Chapter 1

Takeovers and Mergers in the European Union – an Overview

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1.1 Introduction

1.1.1 Background

Over the years 2004 to 2007, there was a significant increase in mergers and acquisitions ("M&A") activity both globally and in Europe. This encompassed both takeovers of public companies – the primary focus of this Guide – and acquisitions of private companies. Over 40 per cent of global M&A activity by volume in 2007 took place in Europe compared to approximately 30 per cent in 2000. This period was characterised by some very large public takeovers, including the battle for Dutch bank, ABN Amro, between Barclays and a consortium of European banks led by the Royal Bank of Scotland ("RBS") in the summer of 2007. The battle was won by the RBS consortium in October 2007 with a mainly cash bid worth €70 billion, allowing the consortium to secure the biggest bank takeover in history. Although the number of takeover deals with European targets grew by just under a third between 2005 and 2006, the value of such deals grew by almost 75 per cent in the same time period, with the trend continuing during the first half of 2007, signalling a significant rise in the size of these deals. Some of the factors and trends which fuelled such growth are examined below.

The majority of this activity took place in western Europe, but the markets of eastern Europe also experienced significant growth. The value of M&A activity in eastern Europe more than doubled between 2003 and 2006, rising to €77.25 billion.[1] However, the vast majority of such activity in eastern Europe comprised of private, not public, transactions.

Moving into 2008 with volatile stock markets and more pessimistic assumptions of economic growth, predictions of future levels of European takeover activity have become exceedingly difficult. Although there is still significant strategic takeover activity, e.g., in the mining/resources sector (BHP Billiton's bid for Rio Tinto Zinc and the potential bid by Vale for Xstrata) and brewing sector (the Carlsberg and Heineken consortium's bid for Scottish & Newcastle), there can be

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[1] All exchange rates in this Chapter are based on the European Central Bank's average bilateral exchange rates for the particular year cited. Current figures are based on the average 2007 rate.

no doubt that the credit crunch that was triggered in August 2007 by the problems in the US sub-prime mortgage market has had a serious impact on market confidence generally and, in particular, on bidders' ability to finance larger acquisitions. Balanced against this, there will be the possibility for companies to make opportunistic acquisitions while stock market prices are depressed.

1.1.2 Recent trends and developments

1.1.2.1 Activity of private equity firms in the market

Private equity has played an increasingly important role in takeover activity during recent years.

Between 2003 and 2006, the aggregate capitalisation of the major global private equity funds,[2] grew from €20.77 billion to €84.42 billion. This growth was fuelled by low interest rates and the availability of funding.

In Europe, the number and size of private equity-driven M&A transactions have both shown strong growth. The number of private equity M&A transactions with European targets has more than doubled when comparing the first quarter of 2003 to the second quarter of 2007. The value of these deals grew during the same period from €15.03 billion to €131.34 billion.

This growth in private equity's influence culminated in headlining deals during 2006 and 2007, including some of the largest leveraged buy-outs in Europe. For example, in June 2007, Alliance Boots, one of the most famous names in British retail, became the first FTSE 100 company to be bought by a private equity firm after Kohlberg Kravis Roberts (the private equity house) and Stephano Pessina (the Boots deputy chairman) won an intense bidding competition with an increased bid of €16.22 billion.

Also, in March 2006, an acquisition vehicle controlled by private equity firms AlpInvest Partners, The Blackstone Group, The Carlyle Group, Hellman & Friedman, Kohlberg Kravis Roberts and Thomas H. Lee Partners, acquired the entire issued share capital of Nielsen Company, a public Dutch market research company. The deal was valued at just under €8.5 billion.

Central and eastern Europe has also seen the appearance of private equity in recent years. This has included takeovers of companies based in this region, such as Permira's public takeover of Hungarian chemicals company Borsodchem, and many pan-European deals with a significant central European component.

Although private equity deals, particularly the larger transactions, have been impacted severely by the credit crunch, it is expected that over time, as unsyndicated debt becomes absorbed and the debt markets settle down, private equity players will continue to be a dominant force in the takeover market.

1.1.2.2 Hedge funds and activist investors

Whilst private equity has become a mainstream player in the public takeover market over the last few years, hedge funds have also increased their profile on

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[2] Funds valued at over €3.65 billion.

the takeover scene. Hedge funds have been increasingly using their financial muscle to buy up substantial shareholdings in public companies, thus accruing significant influence over how those companies are run, bought and sold.

In recent years, hedge funds have looked to achieve ever-higher returns, and have seen the possibilities provided by private equity's presence in the takeover market.

These funds, believed to be worth over €1.46 trillion globally, have been buying significant equity stakes or derivatives based on equity in public companies that were seen as likely targets for takeover, in particular by private equity funds. An example is to be found in the takeover battle for BAA, the British airports operator, in the summer of 2006. It was believed that hedge funds held around 20 per cent of BAA shares, and thus played a significant part in the bidding process, which was eventually won by Spanish infrastructure company, Grupo Ferrovial. Once successful, Ferrovial refinanced the deal, raising €13.20 billion worth of debt finance, including €2.93 billion worth of subordinated debt from the hedge funds.

A further example of the influence of hedge funds over major corporate transactions was in the bidding war for ABN Amro. The bid by the RBS consortium depended heavily on the Belgian bank Fortis, part of the RBS consortium, being able to pass a shareholders' resolution allowing Fortis to make a €13 billion rights issue in order to help fund the bid. Up until the resolution was passed, it was feared that hedge funds holding 30 per cent of Fortis's stock would try to influence the vote and derail the rights issue. However, in the end the resolution was successful and the rights issue was made.

1.1.2.3 The Middle East and Asia

Recent years have seen a significant and high-profile participation by Asian and Middle Eastern countries on the European takeover scene.

Gulf states have sought to employ the immense wealth garnered from their vast deposits of oil and natural gas in various forms of investments, including the global equity markets, as a means of reducing their economic dependence on their natural resources. Some countries and emirates in this region, in particular Dubai and Qatar, have developed their own financial markets and have succeeded in attracting many of the world's leading financial institutions. As discussed below, the relatively recent proliferation of Islamic financing has also had an impact in increasing the Gulf States' appetite for takeovers. This increase in available funds has meant that these countries have been able to partake in significant deals in the European takeover market.

In 2007, Delta Two, a Qatari-backed investment vehicle, held talks with the UK's third-largest supermarket chain, J Sainsbury, over a potential public-to-private buy-out valued at €15.49 billion (although this did not eventually proceed). Furthermore, with the Dubai Borse (a 28 per cent shareholder) and the Qatar Investment Authority (a 20 per cent shareholder) competing to take control of the London Stock Exchange, almost half of its shares were held by Middle Eastern investors.

1.1.2.4 India and China

India and China, with their rapidly expanding economies, have also been making incursions into the European takeover arena.

Since 2000, Indian companies – buoyed by a domestic boom, good availability of credit and a growing confidence to expand – have made great strides in the global markets. This growing investment by Indian companies in large foreign firms is exemplified by Tata Steel's success in winning an intense bidding war for the Anglo-Dutch steel maker Corus in January 2007 with an offer worth €9.06 billion. This followed Mittal Steel's takeover of Arcelor of Luxembourg in June 2006, which created the world's largest steel company. Tata has also emerged as a principal contender to buy Land Rover and Jaguar from Ford, although this would be a private M&A transaction if it proceeds.

China's substantial economic growth and influence has now spread into Europe as well, and, in particular, into the banking sector. For example, China Development Bank ("CDB"), one of the Chinese government's leading institutions, became a significant shareholder in Barclays when it took up an initial stake worth €3.6 billion, with an option to purchase up to a further €9.5 billion worth of shares if Barclay's bid for ABN Amro had proved successful. In the mining sector, Aluminium Corporation of China (Chinalco), together with US-based Alcoa Inc., acquired an indirect 12 per cent stake in Rio Tinto plc, in a surprise high profile dawn raid in February 2008.

1.1.2.5 Islamic finance

The continuing ability of Gulf-based entities (sovereign and corporate) to raise funds has been greatly influenced by the increasing sophistication and viability of Shari'a-compliant financial instruments, such as the *sukuk*, a Shari'a-compliant product that most closely resembles a "conventional" bond issue. It is predicted that the depth and volume of the Islamic finance market, and the *sukuk* market in particular, will continue to grow as investors become more comfortable with the parameters of Shari'a and the differences between the Shari'a principles applicable to financing and conventional financing.

Although the *sukuk* market is still developing, there have been some extremely large issues in recent years. For example, in 2006, Dubai Ports World ("DP World") made a €2.79 billion issue to fund its takeover of P&O. This trend seems set to continue with a number of *sukuk* currently in the pipeline for the financing or refinancing of leveraged buy-outs and other acquisitions as many investors see Islamic finance as a very fertile source of funding. One of the most interesting facets of current *sukuk* issues is that many investors purchasing *sukuk* are not Islamic and their decision to invest is purely driven by satisfaction of credit-risk related issues.

1.1.2.6 Sovereign wealth funds

Sovereign wealth funds have been growing rapidly in size and influence over the last few years. The US Treasury estimates their combined reserves to be between €1,094.49 billion and €1,824.15 billion. Notwithstanding their current scale, it is expected that these funds will continue to grow in size. Many of these funds are from the Middle East and Asia. Over the years, the governments of

these countries, which have benefited from significant deposits of oil and other natural resources, have built up large reserves of foreign currency.

Those countries that have prospered from their oil deposits have sought to use sovereign wealth funds as a way of buffering the effects of volatile oil prices and as long-term savings vehicles. The vast reserves that these countries possess have had a significant impact on more developed markets and regions. For example, Dubai International Capital owns a 3 per cent stake in Europe's EADS, maker of Airbuses and the Eurofighter. As mentioned above, the Dubai Borse and the Qatar Investment Authority hold large stakes in the London Stock Exchange, and the China Development Bank is now a major shareholder in Barclays, one of Europe's largest banking institutions. Further, in May 2007, the Chinese Government, through the Chinese Investment Corporation, invested €2.19 billion in the large US private equity firm, Blackstone.

A high-profile sovereign wealth fund is Temasek Holdings, which is backed by the Singapore Government, and is thought to manage a portfolio valued at an estimated €72.97 billion . Although its primary focus is on Asian markets and sectors, it holds some significant stakes in European companies. For example, it holds an 11 per cent shareholding in Standard Chartered Bank, which it purchased for €3.19 billion in 2006, and also invested €3.65 billion in a stake in Barclays during the British bank's unsuccessful bid for ABN Amro.

Concerns surrounding the influence of these large sovereign wealth funds have led to protectionist reactions. For example, the US Government passed a new law in July 2007 requiring its Committee on Foreign Investment to conduct a full 90-day investigation of takeovers of US companies by foreign government-owned funds, unless a member of the Cabinet determines it would not impair US national security.

