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EU Law and the Harmonization of Takeovers in the Internal Market

by
Thomas Gr. Papadopoulos

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EUROPEAN MONOGRAPHS

Editor-in-chief Professor David O'Keeffe

In this series *European Monographs* this book *EU Law and the Harmonization of Takeovers in the Internal Market* is the seventy-first title. *The titles published in this series are listed at the end of this volume.*

Speech by Jacques Delors

(Luxembourg, 9 September 1985)*

The large market is not just for European businessmen; it is to serve the people too. And this raises extremely thorny problems, particularly on security and health protection grounds. We have to harmonize the rules because there can be no internal market with a reasonable degree of competition unless at least a few of them and hence to some extent business costs as well have been brought into line.

* On 9 Sep. 1985, President of the European Commission Jacques Delors delivers a speech at the first Intergovernmental Conference (IGC) to be held in Luxembourg.
Source: Speech by Jacques Delors, in Bulletin of the European Communities. September 1985, No 9, pp. 7–10.

About the Author

Thomas Papadopoulos is a visiting researcher at Harvard Law School. He received his DPhil in Law (PhD in Law) from the Faculty of Law, University of Oxford. He received a degree of Magister Juris(MJur/LLM) and a degree of MPhil in Law from the Faculty of Law, University of Oxford. He also received his LLB with Distinction (ranked 1st) from the Department of Law, Aristotle University of Thessaloniki, Greece. He is an alumnus of the Anatolia American College of Thessaloniki, Greece. Furthermore, he is Attorney at law (Greece), North Atlantic Treaty Organization (NATO) Scholar and Scholar of the A.G. Leventis Foundation, Paris. He is a part-time law lecturer at the Law School, University of Buckingham and a law tutor at the Oxford University Programme for Undergraduate Studies(OPUS), University of Oxford, UK. Additionally, he was Academic Student Coordinator of the Financial Law Discussion Group, Faculty of Law, University of Oxford. Moreover, he is a contributor to 'Law of the European Union' edited by D. Vaughan, A. Robertson, P. Eleftheriadis and published by Oxford University Press (2008). He participated in workshops of the Technical Assistance and Information Exchange instrument (TAIEX) managed by the Directorate-General Enlargement of the European Commission. E-mail: thomas.papadopoulos@yahoo.com or thomas.papadopoulos@bnc.oxon.org.

Foreword by Derrick Wyatt

Corporate takeovers can have profound effects on the interests of shareholders, and employees, as well as on society at large. Particularly when they are contested, takeovers can provoke vigorous debate in the financial press, and attract the critical attention of national governments. The phenomenon of the corporate takeover has long been the subject matter of a prolific literature examining its implications from the financial, economic, social and legal perspectives. This book makes a new and distinct contribution to the legal literature on takeovers, since it places the EU Takeover Bid Directive in the context of the EU company law harmonization programme, and of the fundamental freedom of corporate bodies under EU law to establish themselves in other Member States. The book examines the freedom of establishment of companies, and explains how it is this freedom which provides the rationale and framework for the EU company law harmonization programme, as well as providing the specific logic underpinning the Takeover Bid Directive. The author offers a clear and readable explanation of the relationship between freedom of establishment and takeover bids, and devotes a chapter to the significance of the corporate mobility case law of the Court for the takeover process. The regulation of takeovers is then discussed in the context of the relationship between company law and capital markets law. One of the most impressive chapters in the book comprises an overview of the Takeover Bid Directive in the context of the EU internal market, which includes examination of provisions of the Directive which deal with mandatory bids, board neutrality, and breakthrough, as well as the controversial rules on reciprocity which allow companies which apply the board neutrality and breakthrough rules to opt out if they are the target of a bidder that does not apply the same takeover provisions. As well as analysing the Takeover Bid Directive, the author examines in light of recent case law the potential horizontal effect of EU Treaty provisions on freedom of establishment and the free movement of capital. Thoughtful and provocative questions are raised as to the extent to which the

Foreword by Derrick Wyatt

corporate constitution and the conduct of the board in a takeover situation might in themselves constitute restrictions on the freedom of establishment (and of capital movement) of a bidder. It was a very great pleasure to supervise the thesis which has provided the basis for this monograph, and I recommend it without hesitation to the reader as a valuable and original contribution to legal literature.

