Derogations from the mandatory bid rule

Law Working Paper N° 760/2024
March 2024

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This paper is part of a series marking the 20th anniversary of the Takeover Bids Directive and put together by the European Company Law Experts (ECLE) Group (https://europeancompanylawexperts.wordpress.com) with a view to publishing a book collection. For valuable feedback we would like to thank participants in the ECLE Workshop "Twenty Years of the Takeover Directive", Stockholm, October 12-13, 2023.

Abstract

The EU Takeover Bids Directive was passed twenty years ago with the main objective of promoting a single European takeover market. The primary mechanism provided by the Directive intended to ensure that minority shareholders' interests are protected on a change of control is the mandatory bid rule. The rule as such is a minimum harmonization provision. It leaves it to the Member States to set the control threshold, to define more precisely what the equitable price is, and to define which parties are to be deemed to be acting in concert for purposes of the rule. Member States may provide derogations from their national rules on mandatory bids, provided that the general principles of the Directive are respected. Member States have made use of their derogative powers in very different ways. The Directive also leaves it to the Member States to define what the substantive meaning of a derogation is. None of this is a bad thing as long as the Member States use the flexibility afforded by the Directive in a loyal way, duly taking into account the overall purpose of the Directive and the purpose of the mandatory bid rule, and apply the rules so as to make sense in the context of local corporate governance models, the structure of the local stock markets, and local protections afforded by general corporate law. The appetite among the Member States for amendments to the Directive is likely to be very limited to say the least. When it comes to the regime for derogations from the mandatory bid rule (provided that one accepts the premises for the existence of the mandatory bid rule in the first place), we do not see any pressing regulatory concerns that would argue in favour of trying to improve this appetite.

Keywords: European Takeover Bids Directive, Mandatory Bid Rule, Derogations, Minority Protection

JEL Classifications: G32, G34, K22

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ABSTRACT

The EU Takeover Bids Directive was passed twenty years ago with the main objective of promoting a single European takeover market. The primary mechanism provided by the Directive intended to ensure that minority shareholders' interests are protected on a change of control is the mandatory bid rule. The rule as such is a minimum harmonization provision. It leaves it to the Member States to set the control threshold, to define more precisely what the equitable price is, and to define which parties are to be deemed to be acting in concert for purposes of the rule.

Member States may provide derogations from their national rules on mandatory bids, provided that the general principles of the Directive are respected. Member States have made use of their derogative powers in very different ways. The Directive also leaves it to the Member States to define what the substantive meaning of a derogation is. None of this is a bad thing as long as the Member States use the flexibility afforded by the Directive in a loyal way, duly taking into account the overall purpose of the Directive and the purpose of the mandatory bid rule, and apply the rules so as to make sense in the context of local corporate governance models, the structure of the local stock markets, and local protections afforded by general corporate law.

The appetite among the Member States for amendments to the Directive is likely to be very limited to say the least. When it comes to the regime for derogations from the mandatory bid rule (provided that one accepts the premises for the existence of the mandatory bid rule in the first place), we do not see any pressing regulatory concerns that would argue in favour of trying to improve this appetite.

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1. Introduction

The primary mechanism provided by the EU Takeover Bids Directive[1] intended to ensure that minority shareholders' interests are protected on a change of control is the mandatory bid rule.[2] This rule provides that when, as a result of an acquisition of securities, a person (alone or with parties acting in concert) reaches the threshold for control set at national level, at the earliest opportunity that person must make a bid to all other holders of the securities for all their holdings at an equitable price.

The Directive states that Member States may provide derogations from their national rules in this area, provided that the general principles of the Directive are respected.[3]

Recital 6 of the Directive reads:

> (6) In order to be effective, takeover regulation should be flexible and capable of dealing with new circumstances as they arise and should accordingly provide for the possibility of exceptions and derogations. However, in applying any rules or exceptions laid down or in granting any derogations, supervisory authorities should respect certain general principles.

Article 4(5) second paragraph of the Directive reads:

> Provided that the general principles laid down in Article 3(1) are respected, Member States may provide in the rules that they make or introduce pursuant to this Directive for derogations from those rules:
>
> (i) by including such derogations in their national rules, in order to take account of circumstances determined at national level;
>
> and/or
>
> (ii) by granting their supervisory authorities, where they are competent, powers to waive such national rules, to take account of the circumstances referred to in (i) or in other specific circumstances, in which case a reasoned decision must be required.