France and Germany, led by Nicolas Sarkozy and Angela Merkel, have been the most vociferous campaigners for the EU to take a stricter stance on sovereign wealth funds. Despite Brussels' traditional attitude that the free movement of capital within the EU is a fundamental tenet of European law, EU ministers have proposed certain schemes that could be implemented to help reduce concerns surrounding large investment by foreign states. The EU has proposed a system of "golden shares" for Member State governments that could allow governments to stop foreign governments taking control of key industries. The trade commissioner argued that such a system could be legitimately used where foreign state-controlled funds sought to buy into European companies in sensitive industries, such as the defence industry. In contrast to these proposals from the EU, Germany is considering adopting a US-style model.

1.1.2.7 Credit crunch

August 2007 saw a dramatic fall in global share prices as investors suffered from the financial turmoil caused by the collapse in the US sub-prime mortgage market. Global stock markets were badly hit in the initial panic and equity prices plummeted. They then staged a gradual recovery but subsequently plummeted again early in 2008. This crisis has seen many large investment banks and also mortgage lenders both in the US and Europe suffer losses, acted as a catalyst for the Northern Rock crisis in the UK and has led generally to a drop in confidence

in the asset-backed securities market. More significantly for the takeovers market, the crisis has also led to a shortfall in the availability of funding for takeovers and acquisitions. M&A activity already started slowing down during the second half of 2007 and this has continued into 2008. Private equity activity (particularly with regard to larger transactions) has waned as the availability of loan finance has lessened. The true long-term impact of the credit crunch remains to be seen but it will almost certainly continue to influence the level of takeover activity adversely until confidence returns to the markets.

1.1.2.8 Pensions – transparency and funding issues

Company pension schemes, and more particularly their funding position, currently play a significant role in the European takeovers market. Since 1 January 2005, all companies listed on a European Stock Exchange have had to account for the cost of making pension provision for their employees under International Accounting Standard 19 ("IAS 19"). The requirement for some recognition of actuarial gains and losses in the accounts (i.e., the difference between the actuarial assumptions used in assessing the company's pension scheme funding and the actual outcome) has led to some EU companies with previously unfunded pension schemes (for example in Germany, Spain and France) having to pre-fund their schemes in order to reduce their deficits.

In the UK, legislation introduced in April 2005 has substantially increased the risks of acquiring a company with a UK defined benefit pension scheme. The Pensions Regulator (a creature of that legislation) has power (albeit to date very rarely used) to pursue a wide net of people, including associates of and persons connected with the employer, for contributions to, or financial support for, an underfunded scheme. Underfunding for this purpose is assessed on the full cost of buying out the liabilities with annuity and deferred annuity contracts (a very expensive option).

This legislation now affects many transactions with a UK element, particularly where the proposed deal is highly leveraged. Potential bidders are finding that it is often crucial to involve, and strike a deal with, the trustees of the pension scheme as part of any proposed takeover or merger. In addition, it is often desirable to seek clearance from the Pensions Regulator in respect of a transaction in order to obtain comfort that the Pensions Regulator will not use its legislative powers to impose significant financial obligations in relation to the target group's defined benefit pension schemes. Whilst clearance can be sought after the event, clearance obtained before the transaction offers greater certainty for business planning purposes during the transaction.

The Pensions Regulator's stance on whether or not parties to a corporate transaction should consider seeking clearance is set out in published guidance. However, this guidance is subject to change and evolving market practice. The Pensions Regulator recently "reminded" parties that the underlying principle for considering clearance is whether the transaction is financially detrimental to the ability of the pension scheme to meet its pension liabilities. If the transaction involves a significant weakening of the employer covenant (e.g., where it is highly leveraged), then it is (and is likely to remain) the Pensions Regulator's view that clearance is an appropriate consideration, irrespective of the funding

position of the scheme involved. Furthermore, the Pensions Regulator encourages the trustees of the pension scheme to consider whether to seek additional funding/mitigation which is significantly higher than the amount required to achieve full funding under IAS 19.

The issue as to whether or not to seek clearance (and its consequential timing implications) is particularly important in the takeovers and mergers market given the Takeover Panel's stance that it will not allow bidders to make a formal bid which is conditional on clearance from the Pensions Regulator.

1.2 Merger control

1.2.1 The Regime

Possibly the most significant factor impacting levels of takeover and merger activity in Member States is EU competition law. Although, in principle, the Commission takes a positive view of major corporate reorganisations within the EU as a means to increase European industry's competitiveness, the Commission may oppose a transaction when it substantially undermines competition in the EU.

All transactions falling within the scope of the EC Merger Regulation ("ECMR") must be notified to the Commission. Where the ECMR applies to a transaction, the Commission has exclusive jurisdiction and the parties are only required to make one filing in the European Economic Area ("EEA") with the Commission (as opposed to multiple filings with national authorities). As at 31 January 2008, 3,696 transactions had been notified to the Commission under the ECMR. Of these transactions, at the time of writing, 20 had been prohibited by the Commission, the latest being *Ryanair/Aer Lingus* (Case M.4439), and 21 had been approved subject to conditions following either a first-phase or a second-phase investigation.

1.2.2 Applicability of the ECMR

As set out in the ECMR, all "concentrations" with a "Community dimension" must be notified to the Commission for approval before being implemented. The Commission Consolidated Jurisdictional Notice (the "Jurisdictional Notice") provides detailed guidance on filing thresholds, with the aim of enabling firms to establish more quickly (and in advance of any contact with the Commission), whether and to what extent their operations may be covered by the ECMR.

1.2.2.1 Concentrations

Concentrations are widely defined in the ECMR and include mergers, acquisitions and certain types of joint ventures. The determining factor is whether the transaction will lead to a lasting change in (direct or indirect) control over one or more undertakings.

The concept of a concentration under the ECMR includes the creation of all joint ventures which perform, on a lasting basis, all of the functions of an independent economic entity. It is not sufficient for the joint venture only to take over

specific functions within the parent companies' business activities without having access to the market itself.

1.2.2.2 Control and decisive influence

The definition of control is very broad. It is sufficient for one party to acquire "the possibility of exercising decisive influence" over another company. Control can be exercised on a de facto or legal basis, regardless of the parties' shareholdings, and this can have important implications for minority shareholders. Therefore, the acquisition of any stake in a company must be carefully considered, in order to ascertain whether it confers either sole or joint control. The Jurisdictional Notice provides guidance in this regard.

Decisive influence may arise through the ownership of all or part of the company's assets or rights which confer decisive influence on the decision-making process of the company. It is therefore not necessary to show that the decisive influence is or will be actually exercised, although the possibility of exercising that influence must be effective (*see Cementbouw* v *Commission* Case T-282/01). Article 3(2) of the ECMR provides that the possibility of exercising decisive influence over an undertaking can exist on the basis of rights, contracts or any other means, either separately or in combination, and having regard to the considerations of fact and law involved. For example, in *Anglo American Corporation/Lonrho* (Case M.754), the Commission considered that Anglo American's 27.5 per cent stake in Lonrho enabled it to cast a majority of votes at shareholders meetings, allowing it to exercise decisive influence over – and thereby control – Lonrho. Anglo American was also the only major mining company holding shares in Lonrho, and the next-largest shareholder held only 3 per cent of Lonrho's shares. Decisive influence can also be constituted by veto rights going beyond normal minority protection rights of shareholders, for example where two or more companies can jointly exert decisive influence over the target's affairs, namely its budget, investment and appointment of management.

Even in the absence of specific veto rights, two or more minority shareholders may jointly control the joint venture where, together, they have the majority of the voting rights and they act together in exercising those voting rights. Such collective action can result from a legally binding agreement to this effect or it can occur on a de facto basis, for example, where strong common interests exist between the minority shareholders. In this respect, the Commission may look at voting behaviour in the pre-existing company's decision-making bodies (in particular, the shareholders meetings) over a period of time.

An important Commission decision regarding joint control is *Conagra/Idea* (Case M.010). Conagra was to acquire 20 per cent of a new joint venture's share capital entitling it to 26 per cent of the voting rights on the board of directors. Conagra also had rights to subscribe for additional shares of up to 50 per cent in total. A 75 per cent majority was required on the joint venture's board for such things as the approval of the annual budget, strategic plans, selection of management, investment and launching new products. The Commission considered that Conagra's ability to block decisions of the board requiring a 75 per cent majority went beyond the usual protection of a minority shareholder and therefore

decided that Conagra had the right to exercise a decisive influence on the joint venture with the result that the acquisition was treated as a concentration.

Where investors subscribing for shares in the target company finance a transaction, there is a possibility they could exert decisive influence. For this reason, management buy-outs and other venture-capital type transactions may also fall within the scope of the ECMR (*see*, for example, *Industri Kapital/Dyno* (Case M.1813)). Whether such a conclusion can be reached will depend on the precise nature of the voting or contractual rights that the investors/subscribers have in the target company. Where such rights go beyond the usual protection afforded to minority shareholders, investors are likely to have joint control with the purchaser over the target.

1.2.2.3 Exceptions

The ECMR does not apply to certain acquisitions by credit institutions holding securities on a temporary basis, certain acquisitions in the context of insolvency proceedings, certain acquisitions by financial holding companies, or to intra-group restructurings.

1.2.2.4 Community dimension

If it is established that the transaction in question is a "concentration" (as described above), it is then necessary to consider whether the concentration meets certain turnover thresholds and therefore has a "Community dimension".

The relevant turnover is the amount derived during the last financial year from the sale of products or the provision of services after the deduction of sales rebates and taxes directly related to turnover. Special rules apply for the calculation of the turnover of financial and credit institutions and insurance companies.

Under the ECMR, a concentration has a Community dimension where:

(a) the combined aggregate worldwide turnover of all of the companies concerned is more than €5 billion (this threshold is intended to exclude mergers between small and medium-sized companies);
(b) the aggregate Community-wide turnover of each of at least two of the companies concerned is more than €250 million (this threshold is intended to exclude relatively minor acquisitions by large companies or acquisitions with only a minor European dimension); and
(c) *unless* each of the companies concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State (this threshold is intended to exclude cases where the effects of the merger are felt primarily in a single Member State, where it is more appropriate for the national competition authorities to deal with it).

