and the method employed in determining it, (f) the maximum and minimum percentages or quantities of securities which the offeror undertakes to acquire, (g) details of any existing holdings of the offeror, and of persons acting in concert with him/her, in the offeree company, (h) all the conditions to which the bid is subject, (i) the offeror’s intentions with regard to the future business of the offeree company and, in so far as it is affected by the bid, the offeror company and with regard to the safeguarding of the jobs of their employees and management, including any material change in the conditions of employment, and in particular the offeror’s strategic plans for the two companies and the likely repercussions on employment and the locations of the companies' places of business, (j) the time allowed for acceptance of the bid, (k) where the consideration offered by the offeror includes securities of any kind, information concerning those securities, (l) information concerning the financing for the bid, (m) the identity of persons acting in concert with the offeror or with the offeree company and, in the case of companies, their types, names, registered offices and relationships with the offeror and, where possible, with the offeree company, (n) the national law which will govern contracts concluded between the offeror and the holders of the offeree company's securities as a result of the bid and the competent courts.

All the above information is crucial for the bidder and contributes to the protection of shareholders of the target company, to the protection of shareholders of the offeror, to legal certainty and to transparency.

Conclusion

As I mentioned above, aim of the Directive 2004/25/EC was to achieve harmonization, minority investor' s protection, increasing efficiency and legal certainty in the course of trade. Additional objective was the protection of the minority shareholders by establishing common rules for all Member States which adapted the Member States always in conjunction with their national law. Unfortunately, all the principles that the Directive adopts do not contribute to this aim. Conversely, instead of harmonization create multiformity. Although they tried many years for a common legal text and although the negotiations were many they finally voted a legal text that is characterized as a compromise.

Former Commissioner Bolkenstein said that *the Takeover Bid Directive is not worth the paper that it is written on*[30]. This means that frustrations were to arrive ultimately at a text which was a compromise. The disadvantages of the Directive are many. The non-frustration rule and the reciprocity rule in conjunction with the optional character of their application present disadvantages. The deficiencies in the text of the Directive are many and are substantive.

[29]F. Eastbook/ D. Fishel, Harv. L. Rev. 1981,1201

[30]Thomas Papadopoulos, The European Union Directive on Takeover Bids: Directive 2004/25/EC, 2008 with reference n. 308 Bulletin Quotidien Europe 26 November 2003

With the most important that some defensive measures fall outside the scope of the Directive. The public share purchase proposals is a modern creature market practice especially useful for controlling a company or for the cooperation of companies. But because there are interests that are served there are also and conflicts. And these conflicts create concern to the Board and its behavior.

The legislator must not forget that the aim of the Directive is the protection of shareholders, the harmonization and the creation of a unified market in corporate control (on EU level).

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