The general principles of the Directive include the principle that if a person acquires control of a company, the other holders of the securities must be protected.[4] As set out in Article 4(5), derogations from the mandatory bid rule may be provided either by including them directly in

[1] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (the Directive).
[2] Article 5 of the Directive and recital 9 of the preamble.
[3] Article 4(5) of the Directive.
[4] Article 3(1)(a) of the Directive.

the national legislation or by granting the national supervisory authorities powers to waive the national rules (*ad hoc* or *in casu* dispensations or exemptions).

All Member States have made or allowed for derogations from the mandatory bid rule.

In this paper, we use the term "derogation" or "exemption" as the broader notions, covering both statutory derogations and derogations by way of dispensation in an individual case.

We do not address in this paper whether the mandatory bid rule is at all an efficient tool to achieve the overall goals of European takeover regulation.[5] Rather, we accept, for the purposes of this paper, the mandatory bid rule and its intended purposes as is. Nor do we address the implementation generally of the mandatory bid rule in the Member States but focus entirely on derogations.

The paper is structed as follows:

1. Introduction
2. The mandatory bid rule and the scope for derogations
    2.1 The 2012 External Study
    2.2 The 2012 Commission review report
3. Derogations and the protection of minority shareholders
4. The nature of the derogation – is the shareholder free to increase its holding further?
5. Too many derogations?
6. Concluding remarks

2. The mandatory bid rule and the scope for derogations

2.1 The 2012 External Study

As part of the mandatory five-year review of the application of the Directive in accordance with Article 20 of the Directive, an external study was carried out on behalf of the Commission (the External Study).[6]

The External Study included an extensive review of the application of the mandatory bid rule, including the possibility to derogate from it. The External Study showed that all Member States,

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[5] See, for example, Hansen, *The Mandatory Bid Rule: Still Unnecessary, Unjustifiable and Inefficient After All These Years*, and Winner, *Does the European Union have a mandatory bid rule?* Both papers are published in Festschrift in honour of Rolf Skog (2021). See also Skog, *Does Sweden Need a Mandatory Bid Rule?* (1995), Enriques, *The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?* (2004) European Company and Financial Law Review 440, Schuster, *The Mandatory Bid Rule: Efficient, after All?* (2013) Modern Law Review 529, and Agstner & Mascheroni, *Breach of the Mandatory Bid Rule: Minority Shareholders' Protection in the Public vs. Private Enforcement Debate*, (2020) European Company and Financial Law Review 726.

[6] Marccus Partners, in cooperation with the Centre for European Policy Studies, *Study on the application of Directive 2004/25/EC on takeover bids* (June 2012).

as permitted by the Directive, allowed derogations from the mandatory bid rule, but that the Member States had chosen quite different approaches in this regard.

The External Study distinguishes between Member States which rely entirely or primarily on statutory derogations and those with a system primarily based on *ad hoc* (or *in casu*) derogations, where the supervisory authority or similar body (such as a Takeover Panel) tries applications for dispensation in each individual case. The latter category includes, among others, Ireland and the Nordics. The German supervisory authority can also grant exemptions from the mandatory bid rule "if, having regard to the interests of the applicant and the holders of shares in the target company, this appears justified in view of the manner of attainment, the objectives being pursued with the attainment of control, a drop below the control threshold subsequent to the attainment of control, the shareholder structure of the target company, or the actual possibility of exercising control". In France, the regulations do not give the supervisory authority an express right to discretionarily grant exemptions, but the authority has given itself this right anyway. A relatively common feature is that in certain situations a derogation is permissible provided that the shareholders of the listed company in question approve that a mandatory bid need not be made. This is commonly referred to as a whitewash procedure.

The External Study thoroughly reviewed the basis for granting mandatory bid derogations either by law or in the practices of the relevant supervisory authority.

Several different categories of derogations can be identified.

1. The first category may be referred to as *technical exemptions*. This includes exemptions due to the characteristics of the individual listed company, for example, if the listed company is an open-ended investment company. The Directive states that Member States in these cases do not need to apply the mandatory bid rule, and in many Member States this is reflected in the wording of the mandatory bid rule itself. In some Member States, however, such as the Netherlands and Hungary, explicit exemptions are stipulated by law.