The ECMR also includes concentrations of a smaller size where it is likely that the transaction concerned would have been caught by multiple national merger-control regimes. Thus the ECMR also applies where:

(a) the combined aggregate worldwide turnover of all of the companies concerned is more than €2.5 billion; and

(b) the aggregate Community-wide turnover of each of at least two of the companies concerned is more than €100 million; and
(c) the combined aggregate turnover of all of the companies concerned is more than €100 million in each of at least three Member States; and
(d) in each of at least three of these Member States, the aggregate turnover of each of at least two of the companies concerned is more than €25 million;
(e) *unless* each of the companies concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

The turnover thresholds under the ECMR have the effect of bringing within the Commission's jurisdiction transactions which take place outside the EU and where neither the parties nor the business concerned are principally European in nature. As long as a concentration has a Community dimension, it is irrelevant that none of the parties have a registered office, subsidiary or branch within the EU. For example, mergers between US companies (such as *Oracle/PeopleSoft* (Case M.3216)) may be caught where each of the merging companies have Community turnover in excess of €250 million, and satisfied the combined aggregate worldwide turnover threshold of €5 billion.

1.2.3 Notification of a concentration

All concentrations with a Community dimension must be notified to the Commission prior to their implementation and following: conclusion of the agreement, announcement of a public bid, or the acquisition of a controlling interest. Notification may also be made where the parties can demonstrate to the Commission a good-faith intention to conclude an agreement, for example following the signing of a letter of intent or, in the case of a public bid, where they have publicly announced an intention to make such a bid. The notification must be made on Form CO, as published by the Commission. Copies of the notification are sent to the competition authorities of the Member States.

A simplified procedure may be used for routine cases which do not involve significant competition issues. Such notifications are made on short Form CO, which requires less information than Form CO. However, a Form CO will be required where the Commission determines that it is necessary for an adequate investigation of possible competition concerns.

The Commission actively encourages the parties to initiate contact at the earliest opportunity and at least two weeks (or longer in more difficult cases) before the expected date of notification. It has in the past been cooperative in providing confidential guidance to parties in informal pre-notification contacts. Such contacts may be instrumental in avoiding a second-phase investigation, particularly if difficult issues are involved, as it effectively gives the Commission more time to examine the case.

1.2.3.1 Suspension of the concentration

The merger cannot be completed until it has been declared compatible with the common market. However, a duly notified public bid can proceed as long as the bidder does not exercise the voting rights attached to the securities in question

or does so only to "maintain the full value of those investments". The Commission may also on request grant a derogation from the obligation to suspend the concentration and will be guided by the effect of the suspension on the parties to the merger (for example, major financial risks) and on third parties, as well as the threat to competition posed by the concentration. However, in practice, the Commission has remained reluctant to grant derogations. As at 31 January 2008, only 95 derogations have been granted.

Parties can be fined if they implement a merger in contravention of the suspension requirements, although failure to comply with them does not affect the validity of the merger itself, as this will depend on the outcome of the Commission's investigation. Similar fines may be imposed for breach of any conditions attached to a clearance or for implementing a concentration in breach of a prohibition decision, as well as periodic fines to compel undertakings to comply with an obligation imposed by the Commission when it grants a derogation from the suspension period, any clearance conditions or prohibition decisions. Lesser fines may be imposed for failure to notify, late notification, or the submission of false or misleading information.

The Commission is using its fining powers with increasing frequency. For example, the Commission fined Tetra Laval €90,000 for providing incorrect or misleading information relating to the acquisition of Sidel (Case M.3255). Further, on 13 December 2007 the Commission announced that it had carried out dawn raids at the premises of two unidentified suspension PVC manufacturers in the UK (under Article 13 of the ECMR) for allegedly implementing a notifiable merger without first obtaining clearance from the Commission.

1.2.3.2 Timing of the Commission's review

Where a transaction falls within the ECMR, the Commission must make decisions "without delay". It has 25 working days in which to make its initial first-phase assessment. This is extended to 35 working days where the parties give undertakings to have the transaction cleared to give the Commission time to seek third-party comments on the proposed undertakings, or where a Member State makes a request that the merger be referred to it. The Commission must then either clear the transaction or open an in-depth second-phase investigation where it finds that the merger raises "serious doubts as to its compatibility with the common market".

In this second phase, the Commission has an additional 90 working days in which to approve (with or without conditions) or prohibit the transaction. This period is extended to 105 working days where the parties offer undertakings, unless they are offered within 55 working days after the opening of the in-depth investigation. These periods may also be extended once, for a maximum of 20 working days, at the request of the parties within 15 working days after the opening of the in-depth investigation, or any time by the Commission with the agreement of the parties.

Under the simplified procedure, concentrations that fulfil the requirements for clearance are declared compatible with the common market at the end of the first phase.

1.2.3.3 Undertakings

Parties may give undertakings to meet specific competition objections and thereby obtain clearance of the transaction. Undertakings can be given either in the first phase so as to avoid a second-phase investigation, or during the second phase. The Commission will consult with third parties concerning the undertakings offered. As set out in its Remedies Notice, the Commission prefers structural remedies (usually involving divestiture of assets) as opposed to behavioural commitments (such as licensing products or brands to third parties), and requires that any activities to be divested must consist of a viable business that can compete effectively with the merged entity. Parties may even be required to offer an "up-front buyer" for the business to be divested as a condition of final approval of the merger (*see*, for example, *Fortis/ABN Amro* (Case M.4844)).

If it becomes apparent that the Commission has serious concerns as to the compatibility of the transaction, the parties can withdraw their initial filing. This gives the parties the opportunity to restructure and renotify the deal to overcome the competition objections. This may help to avoid the opening of a second-phase investigation, the imposition of conditions or a prohibition decision. This approach was adopted by the parties in *Microsoft/Time Warner/ContentGuard* (Case M.3445), where the transaction was restructured and the notification withdrawn as the transaction no longer constituted a concentration. Where a notification is withdrawn, the Commission no longer has the power to adopt the decision and prohibit the concentration (Case T-310/00, *MCI* v *Commission*). Any withdrawn transaction may, however, still fall within the scope of national merger control regimes.

1.2.3.4 The Commission's decision

Where the Commission finds that the merger is not compatible with the common market, it may require divestiture of assets, or order any other action which it considers appropriate to restore conditions of "effective competition". For example, *Tetra Laval/Sidel* (Case M.2416) involved public bids for a French company which had closed before the Commission's decision was taken. The Commission prohibited the concentration and made orders for divestment.

1.2.3.5 Challenging the Commission's decision

The Commission decision to unconditionally clear, conditionally clear or prohibit a transaction may be the subject of an appeal to the Court of First Instance ("CFI"), and, from there, on points of law, to the European Court of Justice ("ECJ") by either the merging parties or third parties such as complainants (e.g., T-114/02, *BaByliss* v *Commission* [2003] ECR II-1279).

As introduced in 2001, any appellant may benefit from the use of expedited procedure to fast-track appeals before the CFI. The expedited procedure has succeeded in delivering judgments within approximately seven months (e.g., Case T-77/02, *Schneider Electric* v *Commission* and Case T-87/05, *EDP* v *Commission*) from the date of the application to appeal, while other appeals have taken considerably longer (e.g., 19 months in Case T-464/04, *Impala* v *Commission*). Due to the delays in the appeal process, there is an ongoing debate whether the expedited procedure should be revised or a specialist EU competition tribunal created.

Despite the length of the appeal process, in substantive terms, as demonstrated by two judgments in 2006 and 2007, it would appear that the CFI is carefully scrutinising the Commission's decisions.

In July 2006, the CFI annulled the Commission's decision to clear the Sony/BMG joint venture (Case T-464/04, *Impala* v *Commission*), following an appeal by the trade association Impala. Although the CFI had previously annulled prohibition and conditional clearance decisions, this was the first time that the CFI overturned an unconditional clearance decision. The Commission had concluded, following an in-depth investigation, that it did not have sufficiently strong evidence to oppose the deal on the basis of collective dominance in the market for recorded music. However, the CFI criticised the Commission for failing to adequately reason the decision and ordered the Commission to re-examine the transaction. Sony and Bertelsmann have appealed the CFI's judgment to the ECJ (Case C-413/06, *Bertelsmann AG and Sony Corporation of America*), although on 13 December 2007, Advocate General Kokott recommended that the ECJ dismiss the appeal. Meanwhile, on 3 October 2007, the Commission announced that, after a further in depth investigation, it had again unconditionally approved the Sony/BMG merger.

In July 2007, the CFI ruled that the Commission must pay Schneider Electric partial compensation for losses sustained due to procedural flaws in the review of its bid for rival Legrand in 2001 (Case T-351/03, *Schneider Electric* v *Commission*). Although this is the first award of damages in relation to an unlawful prohibition of a merger, it adopts a relatively narrow interpretation of the Commission's liability. While procedural breaches are a good candidate for compensation, most substantive errors are unlikely to constitute a "manifest breach" given the margin of discretion available to the Commission in its application of the competition provisions. The Commission is appealing this judgment before the ECJ.

In addition to previous successful appeals to prohibition and conditional clearance decisions, the increased scrutiny of the Commission's decisions in these cases can be expected to further increase the burden on the Commission to fully justify all of its decisions and to follow appropriate procedures in order to respect rights of defence.

1.2.3.6 The role of third parties

Immediately following the notification of a concentration or the opening of a second-phase investigation, the Commission publishes a notice in the *Official Journal of the European Communities*, inviting third parties (customers and suppliers as well as competitors) to comment on the transaction (normally within 10 or 15 days from publication of the notice). In addition, where necessary, the Commission requests third parties to answer specific questions during the course of the investigation. Third parties may also submit comments to the Commission voluntarily at any stage of the proceedings and may apply to be heard by the Commission. Substantial criticism from third parties may trigger a second-phase investigation.

Third parties are often able to impact significantly the EU merger investigation process. It is increasingly the case that, if a merger is likely to be challenged by

a deep-pocketed complainant and/or a considerable volume of negative third-party comment, it will be probed in considerable depth by the Commission. Indeed, as discussed above at 1.2.3.5, the Commission decision to clear the *Sony/BMG* joint venture was annulled by the CFI following an appeal from a third party. Even if the proposed transaction is not subjected to an in-depth investigation, in order to achieve clearance the notifying parties are required to produce more extensive evidence than has previously been the case, and particularly good evidence is required to dispel third-party complaints.

1.2.4 Compatibility with the common market

1.2.4.1 Significant impediment to effective competition

The Commission must determine whether a concentration significantly impedes effective competition in the common market, in particular, by creating or strengthening a dominant position. This substantive analysis also considers any unilateral effects in oligopolistic markets where the merged entity's market share falls below the traditional dominance threshold. Unilateral effects occur in relation to horizontal mergers which remove important competitive constraint on one or more sellers, such as the elimination of a price maverick.

In assessing a concentration's compatibility with the common market, the Commission initially considers the market share of the merged entity in the relevant product and geographic markets. The Commission must define these markets as part of its assessment, and guidance on this process is given in its Notice on the definition of the relevant market. A market share below 25 per cent is generally not liable to impede competition. High market shares (typically in excess of 40 per cent), whilst often triggering a second-phase investigation, will not necessarily lead to a finding of incompatibility as, for example, in *Danish Crown/Vestjyske Slagterier* (Case M.1313), market shares of 80 per cent were cleared.

