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Inside The European Debate On Takeover Regulation

Law360, New York (April 04, 2012, 7:29 PM ET) -- The U.K. has the most mature and active market for corporate control in Europe. This is in large part due to the fact that the number and size of companies which have primary listings in London dwarf (and historically has dwarfed) that of any other exchange in Europe.

It is therefore not surprising that European takeover principles embodied in the EU Takeovers Directive are founded upon the basic principles that have underpinned the regulation of more than 9,000 bids in the U.K. since 1968, and that European regulators have looked to London when formulating and applying their own bid rules adopted to implement the EU Takeovers Directive. Therefore, changes to the U.K. Takeover Code (the U.K. Code) usually have ripple effects across continental Europe.

Sept. 19, 2011, was the day the U.K. M&A market finally ended the introspection occasioned by the Cadbury/Kraft transaction and began to adjust to a number of amendments to the U.K. Code designed to redress the perceived tactical imbalance favoring bidders. Europe, in the meantime, continued to consider a number of regulatory initiatives, driven by an economic and political storm engulfing much of Europe that is shaking the very foundations of the European Union itself.

As eurozone politicians are attempting to avert a financial and credit crunch that could break up the euro and, as a result, set European convergence back by decades, the U.K. is concerned with maintaining control over the regulatory framework that has made London the financial heart of Europe and one of the principal financial centers worldwide.

These powerful dynamics now drive a debate on legal and regulatory issues, the outcome of which (possibly in 2012) likely will give direction to Europe’s regulatory development — including with respect to M&A — for many years to come.

2011: The Cadbury Catharsis — Important Changes to the U.K. Takeover Landscape

On Sept. 19, 2011, after 18 months of debate triggered by Kraft’s bid for Cadbury, the much-anticipated amendments to the U.K. Code, designed to redress the perceived tactical imbalance favoring bidders, came into effect. Those changes, which will be reviewed following their first year of operation, included:

- Identifying, except in limited circumstances, potential bidders in target announcements initiating offer periods and setting a default 28-day bid deadline;
- Banning, except in limited circumstances, deal protections, thus eliminating a number of contractual protections familiar to bidders, such as breakup fees, as well as information and matching rights;
- Displaying financing documents in unredacted form when a firm offer announcement is made (as opposed to when an offer document is posted, up to 28 days later) and

requiring a more detailed description of the financing arrangements in the offer document;
- Requiring bidders and targets to disclose an aggregate estimate of advisers' fees by category, and obligating the bidder to disclose an estimate of financing fees;
- Forcing cash bidders to disclose the same financial information as paper bidders;
- Obligating bidders to provide statements of intention regarding the target (or confirm the absence of such intentions) and adhere to all such statements (positive or negative) for a period of 12 months; and
- Proposing a number of changes to strengthen the ability of employee representatives to provide their opinion on the deal.

U.K. market practice already is responding to these changes to the regulatory landscape. As a principles-based system, it will be important to see how the U.K. Takeover Panel (the Panel) applies the new rules to particular deals. Only then will we know whether the intended shift in the balance of power away from hostile bidders and toward target boards is an effective and proportionate response to concerns raised following Kraft's bid for Cadbury, or whether the changes have gone too far and inhibit deal activity in the United Kingdom.

Three trends are discernible based on the limited data points since the changes took effect. The first is that a significant number of bids are being extended beyond the initial 28-day period, often on more than one occasion, but always by an additional 28-day period. Bidders that engage with the target board therefore are able to relieve the up-front timing pressure. Indeed, in one case a bidder has agreed to pay a reverse breakup fee if it does not make a bid by the end of March 2012, and the target has publicly announced its intention to seek extensions to the 28-day deadline.

We expect that the obligation to pay that reverse breakup fee is conditioned upon such extensions being agreed upon, which, because it does not create an obligation on the target, should not amount to a banned contractual deal protection. In effect, the U.K. Code has been used as a proxy for the contractual undertaking the target may have given previously, since the Panel will expect the target to be bound by its own public statements.

Second, a significant number of targets that announce formal sales processes are in severe financial difficulty; and, notwithstanding that the target could have agreed to a breakup fee and possibly other deal protections to the successful participant in the process (because, as an exception to the general rule, certain deal protection measures are allowed if they apply to the prevailing bid in a formal auction process), this does not appear to be happening. Instead, a number of these companies are being put into administration, and their assets and businesses are being sold by the administrator in so-called "prepack" deals.

Third, where multiple competing bidders are announced on different days, target boards are generally taking the view that their different PUSU deadlines should be conformed.

U.K. Code as Forerunner — The Dutch and Swedish Examples

The U.K. Code principles, which were adopted by the EU Takeovers Directive, have in large part shaped regulation of public M&A in Europe, and European regulators continue to look to London when formulating and applying their own bid rules. The Netherlands, for example, has proposed to make amendments to Dutch Act on Financial Supervision and the Dutch Takeover Decree (collectively, the Dutch Bid Rules), some of which reflect the U.K. Code prior to the most recent changes.