   The technical exemption category also covers cases where an investor exceeds the mandatory bid threshold and, in doing so, becomes such a large shareholder in the target company that a compulsory acquisition procedure (squeeze-out) can be initiated. In several Member States, such as Austria and Sweden, the mandatory bid rule does not apply in such situations.

   In the same vein, this category includes the case where an investor which has exceeded the mandatory bid threshold and become a controlling owner in a company enters into an agreement with the controlled company whereby the latter submits to the controlling company's management. Such a *Beherrschungsvertrag* can be entered into in Germany and the Czech Republic, which, in such cases, also constitutes exemptions from the mandatory bid rule, provided that the controlling company effects a buy-out of the minority shareholders.

2. A significantly larger and, in practical terms, more important sub-group is *exemptions granted (for lack of a better word) to "protect" the controlling shareholder or offeror*.

   This includes transactions which have *not resulted in a real change of control* even though the mandatory bid threshold has formally been exceeded, for example when the transaction is carried out among parties which are members of the same group of companies. Exemptions of this type are available in Germany, France, Italy, the Netherlands, Sweden and a number of other Member States.

   A related situation that falls within this category is where someone has exceeded the threshold but *there is an even larger shareholder in the company*. In certain Member States the exemption is worded as simply as that, while in others it is more complicated. In Germany, for example, no mandatory bid is required if a shareholder has exceeded the threshold but, against the backdrop of the level of participation at the last three general meetings, cannot be expected to obtain a majority of the votes at the next general meeting because there is another, larger shareholder.

   The category also includes instances where the mandatory bid threshold has been *exceeded by mistake or without the intent of taking control of the company*, in certain cases provided that the holding only marginally exceeds the threshold, typically by no more than a couple of percentage points. Among Member States with such exemptions are Ireland, Germany, France, Italy and the Netherlands. These Member States invariably require that the holding is reduced below the threshold within a specific period of time. In certain Member States, such as Germany, this must be done without delay; others provide a specific time limit: one month in the Netherlands, within half a year in France and within one year in Italy, to name a few.

   There are also a number of situations where an exemption is granted to a shareholder potentially facing a mandatory bid even though exceeding the threshold *has, in fact, resulted in a change of control*. This includes cases where the threshold has been exceeded through a *voluntary bid* to acquire all the shares. Although the Directive clearly states that a mandatory bid obligation does not apply in this case,[7] the transposition of this provision varies by Member State. Certain Member States, such as the Netherlands, Belgium, Portugal and Sweden, do not require more than what is stated in the Directive, i.e., an offer to acquire all the shares in the company. In other Member States, such as Germany, Spain and Greece, the exemption requires a certain minimum price in the voluntary offering. Another qualification may be that, for the exemption to apply, the voluntary offering may only be implemented if the bidder obtains at least half of the votes of all outstanding shares in the company.

   Moreover, there are cases where the mandatory bid threshold is exceeded *without the shareholder in question actively acquiring any shares*, for example if the company

[7] See Article 5(2) of the Directive.

reduced its total number of shares through a redemption and thereby pushed the shareholder beyond the mandatory bid threshold. Exemptions are permitted in such cases in, among others, Ireland, Germany, France, Italy and Sweden.

This group of exemptions also includes *indirect shifts in controlling ownership*. Several Member States have rules for cases where someone takes control of a listed company by acquiring shares in a holding company, where a substantive test is performed, and the mandatory bid rule does not apply if the shares in the listed company represent only a certain small percentage of the net assets of the holding company (in Germany not more than 20 percent). Other Member States that apply the substantive test include France, Belgium and Austria.

A fairly obvious group of exemptions related to shareholders who potentially face a mandatory bid are cases in which shares have been acquired by *gift, inheritance, marriage, divorce, etc.* Such exemptions are available in most Member States. In Spain, to take one example, exemptions are made for acquisitions without consideration *causa mortis* and *inter vivos*, the latter only on the condition that the buyer has not acquired shares in the company during the most recent 12-month period and has not entered into a cooperation agreement with the seller.

3. A third category is *exemptions related to creditors*. This typically involves exemptions from a mandatory bid in cases where the shares in question have been acquired as a result of the realization of a pledge or similar. In certain Member States, such as Germany and Denmark, this exemption is unconditional. In others, such as Belgium, the shares in question must be disposed of within a specific time and may not be voted at the general meeting before this is done.