Following the calculation of market shares, the Commission will assess the characteristics of the relevant market in order to determine whether the concentration creates any competition concerns. The Commission may rely on economic theories to articulate its competition concerns, such as:

(a) portfolio effects – in *Guinness/Grand Metropolitan* (Case M.938), the Commission considered the inclusion of strong brands in a range of drinks belonging to separate markets, and found that their inclusion could give each of the brands in the portfolio greater strength on the market than if they were sold individually, thereby strengthening the competitive position of the portfolio's owner on several markets;

(b) conglomerate effects – in *Tetra Laval/Sidel* (Case M.2416), the Commission concluded that Tetra Laval's dominance in one market could be leveraged into another distinct, but closely related, market, and blocked the merger. On appeal, the CFI did not dispute the economic theory but found that the Commission must adduce convincing evidence to support a finding (*see* also *GE/Honeywell* (Case M.2220) and *SEB/Moulinex* (Case M.2621)). It would appear from *GE/Amersham* (Case M.3304) that the Commission has

taken seriously some of the CFI's criticisms by implementing a more rigorous economic and empirical approach;

(c) network externalities – in *WorldCom/Sprint* (Case M.1741), the Commission found that the attraction of a network to its customers was a function of the number of other customers connected to the same network and would have enabled the merged entity to behave independently of its competitors and customers and to degrade the quality of internet-related services offered to its competitors (*see* also *WorldCom/MCI* (Case M.1069));

(d) gatekeeper effect – in *Vodafone/Vivendi/Canal+* (Case JV.48), the Commission found that the merged entity would be able to control the emerging market of TV-based internet portals through proprietary technology (*see* also *Vivendi/Canal+/Seagram* (Case M.2050) and *Microsoft/Time Warner/ContentGuard* (Case M.3445)).

In assessing any competition concerns, as stated in its Horizontal Guidelines, the Commission must take into account factors such as:

(a) strong evidence of potential new entrants;
(b) low barriers to entry;
(c) the availability of alternative (albeit not substitutable) products;
(d) the existence of countervailing buying power;
(e) a tendency to wider geographic markets; and
(f) the limited impact of the concentration on the merged entity's market position.

Although typically reticent to accept any arguments based on post-merger efficiencies, the Commission has cleared the creation of a duopoly on the basis that the transaction would generate substantial merger-specific efficiencies that would be likely to be passed on to consumers (Case M.4057 *Korsnäs/Assidomän Cartonboard*).

The Commission has published guidelines on the assessment of non-horizontal mergers, the purpose of which is to consolidate and elaborate on the Commission's experience in this area. The guidelines note that non-horizontal mergers are generally less likely to create competition concerns than horizontal mergers for two reasons. First, unlike horizontal mergers, vertical or conglomerate mergers do not entail the loss of direct competition between the merging firms in the same relevant market. As a result, the main source of anti-competitive effect in horizontal mergers is absent from vertical and conglomerate mergers. Second, vertical and conglomerate mergers provide substantial scope for efficiencies. A characteristic of vertical mergers and certain conglomerate mergers is that the activities and/or the products of the companies involved are *complementary* to each other. The integration of complementary activities or products within a single firm may produce significant efficiencies and be pro-competitive.

1.2.4.2 Joint dominance and oligopolies

The Commission may prohibit concentrations which create or strengthen oligopolistic market structures, even if the merged entity on its own would not occupy a dominant position. In cases involving collective dominance, the Commission must ascertain "whether the concentration would have the direct and immediate

effect of creating or strengthening a collective dominant position which is such as significantly and lastingly to impede competition in the relevant market" (Case T-342/99, *Airtours* v *Commission* [2002] ECR II-2585). In making this analysis the Commission takes into account a range of factors, such as transparency in the market, product homogeneity, market growth, innovation, barriers to entry, incentives to compete and possibilities for retaliation, as well as the position of smaller operators.

Although the CFI has confirmed the substantive test to be applied, it has been extremely critical of the way in which the Commission has applied the test to the facts of the case. As a result, the Commission would appear to be taking a more cautious approach in its review of mergers. Furthermore, in the wake of the CFI's decision in *Sony/BMG* (discussed above at 1.2.3.5), the Commission is likely to be even more thorough in its assessment and reasoning.

1.2.4.3 Full-function joint ventures

Full-function joint ventures that give rise to coordination of competitive behaviour between the parents (so-called cooperative joint ventures) will, in addition, be examined under Article 81 of the EC Treaty, which prohibits restrictive agreements and practices. These joint ventures are therefore subject to a double test: the establishment of the joint venture will be subject to the same test as for mergers and acquisitions, whereas the coordination between the parents will be assessed under Article 81 of the EC Treaty.

1.2.5 Interplay with national merger controls

There are a number of referral mechanisms whereby concentrations that do not have a Community dimension may be referred to the Commission and also, in an exception to the one-stop shop principle, concentrations with a Community dimension may be referred to the national competition authorities. In addition, there is scope for Member States to review concentrations with a Community dimension other than on competition grounds.

1.2.5.1 Pre-notification referrals to Member States

Parties may request that a concentration with a Community dimension be referred, in whole or in part, to a Member State on the basis that it affects competition in a market within that Member State which presents all of the characteristics of a distinct market. Unless that Member State disagrees within 15 working days, the Commission, where it considers that such a distinct market exists and that competition in that market may be significantly affected, may decide to refer the whole or part of the concentration to the Member State(s) concerned.

1.2.5.2 Post-notification referrals to Member States

The Commission may, at the request of a Member State, refer a notified concentration with a Community dimension, in whole or in part, to the relevant authority of the Member State concerned. It has a discretion as to whether to make such a referral when the concentration threatens to significantly affect competition in a distinct market within that Member State, unless the territory

concerned does not form a substantial part of the common market, in which case the Commission is obliged to make the (partial) referral.

1.2.5.3 Legitimate interests
The Commission retains sole jurisdiction to investigate mergers on competition grounds, but the ECMR sets out other grounds on which Member States may carry out a parallel investigation if its "legitimate interests" are affected, such as "public security", "plurality of the media" and "prudential rules". Member States may rely on other legitimate interests as long as they are notified to the Commission. Other legitimate interests need only be notified by the Commission if they are aimed at the transaction as such (*EDF/London Electricity* decision (Case M.1346)).

However, the Commission remains competent to determine whether a Member State's legitimate interests are affected and may prevent a Member State from blocking a concentration falling within the scope of the ECMR.

There has been a resurgence of economic protectionism across a number of EC industry sectors (in particular, energy and financial services), with national regulators utilising special rights in relation to certain sectors to block an acquisition by a foreign entity or pass through an acquisition by another national company to prevent a foreign acquisition. In response to this protectionism, the Commission has taken action to ensure that its exclusive competence to assess the competitive impact of concentrations with a Community dimension is not infringed.

For example, in July 2007, the Commission unconditionally cleared the acquisition of joint control of Endesa by Enel and Acciona in the Spanish energy sector (Case M.4685 *Enel/Acciona/Endesa*). The CNE, the Spanish energy regulator, had previously imposed a number of conditions on the concentration. As these decisions were adopted without prior communication to, or approval by, the Commission, the Commission launched proceedings against Spain for violation of the ECMR. On 5 December 2007 the Commission announced that it had notified Spain of its provisional conclusion that the conditions imposed by the CNE breached Article 43 (freedom of establishment) and Article 56 (free movement of capital) of the EC Treaty. It also considered that one condition breached Articles 28 and 29 of the EC Treaty (free movement of goods). Although Spain subsequently modified the CNE conditions, following an appeal by Enel and Acciona, the Commission concluded (by a decision of 5 December 2007) that its concerns had not been fully addressed. It required Spain to withdraw the relevant conditions by 10 January 2008. At the time of writing, the Spanish authorities have not informed the Commission of any steps or measures taken in order to comply with the decision of 5 December 2007. As can be seen from *Enel/Acciona/Endesa*, the Commission's powers to enforce the ECMR coincides with its general powers to implement the basic freedoms guaranteed by the EU Treaty. For example, although the Commission cleared the acquisition of Antonveneta, an Italian bank, by ABN Amro, the governor of Italy's central bank, who at the time held a personal veto right over banking mergers, attempted to prevent this acquisition by favouring a rival bid by another Italian bank. Although ABN Amro eventually won the takeover battle, the Commission

investigated the matter and initiated proceedings against Italy on the basis that the discriminatory exercise of the governor's veto rights violated EU rules on free movement of capital and freedom of establishment. The Italian legislators subsequently amended the legislation and the Commission dropped the proceedings.

1.2.5.4 Pre-notification referrals to the Commission

Parties may request that a concentration without Community dimension but which triggers the merger control laws of three Member States be referred to the Commission. Upon such a referral, each Member State, whose merger control is triggered, has 15 working days to express its disagreement. In the absence of any disagreement, the concentration shall be deemed to have a Community dimension and require a full-form notification.

1.2.5.5 Post-notification referrals to the Commission

A Member State, or several Member States acting together, may request the Commission to investigate a concentration that does not have a Community dimension, insofar as the concentration affects trade between Member States. Such a request must be made within 15 working days of the concentration being notified or otherwise made known to the Member States. The Commission will refuse to investigate a concentration unless it meets the criteria set out in the ECMR. For example, the Commission refused Portugal's and Italy's application for a referral of the *Gaz Natural/Endesa* merger from the Spanish competition authority, despite concerns that the transaction was being rushed through by the Spanish authorities in order to create a "national champion" and prevent an overseas company from gaining control of one of Spain's largest energy companies.

1.2.5.6 International cooperation

The increasing frequency of mergers with international or even global effects poses particular challenges in the field of competition enforcement, as they are often reviewed by a number of different agencies.

For instance, many international mergers will be reviewed by both the Commission and the US antitrust agencies (the US Federal Trade Commission and the Antitrust Division of the Department of Justice ("DOJ")). Following the divergent EU/US outcomes in *GE/Honeywell* in 2002 (Case M.2220), the Commission and the US antitrust agencies developed a set of best practices on cooperation in reviewing mergers that require approval on both sides of the Atlantic. The best practices put in place a more structured basis for cooperation in reviews of individual merger cases and recognise that cooperation is most effective when the investigation timetables of the reviewing agencies run more or less in parallel. Merging companies will therefore be offered the possibility of meeting at an early stage with the agencies to discuss timing issues. Companies are also encouraged to permit the agencies to exchange information which they have submitted during the course of an investigation and, where appropriate, to allow joint EU/US interviews of the companies concerned. The practices moreover designate key points in the respective EU and US merger investigations when it may be appropriate for direct contacts to occur between senior

officials on both sides. In 2006, the Commission has worked closely with the DOJ in relation to *Inco/Falconbridge* (Case M.4000).