Professor Derrick Wyatt QC
May 2010

Foreword by Mads Andenas and Philip R Wood

Thomas Papadopoulos has written an important book about the Takeover Directive. His conclusion is that the Directive will have a more limited impact than originally intended but that this impact may yet be important to the development of the law of the Internal Market relating to companies and capital.

Takeover Directive not only spent some thirty years in gestation but went through much false labour. It started out as a proposal by Professor Robert Pennington, mainly codifying the City Code on Take Overs and Mergers in the form of an EU Directive. EU regulation of take overs seemed a wholly reasonable ambition. If all the Member States established different forms of national take-over regulation, that could create restrictions to an Internal Financial Market. But the Germans feared that a European market in corporate take overs would threaten both their employee representation and *Konzernrecht* or group law. The Swedes started to fear that fair take over rules would challenge the dominating position of the Wallenbergs in Swedish industry and finance. In the UK, it was the City Panel on Take Overs that opposed the Directive. This seemed to be a paradox, as the Directive would codify the City Code on Take Overs and Mergers. But the Panel and the Code had no direct statutory basis, and the Panel wished to defend its 'self-regulatory' status. An intermediate stage was to herald a new version of the Directive as a 'framework directive'. Then a few UK companies, including the Daily Mail Group as controlled by Viscount Rothermere, joined in the opposition as the proposed break through rule could weaken the family's hold over the company where they sat on voting stock and the majority of the share capital was issued as non-voting stock. In the end national regulators in some countries wanted to keep national jurisdiction and got a form of host country control in through some rather unclear jurisdictional rules, with various opt-in and opt-out regimes.

Each new round resulted in a watering down of the provisions and the scope of the Directive. It did not become shorter, more concise or clearer.

There is much work to be done in sorting out the problems that the legislative process has accumulated in this way. The European Court of Justice has an important role here. The Commission will certainly propose amending directives. Scholarship can assist courts and the Commission. This book will do so, and it will also be of practical use for lawyers who have to advise on the law under the Directive.

The main text of this book has fifteen chapters which broadly fall into three broad sections. The first places the Takeover Directive in the context of the harmonization objectives of EU law. The second reviews specific articles of the Directive, and the third is mainly concerned with the direct effect of the fundamental freedoms and the Directive in EU law, followed by a conclusion. It follows that the book properly places the Directive in the much wider setting of EU law and shows a fine understanding of this wider perspective.

The first part deals principally with the intersection between EU law and the Takeover Directive. There is a concisely written overarching review of the four fundamental freedoms of the EU internal market as the cornerstone concepts and a sound discussion of discriminatory and non-discriminatory restrictions with pertinent case law, followed by chapters on the legal basis for harmonization (a chapter which convincingly demonstrates the importance of company law and securities regulation in the achievement of the internal market), on the various degrees of harmonization and the obstacles to freedom of establishment, on the scope of the Financial Services Action Plan for a single financial market, on subsidiarity issues in Article 5 of the EC Treaty, on the weaknesses and defects in the harmonization efforts and on the barriers to market integration. This latter chapter contains a well-debated argument explaining the importance of the market for corporate control as an indispensable element of the internal market. There is in this section a comprehensive review of the relevant case law.

A chapter focuses on the Takeover Directive as a company law instrument with strong links to capital markets law and shows deftly how the market for corporate control is a part of regulated capital markets. The section concludes with the essential definitions of the market of corporate control showing a good grasp of the tensions which arise.

In our view this section shows a most commendable understanding of the broader issues and the essential themes at this level and goes through the arguments and the principles with great perspicacity and attention to both policy and legal detail.

The next chapter considers certain specific articles on the Takeover Directive. Dr Papadopoulos reviews the provision in Article 5 as to mandatory bids and exposes the drawbacks and deficiencies of the provision, especially areas of vagueness. There is a perceptive discussion of the squeeze-out and sell-out rights in Articles 15 and 16 with well-supported criticism in relation to circumvention techniques. The author then discusses the non-frustration rule in Article 9, the breakthrough rule in Article 11 and the reciprocity rule in Article 12.

