"Protection" or "Frustration"? The Treatment of Takeover Defenses under the Local Laws of EU Nations

Article contributed by:
Selina S. Sagayam, Gibson, Dunn & Crutcher LLP

The battle for ABN Amro is seemingly drawing to a close, but not without a few more twists and turns and an ever-growing list of topics for discussion for both academics and practitioners to mull over in years to come — from politics in the Dutch courts, to the erosion of stakeholder values in Europe to the threat (or opportunity) presented by "SWFs" (or "sovereign wealth funds" as the mega foreign government funds have come to be known in more genteel circles).

In an impressive act of judicial efficiency, the Hoge Raad (the Supreme Court of the Netherlands) delivered its judgment on the appeals of ABN Amro, Bank of America and Barclays against the interim injunction granted by the Enterprise Chamber of the Amsterdam Court of Appeals. The interim injunction prevented ABN Amro from disposing of its US-based LaSalle banking network without ABN Amro shareholder approval. The Supreme Court delivered its judgment earlier than expected. This was in part spurred on by the urgency to manage the markets in light of the uncertainty surrounding the bids by Barclays and the RBS/Banco Santander/Fortis consortium (Consortium) and exacerbated by waves of actual and threatened litigation, not just in The Netherlands but also across the Atlantic, and in part aided by the analysis and reasoning set out in the "recommendations" of the Attorney-General to the Supreme Court.

The Supreme Court expressly ruled that the legal commitment by ABN Amro to sell its LaSalle banking business to Bank of America was not an unlawful protective measure. As Attorney General Vino Timmerman highlighted in his recommendation, the idea that boards of public companies are prohibited from taking protective measures is not a principle generally accepted in Dutch corporate law. In fact, management is permitted to take "protective" measures which are proportionate and temporal in nature. To the UK takeover practitioner, the idea of boards of companies being permitted to take such measures — however labelled — while the company is "in play" or likely to be "in play," would not be tolerated. One of the earliest translations of the Dutch Supreme Court's judgment characterized the board's ability to take such measures as "protective." Such measures would otherwise be classified as "frustrating" actions if played out in the UK. This divergence in nomenclature is no accident of translation but underlies the fundamentally different approaches which continue to persist across the European Economic Area, even (and perhaps in particular) among the founder member states of the EU.

The principle that boards may not take actions to frustrate an actual or potential takeover attempt has long been a cornerstone of UK takeover bids. This is reflected in both the substantive rules of the Takeover Code[1] and in the overarching General Principles.[2] The original promulgators of the UK Takeover Code took the cynical view that, while relying upon strict adherence and observation of fiduciary and other directors' duties (the most important of which under UK company law is the duty of directors to "act in the best interests of the Company") is acceptable during most periods of corporate life, an additional check is needed when the company is or is likely to be "in play" — a time when due consideration of shareholder interests might strain under the weight of self-interest. This approach is in stark contrast to the Dutch approach, which allows more freedom to, and arguably places more trust in, management, thereby reducing the power vested in the wider shareholder body in relation to such issues.

To the informed reader, or at least one who noted the developments in Europe at the end of 2004, this disparity of approach in takeover regulation may come as a surprise. Did not the EU adopt, after almost 14 years of negotiation and debate, the 13th European Company Law Directive on Takeovers (Takeovers Directive), which set a common standard for the regulation of public offers in Europe? Did not the EU set a deadline of 20 May 2005 for Member State implementation of the Takeovers Directive? The answer to both of these questions is "yes." However, the devil is in the details. First, as is the case with many European directives, not all Member States met the implementation deadline for the Takeovers Directive. The usual mix of implementation results has been evident — some Member States implemented fully in time; others adopted partial interim measures; and yet others have yet to fully implement. The Dutch authorities have been slow to implement the Takeovers Directive, delayed in part by fierce debate over some of its more controversial aspects. Second, in relation to common standards, the Takeovers Directive in its final form provides that the two key anti-bid provisions which had been negotiated for over a decade (i.e. the rules prohibiting frustrating action and the rules prohibiting the imposition of restrictions on transfers of securities and the introduction of special or weighted voting rights), are optional in nature — Member States have the option of determining whether to adopt all or portions of these principles into domestic takeover legislation.