The Commission also has a number of other bilateral agreements, which include cooperation in the field of merger control, for example, with Canada (1999) and Japan (2003).

In addition to bilateral agreements, there is increasingly a trend towards involving a wider range of countries and agencies in a multilateral approach to addressing the issues. This is best illustrated by the development of the International Competition Network ("ICN"), which is a forum within which antitrust officials from developed and developing countries can work to address practical enforcement and policy issues of common concern. The network aims to facilitate procedural and substantive convergence in antitrust enforcement and develop non-binding recommendations for consideration by individual enforcement agencies.

The ICN's Merger Working Group has been focusing on the merger control process as it applies to multi-jurisdictional mergers. In particular, there are two sub-groups focused on merger notification and procedures, and merger investigational analysis.

1.2.6 Merger control and takeovers

Provided the takeover meets the requirements of being a concentration and has a Community dimension, the ECMR will apply. Particularly in transactions which involve companies in more than one Member State, it is usually preferable to fall within the ECMR and have the Commission handle the matter exclusively. With its mandatory timetable, the ECMR provides the companies with more legal certainty than some of the national merger control procedures. Competitive bids for the same target may be subject to different systems.

The initial 25 working day period during which the Commission must make its preliminary finding is unlikely to interfere with most bid timetables which usually require that an offer be open for a minimum three-week period. The consequences for a takeover bid of the Commission initiating proceedings vary between jurisdictions. At one extreme are France and Spain where an offer cannot be conditional on proceedings not being initiated; if proceedings are initiated the offeror must go ahead with the offer and take such action as may be required by the Commission at the end of its investigation. At the other extreme is the UK, where the offer must lapse if proceedings are initiated within a specified period after launch. In Belgium, Germany, Italy and the Netherlands, for example, the bid may be conditional.

1.3 The Takeover Directive

1.3.1 Background

After over 14 years of negotiations and redrafts, the European Directive on Takeover Bids (2004/25/EC) ("the Takeover Directive") finally was adopted in

spring 2004. The Takeover Directive's aim was to introduce certain common rules for conducting takeover bids in the EU, in pursuance of the EU's fundamental objective to promote and achieve a single market in financial services to facilitate pan-European restructuring and help make Europe the most competitive economy in the world. It can be viewed within the context of the regulatory regime changes that have brought about the adoption and implementation of the Prospectus Directive, Market Abuse Directive, Transparency Directive and MiFID, among others. However, in contrast to such aims the Takeover Directive is essentially a compromise, not least owing to the difficulties encountered in reaching agreement between Member States. Moreover, as a "minimum-standards" rather than a "harmonisation" directive, the Takeover Directive has not been wholly successful in achieving a truly level playing field across the EU. The fact that Member States can opt out of some fundamental provisions of the Takeover Directive reduces still further its ability to standardise a regulatory approach to takeovers across Europe.

The Takeover Directive stipulated an implementation deadline of no later than 20 May 2006, by which time EU Member States were to have enacted the laws, regulations and administrative provisions necessary to comply with the Takeover Directive.

Every EU Member State has now implemented the Takeover Directive with the exception only of the Czech Republic, Denmark and Estonia.

The degree to which implementation of the Takeover Directive has (or will have) altered the law and impacted upon market practice in each of the EU Member States varies considerably. In some Member States such as the UK, the overall impact in practice has not been particularly significant. In contrast, Member States that previously had more lightly regulated or less mature takeovers markets have been more significantly affected. The following sections of this Chapter describe, in overview, some of these changes. For a fuller description of specific current regimes, *see* the later Chapters in this Guide.

1.3.2 Main features of the Takeover Directive

1.3.2.1 Scope and framework of general principles

The Takeover Directive applies to takeover bids for securities of companies governed by the laws of a Member State if all or some of the securities are admitted to trading on a regulated market in one or more Member States. The Takeover Directive does not apply to bids for central banks or open-ended investment companies or to targets which are non-EU issuers, even if such companies' securities are traded in the EU.

In the interests of maintaining a unified national takeover regime, many Member States have taken the approach of adopting Takeover Directive equivalent regulation in respect of bids for companies falling without the scope of the Takeover Directive. For example, in the UK, bids for UK companies admitted to trading on non-regulated UK markets (such as the London Stock Exchange's Alternative Investment Market ("AIM")) are subject to substantially the same regime as companies admitted to trading on the London Stock Exchange's Main Market (which is a "regulated market" for the purposes of the Takeover Directive).

Similarly and by way of further example, Spain has chosen to apply Takeover Directive equivalent provisions to its regulation of all bids for listed companies whose registered addresses are in Spain.

In Germany and the Netherlands, the Takeover Act applies only to companies whose securities are admitted to trading on an "organised", that is, "regulated" market. Therefore, takeover offers for companies whose securities are only admitted to trading on other markets (such as the open market) do not fall within the scope of the Dutch or German Takeover Act respectively.

In France, bids for French companies whose shares are admitted to trading on Alternext, a non-regulated market, are subject to a slightly less strict regime than companies admitted to trading on Eurolist Paris (which is a "regulated market" for the purposes of the Takeover Directive).

The Takeover Directive sets out a framework of general principles establishing minimum requirements which must be complied with by Member States when implementing the Takeover Directive. The six general principles, in summary, provide that:

(a) target shareholders of the same class should be afforded equivalent treatment;
(b) target shareholders should be given sufficient time and information to enable them to reach a properly informed decision on a bid and the target board should give its opinion on the effects of the bid on employment and locations of business;
(c) the target board acts in the interests of the company as a whole;
(d) no false markets should be created;
(e) a bid should only be announced after a bidder is certain that it can fulfil any cash consideration; and
(f) the target should not be hindered by a bid for longer than is reasonable.

As noted above, the Takeover Directive is a minimum-standards directive and thus Member States are permitted to impose their own additional and more stringent standards than the minimum. As a result, takeover rules across Member States continue to vary.

1.3.2.2 Supervisory authority

Under the Takeover Directive, Member States are required to designate an authority to supervise bids which can be a public or private body.

Since 1968 takeovers in the UK have been supervised by the Panel on Takeovers and Mergers ("the Panel"). Prior to the implementation of the Takeover Directive in the UK, the Panel was a non-statutory body without statutory enforcement powers. Its rules, as set out in the Code, similarly lacked the force of law. Despite this lack of statutory force prior to implementation of the Takeover Directive, the Panel still exerted much influence, and the courts were impressed by the Panel's ability to regulate the UK takeovers market.

Further to this, the Panel had various sanctions at its indirect disposal. For example, the Panel could request the FSA to take enforcement action against a firm that did not comply with the Code. One of the actions possible was the

so-called "cold shoulder" rule. Under this rule, a firm could not act for any person in connection with a transaction governed by the Code if it had reason to believe the person for whom it was acting was not complying with the Code. The Panel would publish notices identifying specific persons or firms who, in its opinion, were not likely to have complied with the Code. In the UK market, the fear of censure or criticism, whether public or private, by the Panel was, and continues to be, a powerful deterrent for companies and their advisers. In implementation of the Takeovers Directive, the Panel was given a statutory footing, and the Code was given the force of law (in respect of bids for London Stock Exchange Main Market listed companies from 20 May 2006 and in respect of bids for most other listed companies from 6 April 2007). With its new status, the Panel has been granted a wide range of enforcement powers, including the power to require the disclosure of documents and information, the ability to require compensation to be paid to target shareholders, and the power to seek enforcement orders from the Courts.

In Spain, the body responsible for supervising and inspecting the Spanish securities markets and, in particular, responsible for authorising and controlling takeover bid procedures is the Spanish Securities Market Commission, Comisión Nacional del Mercado de Valores ("CNMV"), created by Law 24/1988. The implementation of the Takeover Directive has had little impact on the Commission's status or responsibilities.

In the Netherlands, whilst the Authority for the Financial Markets Autoriteit Financiële Markten ("AFM") remains the competent authority with respect to monitoring the procedural aspects of a takeover bid, the Enterprise Chamber of the Amsterdam Court of Appeal is competent in all company law matters, including, in particular, the determination as to whether a duty to make a mandatory bid has arisen. This effectively means that the supervision of the new rules that were introduced on implementation of the Takeover Directive is allocated between the AFM and the Enterprise Chamber.

1.3.2.3 Jurisdiction

Under the Takeover Directive, if a target has its registered office and its securities are admitted to trading on a regulated market in the same Member State, then the supervisory authority of such Member State has jurisdiction over all matters in connection with the takeover bid. If the securities of the target are not admitted to trading on a regulated market in the Member State in which such company's registered office is situated, jurisdiction lies with the supervisory authority in the Member State on whose regulated market the securities of the target are admitted to trading, but it shares responsibility with the supervisory authority where the target has its registered office.

Although the EU Member States that have implemented the Takeover Directive have generally enacted such jurisdiction provisions into the relevant laws, it is possible that complicated issues regarding shared supervisory jurisdiction will arise at some point. This is because the Directive does not set out a comprehensive list of those aspects of a bid which are to be governed by each authority, nor are any procedures for resolving disputes concerning shared jurisdiction provided for in the Directive.

Given the drive to open up regulated markets across the EU, it is likely to become increasingly common for a company's shares to be traded in a different country to that of its registered office and therefore the issues arising with shared supervisory jurisdiction are likely to have to be addressed in the future.

1.3.2.4 Mandatory bids

The Takeover Directive requires Member States to implement a mandatory bid requirement for the acquisition of shares above a certain threshold, at an equitable price. The threshold at which a bid must be made is left for Member States to determine.

In the UK, prior to the implementation of the Takeover Directive, Rule 9 of the Code already required a person to make a mandatory bid in cash for a company where such person and its concert parties acquired an interest in shares carrying 30 per cent or more of the voting rights of the company. As the minimum price for such mandatory bid was fixed by reference to the highest price such person or its concert parties had paid for shares in the company in the previous 12 months, Rule 9 was already Takeover Directive compliant.

Similarly, minimal changes were required in Member States such as France and Germany, whose regimes previously required mandatory bids set at thresholds, broadly, of 33.33 per cent and 30 per cent respectively of the target share capital.

This is in stark contrast to the position in, for example, Belgium, Spain and the Netherlands. Prior to implementation of the Takeover Directive, Belgian takeover law did not contain a set threshold triggering the obligation to launch a mandatory bid except where an absolute majority of over 50 per cent of voting rights was acquired. Instead, a case-by-case analysis was required, which led to varying stakes triggering mandatory bids in different circumstances.