In cogent paragraphs Dr Papadopoulos criticizes the various opt-in and opt-out regimes in relation to these rules and convincingly argues why they detract from the objectives of a harmonized regime and lead instead to legal diversity and lack of uniformity in essential aspects. At the same time he reviews why these articles proved so troublesome by reason of differing philosophies about corporate takeovers in the EU which effectively prevent a level-playing field. The section concludes with a well-written and succinct discussion of the supervisory authority and applicable law, the information for and consultation of employees' representatives and the transposition of the Directive.

In our view this chapter reveals a scholarly and incisive approach to the objectives and deficiencies of the particular articles examined and how they might work in practice.

The final section covers mainly the direct effect of the fundamental freedoms in EU law and reviews the extent to which conduct of the board and the articles in the corporate constitution might be said to constitute restrictions on the freedom of establishment and the free movement of capital. Dr Papadopoulos discusses the distinction between vertical and horizontal direct effect and demonstrates the resulting legal position by ample reference to leading EU case law.

In his conclusion Dr Papadopoulos cites the remark of the former Commissioner F. Bolkenstein that the Takeover Directive is not worth the paper it is written on. He cogently summarizes the opposing arguments that on the one hand the aim was to consolidate not only financial markets but also to achieve integration of EU industry and to boost competition, while, on the other hand, the arguments in favour of regulatory competition and diversity. He views the opt-in opt-out regime as a blow to the efficacy of the Directive and to a harmonized market in corporate control.

Dr Papadopoulos nuanced conclusion is that the Directive in its current form is not capable of altering decisively cultural or institutional objections to the creation of a single market but that it can contribute to a movement in this direction so that, despite its imperfections, it is not completely not worth the paper it is written on.

In our view the book as a whole shows great strengths in percipient legal analysis and is eloquent in marshalling the points. It shows a scholarly attention to the jurisprudence and the theoretical side of the topic, as well as a mastery of the practical implications. Dr Papadopoulos is as much aware of the policies as the fineness of legal detail and intricate interpretation.

The arguments are presented in a well-organized and thoughtful manner. The text is well-backed up by careful analysis of the case law and by relevant citation from the literature. Throughout there is a high standard of legal intelligence and intellect. There is a first-class bibliography which cites just under 170 books and over 380 articles – a comprehensive and useful list of the leading works on the subject.

In our view the book is an original contribution to knowledge. As the examiners for the University of Oxford D.Phil., we were satisfied that the thesis fully met the standards and criteria required for the degree. We had no reservations nor did we note any corrections which we thought should be made. We were therefore

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glad to recommend that the degree of DPhil be conferred on this candidate, as the University subsequently did. It is only left to us to congratulate Dr Papadopoulos and his supervisor, Professor Derrick Wyatt, QC, on the publication of the dissertation in this book.

Prof. Mads Andenas and Prof. Philip R Wood, QC (Hon.)
July 2010

Acknowledgements

This monograph derives from my doctoral thesis (DPhil in Law) which was written during my time as a member of the Faculty of Law and of Merton College, University of Oxford, UK between 2007 and 2009. I transformed my doctoral thesis into a book while I was a visiting researcher at Harvard Law School, USA. This monograph analyses the Takeover Bid Directive in the light of EU Law, and examines the extent to which this Directive facilitates the exercise of the fundamental freedom of establishment and the free movement of capital in the internal market. Other monographs and articles on the Takeover Bid Directive and on the regulation of takeovers in Europe tend to favour different approaches. For example, they follow a comparative perspective (e.g., comparisons between the EU and the US, or among the different Member States of the EU), a law and economics perspective, an environmental/sustainable development perspective, etc. My monograph follows an EU Law approach – although, of course, when necessary company law, capital markets law and financial law considerations are taken into account.