In the UK, the Code provides that when a company "has reason to believe that a bona fide offer *might be imminent*," it is prohibited from taking "any action that *may* result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits."[3] This broadly expressed provision is supplemented by a non-exhaustive list of specific actions which are prohibited in the absence of shareholder approval from the "issue of any authorized but unissued shares . . ." to the sale or disposal of "assets of a material amount."[4]

The Code goes on to provide guidance[5] on the factors that the UK Panel on Takeovers and Mergers (Panel) is likely to analyze when assessing this materiality test. The Panel will normally consider an asset to be material if its relative value, in relation to the company, is 10% or more of the net worth of the company, although the Panel has retained discretion to consider relative values lower than 10% as material "if the asset is of particular significance."[6]

One of the lines of defense mounted by ABN Amro when the matter was first heard before the Dutch Enterprise Chamber was that, at the time it entered into the binding sale agreement with Bank of America in relation to LaSalle, there was no clear announcement of a possible offer by the Consortium nor was it clear why they would be unable to proceed with an offer in the event of a sale of LaSalle. An analysis of how this line of defense would be assessed under the Code highlights a number of ways in which the Dutch approach to takeover regulation differs from the Code's approach.

Under the Code, the absence of a firm, clear announcement by a potential acquiror would not preclude the application of its "no frustrating actions" rules. At the start of this year, prior to any takeover bids, ABN Amro engaged in a very public "dialogue" with the activist shareholder The Children's Investment Fund (TCI). TCI pressed ABN Amro to consider various options to improve shareholder value. Subsequently, ABN Amro effectively put itself up for sale by announcing that its management would be considering various options, including a sale of the whole company. In this context, it would not be difficult to see that a bona fide offer would be imminent and that, therefore, the Code's no frustrating actions rules would apply. As for the Consortium itself, it appears from recently filed documents that discussions had taken place between Sir Fred Goodwin, chief executive of RBS, and his counterpart at ABN Amro, Rijkman Groenink, about value creating opportunities between the two companies. These discussions had been occurring over a span of months (if not years), and communications had also taken place about one week prior to Barclays' March 19 announcement of its possible offer for ABN Amro. This was followed by a formal announcement by ABN Amro that it had received a letter from the Consortium on April 13 indicating its interest in making an offer, but it did not halt the Dutch company from announcing 10 days later that it agreed to the terms of the sale of LaSalle with Bank of America. While pulling off a large cross-border banking merger is no mean feat, the threshold for demonstrating *bona fide* offers for purposes of the Code is set a low level and it would be difficult to see how any board would have been able to extricate itself from the application of Rule 21 in these circumstances. One possible route out of obtaining shareholder consent to such actions is where the Board of the target company can demonstrate that a decision to take the alleged frustrating action had been "partly or fully implemented" prior to the time when a bona fide offer was imminent. This exemption, which is recognized in the Code, is drawn from the Takeovers Directive and is one which has already given rise to some discussion and debate in member state regulatory circles as to its meaning and application in practice. Under the Code, it is likely that this provision will be construed narrowly and target companies will need to cross a high bar to demonstrate that they partly or fully implemented a course of action. In the ABN Amro bid, this issue was not discussed — accordingly, the board was spared providing details as to genesis of the proposed sale of LaSalle to Bank of America and if (and when) they undertook any actions (prior to April 23) to implement the sale.

One of the key issues discussed in the Dutch courts was whether Section 2:107a of the Dutch Civil Code[7] (DCC) applied to ABN Amro's sale of LaSalle. This section of the Dutch Civil Code stipulates that transactions resulting in a change of identity or the character of a company, such that in effect the nature of the shareholding significantly changes, require shareholder approval. Upon close consideration, it becomes evident that these provisions encapsulated in Dutch civil law do not (and indeed were not) devised as alternatives to the no frustrating action principles found in the Code. The introduction of Section 2:107a into the DCC was not aimed at taking investment decisions away from management and into the hands of shareholders. Rather, it was intended to protect shareholders where the nature or essence of the securities they held is likely to undergo fundamental change. It was on this basis that the Supreme Court took the view that to "stretch" the ambit of the rule to cover the LaSalle sale was not consistent with the intention of the Dutch legislature and would be contrary to the certainty of the rule of law. Had the proposed sale of LaSalle (which accounted for over US$20 billion of the €980 billion (approximately US$1,294 billion) total asset value of ABN Amro as at 31 December 2006) taken place, it would probably have satisfied the "materiality" test under the Code. In any event, if there were doubt or debate as to the results of the various tests, the Panel, in accordance with its consultative approach to takeover regulation[8] and by reference to the spirit of the rules and the general principles of the Code, would probably have arrived at the same conclusion as the Enterprise Chamber. Does, however, the fact that the Consortium has submitted an even more impressive offer for ABN Amro (excluding the LaSalle operations) reinforce the judgment of the Supreme Court and/or cast doubt on the approach under the Code? Most practitioners would take the view that such a conclusion is not defensible because the balance of fairness requires that actions which may have the effect of frustrating any offer (assessed on an objective basis) should be subject to shareholder approval. Once the "milk has been spilt" or the "toothpaste is out of the tube" it is virtually impossible to unwind the offensive actions.[9] Target companies and takeover regulators also need to consider the impact of getting it wrong in relation to this rule. Indeed, the suite of actions which commenced following the grant of the interim injunction against ABN Amro based on breach of contract, misrepresentation, breach of fiduciary duties and other allegations exemplify the horror that can be unleashed if an incorrect step is taken.