4. A fourth and final category is *exemptions related to stakeholders other than creditors*. The External Study states that the purpose of such an exemption is to maintain an acceptable balance between the interests of shareholders and other stakeholders in light of the company's long-term interests.

   One example is cases where control is obtained in order to rescue a company in *financial distress*. Exemptions of this type are granted in most Member States by law or in practice. In certain Member States, the exemption is fairly straightforward. In Ireland, the only condition is that the shares are subscribed in a share issue necessary for the company's survival. In other Member States, such as Italy, it is considerably more complex.

   This category also includes exemptions in situations where an investor has exceeded the threshold for a mandatory bid *as the result of a company's business decision or other corporate action that ultimately is likely to benefit its shareholders*. A typical example is exemptions related to *new share issues*. In Ireland, Denmark, Sweden and Finland, for example, exemptions are granted if a shareholder subscribes for its *pro rata* share of a rights offering and exceeds the threshold due to low take-up by others. Exemptions are also granted in several Member States in connection with directed share issues, but this generally requires a whitewash procedure. In Cyprus, for example, exemptions are granted provided that the decision to disapply shareholder pre-emption rights has been made by the shareholders, that the decision is supported by a simple majority of the votes excluding shares represented by the shareholder(s) targeted by the directed issue, and that the shareholders have been duly informed prior to the general meeting. Exemptions are also available in several Member States if the threshold is exceeded due to *a merger, demerger or similar arrangement to reorganize the company*.

There are also Member States where mandatory bid exemptions are provided by law to *defend against hostile takeovers*. In the Netherlands and Belgium, a company may, in certain circumstances, separate the voting rights of the shares from their economic rights and place the voting right component in a protective foundation to defend management against a hostile takeover. Not surprisingly, a transaction can be exempted from a mandatory bid in cases where such foundation's holding exceeds the threshold.

Lastly, this category of exemptions includes acquisitions of controlling holdings within the framework of *privatizations* of formerly publicly owned enterprises. In Greece, for example, the takeover rules contain an exemption from mandatory bids for just such an acquisition.

In total, the External Study cited as many as 36 reasons for mandatory bid derogations, whether statutory or *ad hoc*.

2.2 The 2012 Commission review report

Also in 2012, the European Commission published its report on the application of the Directive.[8] Broadly, the Commission concluded, based on the External Study, that the regime created by the Directive was working satisfactorily and that no structural compliance issues had emerged. Consequently, the Commission's report concluded that the Directive should not be amended for example by making its optional articles mandatory.

The conclusion that the mandatory bid rule was "effective" is by no means the same as "economically efficient" but probably merely reflects the finding that the rule was generally observed in national law. The External Study rather recognized the mandatory bid rule as an anti-takeover measure, which implied an "intrinsic contradiction" between the rule and the intended purpose of the Directive, i.e., to facilitate takeovers as an instrument of industrial

[8] *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Application of Directive 2004/25/EC on takeover bids*, COM(2012) 347 final. See also Commission Staff Working Document, *Report on the Implementation of the Directive on Takeover Bids* (21 February 2007), SEC(2007) 268.

reorganization and development.[9] This contradiction could perhaps be explained as part of an ambition to strike a balance between furthering takeovers and protecting minority shareholders, provided of course that one accepts the premise that such protection is indeed needed beyond merely safeguarding fair play when takeover bids are actually made.

Nevertheless, the report identified a number of areas where the rules of the Directive could merit clarification in order to improve legal certainty and the effective exercise of the rights of shareholders. One of these areas was the protection of minority shareholders in case of a change of control.

The Commission noted that within the range of different national derogations to the mandatory bid rule, it is not always clear how the protection of minority shareholders is ensured on a chance of control. As set out in Article 4(5) of the Directive, Member States that provide for derogations must respect the general principles of the Directive, one of which is the above-mentioned principle that, if a person acquires control of a listed company, the other holders of securities must be protected.