Among the changes to the Dutch Bid Rules, a "put-up-or-shut-up" (PUSU) rule is being proposed, modeled on the U.K. Code rule first publicly articulated by the Panel in 1991. Even before then, the Panel allowed a target to request the Panel to set a date (usually six weeks hence) by which a possible bidder must either bid or walk away, in order to give effect to the general principle that target companies should not be subjected to an unnecessarily long period of siege and uncertainty. If the Dutch Bid Rules are implemented as currently proposed, Dutch targets will be able to request that the Dutch Authority for Financial Markets (AFM) set a PUSU deadline mandating a bid or no-intention-to-bid statement within six weeks.

Time will tell whether at some point in the future the AFM will reach the conclusion, as the Panel did, that it is a "difficult and contentious" decision for a target board to request a PUSU deadline, and as a result, a 28-day deadline should apply as a default from the public identification of a possible bidder.

In Sweden, the Corporate Governance Board proposes to revise the takeover rules, among other things, to prohibit targets from agreeing to deal protection measures except where there are “special circumstances” and to allow targets to seek a PUSU even where a leak has not occurred, recognizing that the targets suffer an element of siege even before deals are publicly announced. This concept of a “private PUSU” was considered during the review of the U.K. Code but not adopted.

It would not be surprising if other member states amend their rules in ways that reflect the changes to the U.K. Code.

Continental European Trends

In April 2004, the EU Takeovers Directive was adopted as one of the key items of the EU Financial Services Action Plan. Approval by the member states was only achieved following rejection by the European Parliament of previous versions of the EU Takeovers Directive (for various reasons, including that it failed to level the playing field with U.S. companies) and the application of the "reciprocity" principle (the Portuguese compromise) to the board neutrality and breakthrough rules, which broadly prohibit a target from taking frustrating action before or during a bid.

The EU Takeovers Directive was controversial at the time it was adopted, and therefore member states included an "escape hatch" in the form of a five-year review requirement.

However, the EU Takeovers Directive’s principles now have become a cornerstone of public M&A in continental Europe and are there to stay. A new European regulator has been created — the European Securities Market Association (ESMA) — with ostensible authority over the EU Takeovers Directive.

Review of the EU Takeovers Directive currently is underway, and it is not possible to predict what changes may be contemplated. However, it seems that the basic structure and compromises agreed upon in 2004, are unlikely to be changed significantly. That said, it will be interesting to see how much, if any, of the recent changes to the U.K. Code will be considered in the review of the EU Takeovers Directive (in particular, those that were based on European concepts).

The EU Takeovers Directive should not be seen in isolation, but rather as a harbinger of change in the broader sphere of European company law and a significant step toward regulatory conversion. In this regard, the proliferation of EU corporate law since the adoption of the EU Takeovers Directive and the number of current proposals for new laws must be considered. A discussion of all current proposals is beyond the scope of this article, but these include:

- The EU Green Paper on Corporate Governance. Corporate governance underpins takeover regulation, and the development of this debate, spurred by the perceived failings of financial institutions in the most recent crisis, will be important.

- Proposed Amendments to the Transparency Directive. Some proposals, such as those requiring disclosure of certain cash-settled derivatives in the target's stock, may be welcomed; they essentially catch up with U.K. requirements that have applied since 2006 and the German requirements that will be in force from Feb. 1, 2012. However, the "maximum harmonization" approach taken to the notification of interests in voting shares, which would limit the ability of member states to impose more onerous requirements than those set out in the EU Takeovers Directive ("gold-plating"), would not be welcomed, as they would reduce the amount of information required to be disclosed outside a bid situation in the U.K. and reduce the quality of disclosure during the course of a bid regulated by the U.K. Code.

- Short Selling Regulation. Though bans on covered short selling in France and Belgium were lifted this year, the belief held by European regulators and politicians that they are facing a single combatant called "The Bond Market," rather than a multitude of individuals making trading decisions on the basis of credit analyses, appears to persist. Indeed, the EU has published its Short Selling Regulation, which comes into effect on Nov. 1, 2012, although there are important transitional provisions for short positions and sovereign CDS positions entered into before March 25 and between March 25 and Nov. 1. ESMA has recently submitted draft technical standards to the European Commission which the commission has 3 months to decide whether to adopt. The Short Selling Regulation gives ESMA the power to conduct inquiries into issues or practices relating to short selling and credit default swaps. The extent to which the EU seeks to regulate the financial markets in this, and other areas (such as hedge funds), is of great concern to the U.K., and it would not be surprising if the U.K. government continues to attempt to put a brake on certain European initiatives in this area, as evidenced by David Cameron's veto EU Treaty changes in December 2011.

European Currency

If the European project is able to weather the storm, we expect to see a continued, and accelerated, expansion of EU law and regulation designed to drive European integration toward a single market. This likely will have a significant effect on mergers and acquisitions, as well corporate law more generally, and financial regulation in EU member states. An important determinant of the shape of that structure will be the role the U.K. plays in its development, and the extent to which U.K. ideas and perspectives maintain their currency in the eyes of continental European constituencies.

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[1] For a more detailed discussion of the UK Code amendments, see Skadden's Insights discussions on "UK Takeover Code — Changes Effective September 19, 2011" (Sept. 21, 2011), available at skadden.com/newsletters/UK_Takeover_Code_Changes_Effective_September_19_2011.pdf and "Backing the Target Board: Proposed Changes to Rebalance UK Takeover" (June 21, 2011), available at skadden.com/newsletters/Backing_the_Target_Board_Proposed_Changes_to_Rebalance_UK