Now, it is up to the shareholders of ABN Amro to decide the fate of the company on the merits of the Barclays and Consortium offers. In the wake of the collapsing credit markets and the downward pressure on Barclays' share price[10], will the shareholders of ABN Amro (as well as certain members of the Consortium and Barclays itself, who have yet to approve the proposed bids) take the view that "cash is king" and support the Consortium bid? The board of ABN Amro found itself in a very difficult position. On one hand, it was still supportive of the Barclays camp and the longer-term opportunities which a merger with Barclays could bring. On the other hand, in light of the significant discrepancy on paper in the value of the two bids today, the ABN Amro board found itself unable to recommend either of the two bids. Had this takeover battle been fought across the Atlantic, one cannot but help note that US corporate governance principles would have allowed the ABN Amro board to take a more protectionist approach than the one actually taken.

As a final note, the latest topic for discussion arising from the ABN Amro saga is the question of state protectionist measures. To pull together its increased revised offer, Barclays turned to the East to garner support from the Singaporean SWF, Temasek, and the might of the China Development Bank. Britain's sanguine view of investment in Barclays by state-controlled entities is not shared by its Continental and trans-Atlantic colleagues. The US has shown its concern about foreign state-controlled companies acquiring stakes in "strategic" industries by blocking a proposed bid of Unocal by the Chinese oil company CNOOC and requiring Dubai Ports World to divest the management of a group of US ports that it acquired as part of its bid for Peninsular & Oriental Steam Navigation Co. The German government which, together with the Dutch authorities, has long been skeptical of investment vehicles such as hedge funds and private equity funds (branding them as "locusts")[11] appears to be leading the backlash against SWFs. Angela Merkel, the German Chancellor, wants the EU to adopt a similar defense mechanism to the US — an agency to scrutinize foreign takeovers. The US has called upon the IMF to draw up a code to govern the capital flows resulting from these (often) mega takeovers backed by sovereign agents. While in some quarters the SWFs are being regarded as the new bogeyman, for others, such as the UK and its opportunistic companies such as Barclays, the influx of the SWFs means chances for exciting investment opportunities so long as standards of corporate governance and corporate and social responsibility are maintained.

Selina S. Sagayam is a partner at Gibson, Dunn & Crutcher LLP. Her practice is focused on public and private mergers and acquisitions, joint ventures, equity capital markets, fund raisings, corporate governance, AIM IPOs and general corporate work. She has particular expertise in the Takeover Code and public company M&A, having worked for two years with the UK Panel on Takeovers and Mergers, the key regulatory body that governs public company acquisitions in the UK. While at the Panel, she regulated a number of headline bids including Kellen's bid for East Surrey Holdings; Telefónica's bid for 02 plc; and Honeywell's hostile bid for Novar plc.

---

[1] Rule 21.1 of the City Code on Takeovers and Mergers

[2] General Principle 3 of the Code – which was recently changed to replicate the general principles set out in the European Directive on Takeovers

[3] Rule 21.1(a) of the Code.

[4] Rule 21.1 (b) of the Code

[5] Note 2 on Rule 21.1 of the Code

[6] To determine materiality with respect to a particular transaction, the asset's relative value is compared with the aggregate value of the consideration to be received or given; the value of the assets to be disposed of or acquired; or the operating profit attributable to the assets to be disposed of acquired, in each case compared to that of the target company.

[7] This rule and an analysis of the Enterprise Chamber's ruling was reported in Jan van der Horst, *The Battle for ABN AMRO: Shareholder Approval of M&A Transactions under Dutch Law*, Bloomberg Law Reports, Vol. 1, No. 4 (June 2007).

[8] In the context of application of Rule 21.2 of the Code, the Panel would ordinarily seek the views not only of the target board and its advisers, but also the view of any other (announced or un-announced potential offerors) and would consider the representations of any other interested parties.

[9] Many would agree that Sir Fred is exceptional in his sheer resolve to execute his plans and little would "frustrate" his determination. But not all bidders are headed up by the likes of Fred Goodwin.

[10] While the Consortium bid also comprises and element of shares and the revised Barclays offer introduces a cash component, the proportion of shares in the Barclays offer is greater — approximately 63 percent as opposed to seven percent in new RBS shares in the Consortium offer. Barclays also has greater exposure to the collapse in the sub-prime market which is unlikely to lift recover for at least another four to six months according to some market commentators.

[11] *See* Carter Dougherty, *The Buzz on German Private Equity*, International Herald Tribune, Aug. 3, 2007.