I would like to acknowledge the gratitude that I owe to all those who helped and supported me directly or indirectly during the conduct of this research. I would like to thank my father, Grigorios, my mother, Evdokia, my grandmother, Vivi, and the rest of my family, without whose love and support this doctoral thesis would not have been possible. I would also like to thank my supervisor, Professor Derrick Wyatt, QC, for his patience and for his encouragement during the supervision of my thesis. I would also like to thank my DPhil examiners, Prof. Mads Andenas and Prof. Philip Wood, QC. Moreover, I would like to thank Dr Pavlos Eleftheriadis for his interest in my research and for his moral support.

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Access to libraries with up-to-date collections and to online legal databases is crucial for legal research. The Bodleian Law Library of the University of Oxford as well as the Harvard Law School library constituted perfect environments for legal research, and facilitated my work by offering easy access to bibliography.

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Preamble

This book analyses the Takeover Bid Directive in the light of EU Law, and examines the extent to which this Directive facilitates the exercise of the fundamental freedom of establishment and the free movement of capital in the internal market. Takeover bids are very important for the internal market, because they contribute to market integration and to business consolidation. According to the Directive's Preamble, it is necessary to protect the interests of the holders of securities of companies (in particular, those with minority holdings). This is in order to create EU-wide clarity and transparency in respect of legal issues to be settled in the event of takeover bids and to prevent patterns of corporate restructuring within the European Union from being distorted by arbitrary differences in governance and management cultures.

At the beginning of this book, there is an analysis of the fundamental freedom of establishment of companies, as well as of the legal bases for the harmonization of company law and capital markets law at EU level. Some other aspects of EU company law harmonization, as well as the permissible limits of harmonization (subsidiarity issues), are discussed. These initial discussions will assist the reader in approaching the Takeover Bid Directive in its EU law context, and in understanding

the wider EU legal framework surrounding the harmonization of takeovers in the internal market.

Since the Directive is based on the EC Treaty chapter on freedom of establishment (Articles 43 and 44(2)(g) EC Treaty), it should, in principle, contribute to cross-frontier corporate mobility in the internal market through takeover bids. This was certainly the aim of the Commission in its various proposals. Takeover bids and the EC Treaty provisions on freedom of establishment are closely related. Additionally, the significance of corporate mobility and of the freedom of establishment case law of the European Court of Justice for the takeover process is analysed. The Directive forms part of the EU company law harmonization programme, whose weaknesses and limits are also explored. However, the Takeover Bid Directive is an EU company law instrument with strong links to EU capital market law. The initial aims of the EU legislature were to establish an internal market for companies and to achieve market integration in the field of EU company law. However, the Takeover Bid Directive is a compromise and watered down version of a proposal which the Commission envisaged would lead to a more effective pan-European takeover regime than that which actually proved possible. The need for compromise was the result of the very different legal and policy approaches of the Member States in the field of takeover regulation. Some provisions of the Directive are obligatory for all Member States. These provisions include the mandatory bid rule, the squeeze-out right, and the sell-out right. All these obligatory provisions of the Directive are, in their present form, liable to some criticism.

The two key provisions of the Directive have been made optional for Member States. These are the non-frustration rule, which requires the board to obtain the prior authorization of the general meeting of shareholders before taking any action that could result in the frustration of the bid; and the breakthrough rule, requiring that any restrictions on the transfer of securities or voting rights provided for in the articles of association of the offeree company or in contractual agreements between the offeree company and the holders of its securities or in contractual agreements between holders of the offeree company's securities shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid. Nevertheless, those Member States that opt out are obliged to allow individual companies to opt in. Moreover, a reciprocity rule was also adopted, which allows Member States to permit those companies that do apply these provisions to opt out again if they are the target of a bidder that does not itself apply the same takeover provisions. Additionally, the non-frustration and breakthrough rules are not fully comprehensive, and, even when a company applies them, it is still possible to evade their application, since some corporate and financial structures remain outside the Directive's scope.

Finally, this monograph discusses the extent to which obstacles to cross-border takeovers addressed by the Directive, or indeed left intact by the Directive, are to be regarded as restrictions on the right of establishment *stricto sensu*, or simply as obstacles in practice to making a successful takeover bid. More specifically, it scrutinizes the horizontal direct effect of the EC fundamental freedoms