The Commission noted in this regard that the Directive does not regulate how Member States are to ensure that the general principles are respected and said that it intended to carry out further investigation on how minority shareholders are protected when a national derogation to the mandatory bid rule applies. More information, the Commission continued, was needed on the scope of application of national derogations to the mandatory bid rule, on the extent to which national derogations limited the protection of minority shareholders in change of control situations and, where relevant, what alternative mechanisms existed in national law to protect minority shareholders on a change of control. The Commission said that if the protection of minority shareholders proved to be inadequate, the Commission would take necessary steps (for example through infringement procedures) to restore the effective application of the relevant general principle of the Directive.

Accordingly, in 2013, the Commission collected information on the topic from the Member States to better understand the state of play in the Member States. This collection of information confirmed the findings in the External Study but did not lead to any further measures taken or proposed by the Commission. Apparently, the Commission found that there was not sufficient cause for taking any further action after all. An updated inquiry by us with colleagues across the Member States in 2023 shows that the situation identified already in 2012-2013 is still true in most if not all regards.

In its 2012 report, the Commission also referenced the findings of the External Study when it comes to the mandatory bid exemption included directly in the Directive for situations where control has been acquired following a voluntary bid for all shares of the company.[10] It was noted that this had sometimes created a possibility for offerors to circumvent the mandatory bid rule by acquiring a stake close to the mandatory bid threshold and then launching a voluntary bid for a low price (so-called *creep in*). As a consequence, the offeror would cross the

[9] External Study p. 18.
[10] See Article 5(2) of the Directive.

mandatory bid threshold without giving minority shareholders a fair chance to exit the company and share in the control premium. The Commission noted that this was clearly not in line with the objective of the Directive to protect minority shareholders on a change of control, although it did not appear to breach the letter of the Directive. Examples in national legislation, such as additional mandatory bid thresholds or minimum acceptance conditions to takeover bids, showed, the Commission stated, that there are possibilities to prevent the use of this technique. The Commission stated that it would take the appropriate steps to discourage the use of this technique across the EU, such as through bilateral discussions with the relevant Member States or Commission recommendations. We are not aware of any such bilateral discussions and to our knowledge no recommendations have been issued.

3. Derogations and the protection of minority shareholders

The proviso in Article 4(5) of the Directive makes reference to *all* general principles set out in Article 3(1). However, only Principle (a), regarding the protection of minority shareholders on a change of control, is relevant in practice when it comes to a derogation from the mandatory bid rule.

The mandatory bid rule itself is intended to protect the minority shareholders on a change of control by affording them an exit right and a share in the control premium. Per definition, if an exemption from the mandatory bid rule is granted, the shareholders will *not* be afforded this protection.

What, then, does the reference in Article 4(5) to the minority protection principle in Article 3(1) mean in the case of a derogation from the mandatory bid rule?[11]

Arguably, when it comes to exemptions from the mandatory bid rule, the reference to the principles does not appear to add much at all, which may explain why several Member States have not explicitly incorporated the reference to the principles in their statutory mandatory bid exemption regimes. Surely, however, the reference cannot be assumed to mean nothing.

We believe that it is helpful to analyze the minority protection requirement in light of the various types of derogation used.

a. An apparently uncontroversial example is when the mandatory bid rule is formally triggered despite there being *no real change of control*. In such a situation, there is no valid reason for upholding the mandatory bid rule regardless of any other minority protections. In these cases, the derogation – which typically comes in the form of an *ad hoc* dispensation – rather serves as a safety valve to take care of situations which should not have been caught by the mandatory bid rule in the first place.

b. From the point of view of affording specific minority protection in connection with a specific derogation, situations where the derogation is available subject to compliance

[11] Article 4(5) allows for derogations from *other* provisions of the Directive too. The specific question here, however, is what the reference to the general principles means in the context of derogating from *the mandatory bid rule*.

with a *whitewash procedure* are straightforward. In these cases, the whitewash procedure itself offers minority protection through shareholder scrutiny and approval by a majority of the minority. The whitewash approach is typically used for situations where it might otherwise have been more difficult to identify how minority protection would be safeguarded. A typical example is where a dispensation is granted for a corporate acquisition by the listed company, with a sufficient number of new shares being issued as consideration to lead to control by the seller. Another example is dispensations enabling an underwriter of a rights offering to honour its obligations even if this leads to control.