Belgium implemented the Takeover Directive on 1 April 2007 and had to substantially alter its former regime. The new regime entered into force on 1 September 2007. It provides that, similarly to the situation in the UK and Germany, the threshold at which a bid must be made is 30 per cent. A "grandfathering clause" allows shareholders, alone or acting in concert, not to launch a mandatory bid if they held more than 30 per cent prior to the entry into force of the new law on 1 September 2007 (provided that they had notified this situation to the company and the competent authority, the Belgian Banking Finance and Insurance Commission).

The pre-Takeovers Directive regime in Spain required a bidder to make a filing before it acquired the relevant shareholding in the target. A mandatory bid may have arisen, depending on the percentage of the share capital of the target that the bidder would have acquired, as well as on the number of directors of the target that the bidder would have been entitled to appoint as a result of the acquisition. The previous Spanish regulations provided not only for mandatory bids for 100 per cent of the target's securities, but also for mandatory partial takeover bids in certain circumstances.

Following implementation of the Takeover Directive in Spain, the historic regime has been replaced by a mandatory full takeover bid procedure pursuant to which the party acquiring control (broadly the acquisition of more than 30 per cent of

the voting rights, or a smaller stake with the appointment of a majority of directors within 24 months following the acquisition) of a listed target company has to launch a bid for 100 per cent of such company at a reasonable price.

The implementation of the Takeover Directive introduced a mandatory bid in the Netherlands for the first time. The threshold triggering a mandatory bid is set at 30 per cent of the total amount of the shares or depositary receipts owned in a Dutch public company listed on a regulated market. The minimum price for such a mandatory bid is fixed by reference to the highest price that the mandatory bidder or its concert parties have paid for shares in the company in the previous 12 months, or, when the mandatory bidder or its concert parties did not acquire any shares in the company during the previous 12 months, the average share price during the same 12 months.

The 30 per cent threshold for mandatory bids has been fully implemented in a number of eastern European countries too, for example, in Hungary, Romania and Poland, although in these three countries the threshold is slightly higher at 33 per cent.

1.3.2.5 Squeeze-out and sell-out rights

The Takeover Directive requires Member States to enact provisions enabling a bidder to squeeze out minority shareholders at a fair price once it has obtained a percentage threshold (between 90 and 95 per cent, at the discretion of the Member State) of the target's voting share capital and to provide minority shareholders with a reciprocal right upon a bidder's shareholding reaching such threshold.

In the UK, such squeeze-out rights (and reciprocal minority sell-out rights), set at a threshold of 90 per cent of the shares to which an offer relates, already applied to UK takeovers prior to implementation of the Takeover Directive. Aside from a few procedural changes, these provisions have not materially changed.

Similarly, in France the threshold remains at 95 per cent of shares and voting rights in accordance with previous practice.

Dutch corporate law already provided for a squeeze-out procedure, with a 95 per cent threshold. This was augmented by the introduction of sell-out provisions contemplated by the Takeover Directive available in the context of a successful takeover bid. The implementation of the Takeover Directive in the Netherlands did introduce the possibility of a squeeze-out procedure in relation to a separate class of shares (if applicable to the target company), thus enabling the bidder only to squeeze-out holders of a certain class of shares, rather than having to squeeze-out all shareholders.

Prior to the implementation of the Takeover Directive, Belgian law already provided that a shareholder holding 95 per cent of the voting securities of a company following a successful offer had the right, but not the obligation, to buy out the remaining minority shareholders, provided such shareholder had been able to acquire at least 66 per cent of the securities he did not hold prior to launching the offer. This procedure remained unchanged following the implementation of the Takeover Directive, with a 95 per cent threshold requirement, but the 66 per cent threshold was increased to 90 per cent. However, the

requirement that a shareholder who holds 95 per cent of the voting securities following his bid should also have acquired 90 per cent of the securities he did not hold prior to launching the bid only applies if the bid was voluntary, and not if it was mandatory. Under the new rules, it will also be possible to offer shares as consideration in a squeeze-out offer following an exchange offer. Further, the Belgian rules have been supplemented by the sell-out procedures contemplated by the Takeover Directive.

A squeeze-out procedure existed in Germany prior to the implementation of the Takeover Directive, whereby with a 95 per cent holding in a company's share capital, no matter how that holding was acquired, or whether or not the company was listed, it was possible to request the squeeze-out of the minority shareholders. Following the implementation of the Takeover Directive, additional squeeze-out provisions as well as sell-out provisions have been introduced into the German Takeover Act. The thresholds for both procedures pursuant to the German Takeover Act amount to 95 per cent of the voting rights.

For many Member States, such as Spain, Greece, Luxembourg, Slovenia, Malta and Slovakia, the introduction of the squeeze-out provisions was a major development, as their previous regimes did not contemplate such provisions at all.

1.3.2.6 Frustrating action and breakthrough provisions

The Takeover Directive contains provisions which prohibit target companies taking action without shareholder approval, which might have the effect of frustrating or hindering a bid ("frustrating-action provisions").

The Takeover Directive also includes so-called "breakthrough provisions" which require that, once a bid has been made public, any restrictions on share transfers are to be suspended during the acceptance period, and any restrictions on voting rights, or weighted voting rights, are to be disapplied with respect to the passing of shareholder resolutions relating to defensive measures proposed by the directors. Under the breakthrough provisions, a bidder who has acquired 75 per cent of a target is entitled to "breakthrough" any restrictions on the transfer of securities contained in a target's constitutional documents and to override multiple voting rights. The Takeover Directive requires that equitable compensation be paid to shareholders suffering a loss as a result of the operation of the breakthrough provisions and bidders will therefore need to assess whether this will impact on the pricing of their bid.

The 14-year battle over the Takeover Directive focused principally on the frustrating action and breakthrough provisions, and illustrated the difficulties of establishing common ground between Member States. In order to reach agreement on the Directive, a compromise was reached which allows Member States to choose to opt out of the frustrating-action provisions and breakthrough provisions. However, where a Member State opts out of either or both of these provisions, companies in that Member State may nonetheless opt back in if they obtain shareholder approval.

The Takeover Directive also contained optional "reciprocity" provisions with the effect that if Member States choose not to opt out of the frustrating-action

provisions and breakthrough provisions, they can permit companies in their jurisdiction to disapply such provisions if the bidder is not subject to the same restrictions.

This complex compromise recognises therefore that the playing fields for takeover bids in the EU may not be level. Indeed, this may lead to certain bidders being discriminated against (including non-EU bidders and private companies) which do not have the reciprocal benefit of these provisions.

The UK has opted in to the prohibition of frustrating-action provisions. This principal was already enshrined in the Code at Rule 21.

However, the UK has opted out of the breakthrough provisions, but has enacted the necessary provisions enabling companies to opt in with shareholder approval. Note that the restrictive provisions in companies' articles that the breakthrough provisions are intended to dismantle are not commonly found in UK listed companies. The UK has not opted in to the reciprocal provisions.

France has opted in to the provisions in Article 9 of the Takeover Directive on frustrating action. Under the previous regime, the Board was simply required to notify France's financial regulatory body, the Autorité des Marches Financiers ("AMF"), prior to any such action which was likely to deter an offeree from initiating any defensive action where this had not received the prior approval of the AMF.

France has not opted out of the breakthrough provisions. However, French law has been amended to mitigate the effects of existing legislation that allow the articles of association to limit the number of voting rights exercisable by a single shareholder. Such limitation is suspended at a first general meeting of shareholders that takes place following the closing of an offer where the bidder becomes holder of a stake that exceeds two-thirds of the share capital or total number of voting rights.

Germany has opted out of the frustrating-action provisions of the Takeover Directive. However, German rules already provided for extensive prohibition of frustrating action. In cases where German stock corporations do not opt in to the frustrating-action provisions of the Takeover Directive, they are nevertheless subject to frustrating-action provisions pursuant to the German Takeover Act and the German Stock Corporations Act. These frustrating-action provisions are not, however, as strict as those contained in the Takeover Directive.

Germany has also opted out of the breakthrough provisions. As required by the Takeover Directive, German companies may opt in to either the frustrating-action provisions or the breakthrough provisions, in which case they must submit their amended articles of association to the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht).

In the Netherlands, a Dutch listed company may opt to become subject to the requirement that any proposed frustrating action be approved by the shareholders in general meeting, by voluntarily incorporating this into its articles of association. Furthermore, a company may provide that transfer restrictions that may frustrate a bid will not apply to shares being offered to the bidder.

The Netherlands has also opted out of the breakthrough provisions. However, it is still possible for a Dutch listed company to opt voluntarily for the breakthrough provisions of the Directive to apply by incorporating the necessary provisions in its articles of association, although it is expected that few Dutch listed companies will opt in. For those companies that do, the ability for a major shareholder to propose and adopt resolutions will be limited to resolutions appointing and dismissing directors. Furthermore, the breakthrough provisions will not affect the so-called large company rule, which applies to a significant number of Dutch companies. Under this rule, it is the supervisory board and, to a lesser extent, the relevant works councils, rather than the shareholders that can effectively control the composition of a company's board.

Belgium opted out of both the frustrating-action provisions and the breakthrough provisions. However, Belgian companies may voluntarily opt in by amending their articles of association. If a company decides to opt in, it may do so under condition of reciprocity (i.e., the bidder must also have opted in). The reciprocity condition must also be inserted in its articles and be renewed every 18 months (otherwise it lapses and may no longer be invoked against the bidder).

1.3.2.7 Litigation

Prior to the implementation of the Takeover Directive, there were concerns that there would be an increase in the amount of tactical litigation, as often seen in the course of US takeover battles, particularly since the creation of statutory frameworks and statutory bodies to govern bids would seem to invite a more legalistic and, therefore, more litigious approach to takeovers. In practice, however, the drafting of the Directive itself, and its implementation, has meant that there has been little or no takeover-related litigation resulting from the implementation of the Directive, although this cannot be ruled out in the future.

Traditionally in the UK, the courts have been reluctant to interfere with the Panel's de facto jurisdiction over UK takeovers; indeed, in the landmark 1980s *Datafin* and *Guinness* cases, the court expressly recognised that contemporary intervention by the court in the heat of a takeover battle would be impossible or contrary to the public interest, assisting to ensure that the courts have not become involved in the conduct of takeovers, which have instead been regulated by the Takeover Panel (the "Panel"), with its flexibility and ability to move rapidly. Article 4(5) of the Takeover Directive requires that the national supervisory authorities (such as the Panel) shall be vested with all the powers necessary for the purposes of carrying out their duties, including ensuring compliance with the rules introduced pursuant to the Takeover Directive. Article 4(5), therefore, by ensuring that the national supervisory bodies are in effect self-governing and legally self-sufficient, has arguably, in the UK at least, strengthened the position of the Panel.

