Crack the OOC-Code!

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The European Takeover Directive should have been transposed into national legislation ultimately on 20 May. However, a large majority of EU Member States – *i.e.* 20 out of 25 – did not meet this deadline. Furthermore, it is expected that eventually in many countries anti-defensive elements of the Directive will not be mandatorily imposed. So what does the Directive add to the further development of European company law?

To refresh the readers' minds let me first set out the main features of the Directive. The Directive provides that the party acquiring control of a listed company as a result of a shareholding, must make a bid on the remaining issued shares. This *mandatory bid* aims to protect the minority shareholders. Furthermore, the Directive provides that the annual report is to contain detailed information as to the existence of restrictions on takeover and defensive measures. In addition, the Directive prohibits the target company's board from taking defensive measures as long as the general meeting of shareholders ("GM") has not been able to express its opinion on the bid: the so-called *anti-frustration rule*. During such GM all restrictions on voting rights are lifted and shareholders will vote based on the principle of one-share-one-vote: *the breakthrough provision*. This breakthrough rule also applies in the event of a vote on amendment of the articles of association and appointment or dismissal of directors or supervisory directors, as soon as anyone has acquired at least 75 per cent of the voting rights. The breakthrough provision and the ban on frustration are, however, only optional elements of the Takeover Directive. This means that although Member States are obliged to include these elements in their national legislation, they may – but they need not – impose them on listed companies in their jurisdiction as mandatory provisions. If a country chooses not to do so, consequently listed companies will be free to include these elements in their articles of association or not.

Now what is the current situation in the EU's "big three"?[1] Of course the UK already has a long-standing experience with anti-takeover practice based on the self-regulatory system of the City Code and the Panel on Takeovers and Mergers, similar to the anti-frustration rule of Article 9 of the Directive. However, the UK legislator has decided, as part of the Company Law Reform Bill, not to impose the breakthrough rules of Article 11, but to leave this to the listed companies' own discretion. The Bill is still underway in Parliament.[2] The attitude of the French Government towards the Directive has been a rather flexible one. It has imposed the anti-frustration rule of Article 9 and the breakthrough rule of Article 11, Section 4, of the Directive. However, the breakthrough rule of Article 11, Section 2, is left optional. Moreover, it has extended the reciprocity rule of Article 12, Section 3, to the situation where a French target company is attacked by a company whose management itself is not restricted by a neutrality rule such as laid down in Article 9. On top of that the French law introduces a new defensive measure based on the idea of "Economic Patriotism." The French law is effective as from 31 March this year.[3] Since the optional character of the anti-frustration rule and the breakthrough provision in the Directive is the result of a German initiative in the European Parliament, it is highly unlikely that Germany will not fully apply these opt-out facilities.[4] Germany introduced the mandatory bid in 2001 and will now have to adapt its law to the Takeover Directive. A government proposal of February 2006 is currently being debated in Parliament.[5] It follows the anti-frustration rule but will allow German companies to opt out. The breakthrough provision will be optional, too.

Does this overview prove that – quoting former EU Commissioner Mr. Frits Bolkestein – the Directive is not worth the paper it's written on? I do not agree. In my opinion the Directive may already have a major impact on takeover practice in Europe. I will illustrate this thesis by referring to the situation in my own country, the Netherlands.

It is expected that the Netherlands will mandatorily impose neither the ban on frustration nor the breakthrough provisions of the Directive. Although the current draft law does contain a provision that would overrule known Dutch defensive constructions, such as the issue of depositary receipts for shares and priority shares, this provision is not likely to be implemented given the opposition rising against it. Thus, listed companies in

1 This editorial was written on 8 June 2006.
2 *Cf.* John Birds, Country Status Report from the United Kingdom, *ECL* 2006/2, p. 48 and *ECL* 2006/3, p. 153.
3 *Cf.* Michel Menjucq's Country Status Report from France in this issue of *ECL*.
4 *Cf.* Peter Verannemann and Kerstin Grupp, Country Status Report from Germany, *ECL* 04/1, p. 16.
5 *See* the comments on the draft by DeutscherAnwaltVerein, published in Neue Zeitschrift für Gesellschaftsrecht (NZG) 2006, p. 177.

the Netherlands will be free to be more or less open to hostile takeover bids.

Is this very helpful? Perhaps to a certain extent it is. From a defensive point of view there may be a category of "open" and a category of "closed" listed companies. In the terminology of the Directive: there will be Opted In Companies (OICs) and Opted Out Companies (OOCs). The OIC or OOC-status may, as I stated earlier,[6] subsequently lead to a certain ranking on the securities market, similar to the degree of creditworthiness. But there is more. Article 10 of the Directive requires the board not only to provide an insight into, but also an explanation of, the existing restrictions on takeover and defensive measures. An explanatory report is to be submitted to the GM on an annual basis. This means that each year a company's OOC-status, if applicable, will be open to discussion and will have to be explained and justified by the board. After all, corporate governance is irreconcilable with a permanently closed corporate structure directed against hostile takeover bids. This is confirmed not only by the Dutch Code on Corporate Governance, but also by case law of the Enterprise Section of the Amsterdam Court of Appeals and the Netherlands Supreme Court.[7] This is also the spirit of the Takeover Directive; *see* the General Principles it is based on, as laid down in Article 3. Hence, *the OIC-status is the rule, the OOC-status is the exception!* In other words, if a Dutch listed company continues its OOC-status year after year, perhaps supported by a – qualified – shareholders' majority, the minority shareholders may object by means of the right to institute inquiry proceedings if they feel that the explanation of the board is insufficient.[8] This seems to mark a new task for the Dutch Association of Stockholders (*VEB*) and the Enterprise Section of the Amsterdam Court of Appeals.

A problem in legal practice is, however, that the right to institute an inquiry currently does not provide for imposing, by way of a provision, – permanent – measures under the articles of association, such as the ban on frustration or the breakthrough provision. Thereto the right to institute an inquiry should be adjusted. However, the mere awarding of an inquiry will probably suffice in certain events to change the board's mind. Moreover, a minority shareholder may at all times request the Enterprise Section to impose preliminary relief, *e.g.* by ordering the board in the short term to submit proposals to lift the OOC-status.

In other Member States, too, investors may try to "crack a company's OOC-code" and enforce its OIC-status in court along the appropriate national legal lines. The Takeover Directive, in particular the General Principles it is based on, may work as a sort of crowbar to remove unjustified defensive constructions, irrespective of the way in which it is implemented into national legislation and without prejudice to its largely optional nature. Thus, European legislation will be harmonized from the bottom up. This illustrates the autonomous development of European company law. To further this development *ECL's* editorial board invites readers to send in articles on how to crack the OOC-code of companies listed in their own jurisdiction according to national law. The author of the best contribution will be awarded a full year's free subscription to *ECL*, plus free entrance to the second CECL conference on European company Law in Utrecht next year (*see* announcements at www.CECL.nl), and a two days' stay in that wonderful city.

6 Analysis and Consequences of the Directive on Takeover Bids, *ECL* 2004/1, p. 5.

7 Dutch Supreme Court, 18 April 2003, *NJ* 2003, 286 (Rodamco North America).

8 On the merits of the relevant Dutch inquiry proceedings *see* Mieke M. Tuijtel, The Dutch Inquiry Proceedings: A Unique Instrument for Minority Protection from a Company Law Perspective, *ECL* 2005/3, p. 90.