1.3.3 Impact of the Takeover Directive

As seen above, the Takeover Directive has led to a significant degree of harmonisation of takeover law and practice in Europe, but it does not guarantee a totally level playing field, not least because of the opt-out provisions. Further, its impact has varied considerably between Member States. Implementation of the

Takeover Directive has, for example, involved few changes of substance in UK takeover law and practice. However, the Takeover Directive has introduced certain elements that, whilst familiar to markets such as the UK, were entirely new to other countries. For example, minority squeeze-out provisions were introduced into the jurisdictions of Greece, Spain, Luxembourg, Slovenia and Slovakia for the first time, and in Poland squeeze-out has been expanded to apply to listed and unlisted companies.

1.4 Market Abuse Directive

Takeover activity has always carried with it the spectre of market abuse in its various forms, in particular, insider dealing and market manipulation. Whilst many jurisdictions have over recent decades introduced national laws to combat such practices, the Directive on Insider Dealing and Market Manipulation (known as the Market Abuse Directive or "MAD") (2003/6/EC), adopted in December 2002, sought to address these issues on an EU-wide basis.

The MAD required only minimum harmonisation of rules relating to market abuse and, in many jurisdictions, MAD-compliant rules were already in force prior to the MAD's implementation date.

Some of the most important elements of the MAD are that it:

(a) applies to all transactions concerning shares, securities or other financial instruments that are admitted to trading on at least one regulated market within the EU. Whether the transaction is actually undertaken on a regulated market is irrelevant, and the Directive will apply;
(b) established transparency standards requiring people who advise on and recommend investments to the public to disclose their relevant interests. This would cover, for example, financial analysts and journalists who recommend investments to the public;
(c) introduced an obligation to report suspicious transactions;
(d) covers both insider dealing and market manipulation to ensure that the same framework is applied to both categories of market abuse; and
(e) requires each Member State to designate a single administrative regulatory and supervisory authority, with a common set of responsibilities, to deal with insider dealing and market abuse.

The MAD introduced new measures to help detect and prevent market abuse. Such measures include the introduction of "insider lists", requiring companies which have securities admitted, or which have requested admission, to trading on a regulated market to maintain lists containing names of all persons who have access to inside information. It also introduced provisions for "suspicious transactions reporting", which require professionals engaged in arranging transactions in financial instruments to notify to the competent authority transactions where there is a reasonable suspicion that market abuse might have taken place.

In the UK, the MAD amended Part VIII of the Financial Services and Markets Act 2000 ("FSMA 2000"). The UK regime prohibits behaviour amounting to

insider dealing (including dealing with insider information and improper disclosure) and market manipulation (including disclosure of misleading information and failure to properly disclose information to the market). The regime also catches those who require or encourage others to breach the laws on market abuse and insider dealing.

Through its Code of Market Conduct, the FSA provides formal guidance on the UK market abuse regime and specifies certain types of behaviour that do not amount to market abuse, known as defences or safe harbours. In the context of takeovers, the regime allows for some forms of behaviour that may be considered to constitute market abuse to fall outside of the provisions of the FSMA 2000. For example, stakebuilding, seeking irrevocable undertakings or letters of intent should not amount to market abuse. The FSA has power either to impose unlimited financial penalties or to censure publicly a person that has engaged in market abuse, or that has required or encouraged another person to so do. The FSA can also make use of injunctions and restitution orders against any person. The market abuse regime supplements rather than replaces the criminal sanctions for market abuse and insider dealing that had previously existed under UK law.

In the Netherlands, most of the material provisions of the MAD were already enshrined in national regulation. However, the implementation of the MAD in the Netherlands also introduced new elements. These include broadening the scope of the definition of market manipulation, transferring the supervision of the publication of non-public price-sensitive information from Euronext Amsterdam to the AFM, together with provisions for suspicious transactions reporting and the obligation to ensure transparency when giving investment recommendations. The latter serves to protect investors by granting them the opportunity to verify the status and credibility of an investment recommendation.

In France, in particular, French securities regulations on insider trading have been aligned with the minimum provisions of the MAD. French law still provides for additional criminal sanctions and proceedings where the offences of disclosure of false information, market manipulation and insider trading occur, but these are applied less often than those sanctions enshrined in the MAD-compliant French securities regulation. The French securities regulator will probably continue to follow the same standards that were developed before the implementation of the MAD, meaning that it is likely that the MAD will not have a significant impact on the regulation of French securities.

In Germany, in 2005, the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht) ("BaFin") published its *Issuer Guide* (*Emittentenleitfaden*). This provided practical advice to domestic and international issuers whose securities were admitted to trading on a Stock Exchange in Germany on how to deal with the change in regulations brought about by the implementation of the MAD. Although the guide did provide guidance on the MAD and its implementing regulations, it has not yet been amended to take into consideration the implementation of the Transparency Directive (*see* 1.5 below).

1.5 Impact of the Transparency Directive

1.5.1 Background

Directive 2004/109 (the Transparency Directive) was adopted on 17 December 2004 with the aim of harmonising requirements for disclosure of information about companies whose securities are admitted to trading on regulated markets across the EU ("issuers"). The deadline for implementation of the Transparency Directive by Member States was 20 January 2007. The Transparency Directive is a minimum harmonisation directive in that it sets out minimum standards upon which Member States may impose more stringent requirements.

1.5.1.1 Relevance to EU Takeovers

The key provisions of the Transparency Directive relate to periodic financial reporting by issuers and notification of major shareholdings. It is this latter requirement that is most significant in the context of takeovers, in that it restricts the ability of potential bidders from stakebuilding in an issuer undetected.

The Transparency Directive provides that each Member State must ensure that where a shareholder acquires or disposes of shares of an issuer, to which voting rights are attached, then such shareholder must notify the issuer of the proportion of voting rights that it holds as a result of such acquisition or disposal where that proportion reaches, exceeds or falls below the thresholds of 5, 10, 15, 20, 25, 30, 50 and 75 per cent. The Transparency Directive also provides that the Member State must ensure that once the company has received such notification, it must then inform the market of such acquisition or disposal.

1.5.1.2 Impact of implementation

Prior to implementation of the Transparency Directive in the UK, statutory disclosure requirements pursuant to the Companies Act 1985 already provided that when a person acquired or disposed of an interest in shares of a public limited company (whether listed or not) that took its holding of that class of shares in such company above or below 3 per cent (and every subsequent 1 per cent above 3 per cent) of the issued shares of that class in such company, such person was obliged to notify the company of such acquisition or disposal.

These statutory provisions were repealed when the Transparency Directive was implemented on 20 January 2007. Equivalent provisions were instead included in the UK Disclosure and Transparency Rules ("DTRs"). The DTRs kept the same threshold limits of 3 per cent and every 1 per cent above that, effectively "gold plating" the requirements of the Transparency Directive. Moreover, the DTRs apply these requirements to issuers other than those listed on the London Stock Exchange's Main Market (a "regulated market"). Significantly, in contrast to the previous UK statutory regime, the DTRs calculate such thresholds by reference to interests in voting rights in the target company, and not by reference to the broader concept of an "interest in shares".

No significant change resulted from the implementation of the Transparency Directive to the French practice of disclosure arising from the building of stakes in French listed issuers. However, at the same time as the implementation of the Takeover Directive, the French Parliament was influenced by the *Danone/Pepsi*

case in the summer of 2005 to vote in March 2006 for a "put up or shut up" obligation. Under these rules, the AMF may require persons publicly to disclose their intentions within a set deadline if there are rumours and large swings or unusual trading volumes. A negative statement of intentions is binding for the following six months.

At the time of writing, the Transparency Directive had only partially been implemented in Belgium and the provisions of the Transparency Directive impacting upon disclosure of stakebuilding activity had not been brought into force. The standard notification threshold will still be set at 5 per cent or any multiple thereof. Under the current regime, the articles of association of the issuer may provide for a lower notification threshold at 3 per cent and multiples thereof (i.e., 6 per cent, 9 per cent, 12 per cent etc.). Under the new regime, the issuer may set lower thresholds of 1, 2, 3, 4 or 7.5 per cent in its articles of association. Most significantly, reaching, exceeding or falling below any such threshold will also require a notification when the change in percentage does not result from a positive action of the person who is obliged to notify (for instance, where there is a change in the securities in issue, such as a capital increase or share buy back, which would respectively entail a dilution or restoration/reinstatement of the notifying person's interest).

In Spain, the Transparency Directive was also implemented through Law 6/2007, which came into force on 13 August 2007.

The implementing legislation will require the notification by the entity holding a stake in a company whose securities are listed on the Spanish Stock Exchange of the acquisition or loss of significant stakes in capital with voting rights in the issuer's share capital or of financial instruments that provide the right to acquire such securities. This new legislation will lower the previous minimum threshold from 5 per cent to 3 per cent.

The German law implementing the Transparency Directive also sets the lowest disclosure threshold at 3 per cent of the voting rights in an issuer (as opposed to 5 per cent under the prior regime).

The Netherlands has not yet fully implemented the provisions of the Transparency Directive but has implemented those provisions relating to the notification of major shareholdings with little or no "gold plating", setting the minimum notification threshold at 5 per cent. Recently, it has been proposed by the Dutch Secretary of Finance to include a new, lower notification threshold of 3 per cent, thus forcing potential bidders to reveal their stake building in a target company even earlier.

1.6 Cross-Border Mergers Directive

The Cross-Border Mergers Directive (2005/56/EC) (the "Mergers Directive"), which was adopted on 26 October 2005 and whose purpose is to facilitate the carrying out of cross-border mergers between various types of limited liability company governed by the laws of different Member States, was to be implemented by Member States no later than 15 December 2007. A cross-border

merger for the purpose of the Mergers Directive can take one of several specified forms and where a company transfers all of its assets and liabilities to another company in exchange for shares in the transferee company or to a parent company holding all its shares, the transferor company ceases to exist. Further, the company resulting from the cross-border merger is to be subject to the employee participation rules (if any) in force in the Member State in which that company has its registered office. In many Member States, this creates a new type of statutory merger.

Although the Mergers Directive will make available to companies different potential merger routes, for companies that currently do not have employee participation arrangements in place, it is unlikely these routes will be viewed as an attractive alternative to existing takeover transaction processes. Further, regulatory authorities have had to review whether existing takeover rules apply to cross-border mergers under the Mergers Directive. For example, in the UK, the Panel issued a Practice Statement in October 2007 confirming circumstances in which certain cross-border merger transactions would be subject to the Takeover Code.

1.7 Structural barriers to takeovers

1.7.1 Examination of barriers

1.7.1.1 The responsibilities of directors

The responsibilities of the directors of a company under the laws of the jurisdiction to which it is subject vary considerably throughout Europe, reflecting the diversity of cultures and social attitudes. This, in turn, translates into significant differences in the rules governing a target board's duties following receipt of an offer.

At one extreme is the UK, where the paramount responsibility of the directors has traditionally been to the owners of the company, the shareholders. Many potential defensive techniques or actions founder on the principle that it is contrary to the interests of shareholders for the directors of a company to restrict the means of their realising value from their shares. For this reason, many takeovers which are not initially welcomed by the target's board of directors may ultimately receive their recommendation if the terms are such that it is in the interests of shareholders to accept them.

In October 2007, the relevant sections of the UK Companies Act 2006 creating new laws relating to directors' duties and codifying in statute for the first time many previous common law and equitable duties were implemented. One of the most significant changes was the introduction of an overall duty for a director to "promote the success of the company for the benefit of its members as a whole".

The new Companies Act provisions introduced a non-exhaustive list of factors to which directors must have regard when exercising their duty to promote the success of the company for the benefits of its members as a whole. These factors include, amongst other things, a duty to have regard to the:

(a) likely consequences in the long term;
(b) interest of the company employees;
(c) need to foster relationships with suppliers, customers and others; and
(d) impact of the company's operation on the community and the environment; and
(e) desirability of the company maintaining a reputation for high standards of business conduct.

However, it should be noted that the Government rejected the approach of extending directors' duties so that they are owed beyond the company and its members to third-party stakeholders.

It remains to be seen how the UK courts will interpret the new provisions, but as directors are only required to "have regard" to these factors, amongst others, it is difficult to see bids actually being frustrated by boards' compliance with these new requirements.

In many other Member States, directors and equivalent managers have long since owed duties to a wider range of stakeholders than shareholders alone. Often management may be entitled, or required, to give equal weight to the interests of employees, creditors and those of the business itself (including the continuation of the current management). For example, in the Netherlands and to a certain extent Germany, where large public companies typically have a supervisory board as well as a management board, and many of what would otherwise be shareholders' powers are vested in the supervisory board, both boards have a duty to consider the interests of the company as a whole, which comprises the interests of the employees, creditors, suppliers and customers and the public interest as well as the interests of shareholders.

In Germany, the duty of neutrality of the target management has been one of the most discussed aspects of the Takeover Act. The Takeover Act grants the management a certain amount of room for manoeuvre in terms of defending against an unwelcome offer, although shareholder approval is still needed in some circumstances depending on the nature of the frustrating action. The consent of the general meeting can be granted either after the takeover offer is launched or by way of an anticipatory resolution, which is an abstract resolution issued prior to a takeover situation authorising the management to frustrate unfriendly bids by specific measures and for a maximum time period of 18 months after the resolution.

In Italy, legislative decree number 58/98 (the *Testo Unico sulla Finanza*) and the regulations published by CONSOB (the state Stock Market Supervisory Authority) have introduced new rules in the field of directors' responsibilities. Whenever a bid is launched, the directors have to issue a statement providing relevant information, setting out their opinion and stating whether or not a general meeting will be held to consider defensive measures. At the shareholders' meeting, members representing more than 30 per cent of the share capital can authorise actions which might be considered prejudicial to the bid. Prior to the introduction of these rules, Italian boards were exclusively responsible for matters relating to the management of the company.

In Belgium, the board of directors of a target company does not have a general duty of neutrality and hence can take certain frustrating actions or preventative measures. The Takeover Directive has not required the limitations on the power of the board to frustrate or prevent a bid that existed prior to its implementation to be amended. The situation has thus remained unaltered and, as a matter of principle, the board of directors of a target company may carry out the frustrating actions or implement the preventative measures allowed to it by the target's articles of association and the Company Code. However, Belgian law offers the possibility for companies to opt in to the frustrating-action provisions (*see* 1.3.2.6 above). Following implementation of the Takeover Directive in Belgium, the process by which the target's board conveys its opinions on the bid has been amended. Under the new regime, in a first phase, the target's board must give an opinion in respect of missing elements or misleading information in the draft offer document within five business days. In a second phase, and within five business days from the receipt of the offer document as approved by the Banking Finance and Insurance Commission ("BFIC"), the target's board must provide the BFIC with a draft memorandum in reply setting out, *inter alia*, its remarks concerning the offer document, its views on the bidder's strategic plans and their impact on the target, the board's opinion on the offer, having regard to the interests of the company, all of its securities holders, its creditors and its employees.

1.7.1.2 Ownership

In many Member States, the widespread existence of cross-shareholdings, controlling family groupings and holdings by institutions with close relationships with the incumbent management have historically represented a key structural barrier impeding the achievement of a "level playing field". However, there are a number of developments which have lowered these barriers in a number of Member States.

The importance of the banks as investors in German companies is attributable to a number of factors. Post-war Germany was built on debt rather than equity financing. As a consequence, banks sought to protect their investments and had easy access to equity participation and seats on the supervisory boards. The banks were traditionally also large investors in listed companies. In their position as investor, adviser, lender and often with representation on the management and supervisory boards, the banks used to exercise considerable influence. Combined with an investment culture which looked to long-term development rather than short-term profit, this resulted in a relatively low level of market activity in Germany, particularly in relation to the size of its economy. However, recent years have seen a strong trend towards a much stronger equity culture, with many banks divesting their industrial holdings. This continuing trend, together with a considerably improved investment climate resulting from recent reforms, has led to increased takeover activity and is – despite the current credit crunch – expected to continue. This prospering market environment has, in particular, attracted financial investors to invest in the German market. However, in the months prior to the time of writing, German industrial companies had also increased their investment activities.

In an attempt to limit the constraints caused by cross-shareholdings in Italian companies, legislative decree number 58/98 (the *Testo Unico sulla Finanza*) has provided that where a cross-shareholding held by an Italian listed company exceeds 2 per cent of the share capital of another listed company (or 5 per cent if approved by both companies' shareholders in general meeting), the last shareholder purchasing the shares is prevented from exercising the voting rights which relate to the shares in excess of the threshold and must sell those shares within 12 months. This rule does not apply where the threshold is exceeded following the launch of a bid, the purpose of which is to acquire at least 60 per cent of the company's ordinary shares.

On the other hand, this barrier remains strong in a number of countries. For example, in Spain, the high percentage of shares in listed companies held by banks, institutional investors and family groups has also contributed in part to the low level of takeover activity to date. Further, in Belgium, the shareholding structure of listed companies is often characterised by the presence of one or more shareholders having either the absolute majority of the voting rights or a significant percentage of voting rights who, by effect of law or de facto, control the board of directors.

1.7.1.3 Identifying and accessing shareholders

One of the greatest obstacles to effecting a takeover is the difficulty of identifying and accessing the shareholders of the target company. Only in the UK and Sweden are quoted companies required to maintain a complete and up-to-date share register which is readily accessible to all, although in the UK the increasing use of derivatives (by hedge funds and others) to exercise de facto control over underlying shares means that the "ownership" picture can become harder to interpret during takeover situations.

In the UK, the increased significance of derivatives was recognised by the Panel and led to a series of changes being made to the Code during 2005 and 2006. In particular, Rule 8.3 of the Code, which provides for the disclosure of dealings in securities of a target by persons interested in 1 per cent or more of any class of relevant securities in a target during a takeover "offer period", was amended such that holdings and dealings in certain derivatives became captured by the definitions of interests in securities and dealings respectively. As testament perhaps to the significance of derivative dealings, according to a review by the Panel's Code Committee, the number of Rule 8.3 disclosures increased by 19.3 per cent over the period from 7 November 2005 to 31 May 2007.

With the increased use of registered shares in Germany since the Daimler–Chrysler merger in 1999, registers in Germany provide better information on the shareholder structure, though this is generally available only to the shareholders. In Member States where there is a register, to the extent that there is a register which is accessible to the public, nominee or custodian names will frequently obscure the identity of the real holders. In Germany, the share register frequently shows only a small percentage of the shareholders because many shareholders make use of nominee registrations. According to the draft Risk Limitation Act which aims, *inter alia*, at increasing transparency in relation to the true owners of registered shares, a stock corporation shall be entitled in its articles of

association to stipulate the extent to which nominees can be registered. Furthermore, the stock corporation shall be entitled to request that the registered party provides information on the persons for whom it is holding the shares. This claim to information extends over the entire chain of intermediaries through to the true owner of the shares.

The use of bearer shares, particularly common in Austria, Belgium, France and the Netherlands, makes it very difficult to access shareholders. In Italy, only the company's own shareholders have a right to examine and obtain abstracts of the share register (however, listed companies or companies which hold, directly or indirectly, an interest in a listed company are required by CONSOB to publish details of any major shareholding). In France, shareholders have access to shareholder lists (not including the names of holders of bearer shares) prior to each shareholders meeting and, at any time, to the attendance sheets for all shareholders meetings held during the last three financial years.

Whether or not shareholder identification issues are an obstacle to making an offer or a problem encountered in carrying it through will depend very much on the attitude of the target company's board. If the board is supportive of the offer, then its cooperation will assist in identifying shareholders and gaining acceptances. If, on the other hand, the board rejects the offer, it may be almost impossible to identify shareholders to seek to persuade them of the merits of the offer and put pressure on the board to recommend it.

These difficulties have been alleviated in recent decades by the Directive on disclosure of major shareholdings (88/627/EEC), and of course, more recently, by the Transparency Directive (discussed above).

1.7.1.4 Availability and reliability of information

Historically, there has been a wide disparity between Member States in the information which companies are required to publish, and in the rigour with which filing requirements are enforced.

By the turn of the twentieth century, national accounting requirements based on the Fourth and Seventh Directives were seen increasingly as a barrier to EU companies' attempts to access global capital markets. In 2002, the Commission passed the EC Regulation on the application of international accounting standards (EC/1606/2002) which came into force on 12 September 2002 and changed the landscape of financial reporting in the EU by requiring that publicly listed companies governed by the law of an EU Member State must, with certain exceptions, prepare their consolidated financial statements in conformity with International Financial Reporting Standards ("IFRS"). The introduction of IFRS marked a significant development towards harmonising financial reporting across the EU.

1.8 Conclusion

After the lull in takeover activity at the turn of the century, following the burst of the "tech bubble", the last few years have proved an exciting time for European takeovers, with a significant increase in activity leading to some

high-profile and ground-breaking bids, and the emergence or increased aggressiveness of new, or less traditional, players, such as sovereign wealth funds, hedge funds and investors from the Gulf States and Asia. Similarly, private equity, which has been making major incursions into the takeover arena over recent years, has become a truly mainstream takeover participant. At the time of writing, however, these developments were inevitably overshadowed by the ongoing credit crunch and market volatility, and it is impossible to predict what the long-term effects of this crisis will be.

The years since the turn of the century have also proved significant from a legal perspective, with the implementation across most of the EU of the Takeovers Directive, the Transparency Directive and the MAD. Whilst these changes have meant relatively little change for certain jurisdictions such as the UK, they have necessitated significant overhauls of various other Member States' regulatory regimes, particularly those of the central and eastern European accession states.