Another example of a typical case of derogation where the context of the derogation includes immediate alternative minority protection, is when the acquirer immediately upon obtaining control goes on to pursue an adequately protective compulsory acquisition procedure (squeeze-out, cf. Article 15 of the Directive).

c. In many other situations, the question of minority protection is rather a matter of generally testing whether the reasons for an exemption, typically or in an individual case, *outweigh* the reasons for a mandatory bid.[12]

This is relevant, for example, upon receipt of a gift or inheritance of a controlling stake, in creditor-related derogatory situations, in cases of financial distress or otherwise when the derogation is deemed necessary to achieve an outcome which is more beneficial to the collective of shareholders than in foreseeable alternative scenarios. The latter can, for example, be the case if a derogation is granted to allow a significant directed share issue needed to rescue the listed company from imminent bankruptcy, a scenario which would clearly be more damaging to the interests of all shareholders than a shift in control without a mandatory bid.

Commonly, in these situations, the derogations require a decision from the supervisory authority or similar body involving the exercise of some degree of discretion on its part. This allows for the interests of minority shareholders to be appropriately taken into account in the specific situation at hand. All Member States seem to take the view that their national supervisory authorities, when granting a dispensation from the mandatory

[12] Clearly, this is true also in the whitewash examples, however without the specific protection afforded by the whitewash procedure itself.

bid rule, must always comply with the general principle of minority protection, despite this not always being explicitly set out in statute.[13] [14]

In these instances, it may be relevant to take into account the general corporate law minority protection regime that applies in the listed company in question. Such regime may include, for example, corporate law provisions designed to prevent resolutions which provide a shareholder with an undue advantage to the detriment of the company or other shareholders. It may also include rules requiring certain resolutions to be passed by a qualified majority vote of the shareholders, special rules on related-party transactions, etc.[15]

As a general rule, derogations are often rightly seen as a necessary tool to provide the flexibility needed to ensure the smooth functioning of the market and avoiding unfair or disproportionate consequences of the mandatory bid rule. It may sometimes simply, and completely legitimately, be a matter of concluding in an individual case that the reasons for upholding the mandatory bid rule, in light of the purpose of the rule, do not outweigh the reasons for a dispensation, i.e., the minority holders are better off, or at least not relevantly worse off, if a dispensation is granted.[16]

Here the difficulty rather lies in the concrete application of derogatory powers in a potentially widely diverging set of circumstances. When and to what extent, more precisely, should the interests of other stakeholders prevail over the interests of minority shareholders otherwise protected by the mandatory bid rule? It has been discussed whether a solution would be for the Commission to draw up an exhaustive list of acceptable derogations. Clearly, however, this is not a workable solution. In practice,

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[13] In our home Member State (Sweden), for example, the typical examples of grounds for *ad hoc* dispensations, and the need to take into account the intended purpose of the mandatory bid rule when trying applications, are set out in the *preparatory works* pertaining to the mandatory bid rule. In practice, this means that even if a particular application for dispensation relates to a situation where dispensation is typically granted, the Swedish Takeover Panel (the Securities Council) cannot grant a dispensation in the specific case unless deemed appropriate in light of the interests of the minority shareholders.

[14] Also, decisions granting dispensations from the mandatory bid rule are typically appealable, cf. recital 8 of the Directive.

[15] One might question how situations where a mandatory bid has been triggered by mistake, or only technically or temporarily, fit into this line of reasoning? Here, requiring the shareholder to sell down within a specified period of time is typically a relevant tool.

[16] Cf. the European Court of Justice’s judgment of 15 October 2009 in case C-101/08, Audiolux SA e.a v Groupe Bruxelles Lambert SA (GBL) and Others and Bertelsmann AG and Others, paragraph 58: “The establishing of an obligation on dominant shareholders and the fixing of the conditions triggering such an obligation would require a decision as to whether, in the specific situation in which a shareholder acquires or strengthens his control of a company, the minority shareholders need special protection which must be ensured by the imposition of an obligation on the dominant shareholder. Such a decision would presuppose both the weighing of the interests of the minority shareholders and those of the dominant shareholder and of the not inconsiderable consequences for corporate takeovers, and would require specific expression, in accordance with the principle of legal certainty, so that those concerned could ascertain unequivocally what their rights and obligations were and take steps accordingly (see, as regards the requirements for the principle of legal certainty, Case C-345/06 Heinrich [2009] ECR I-0000, paragraph 44).”

> the situations that arise are diverse and cannot be adequately covered by detailed rules, and any such detailed rules should any in any event be left for the Members States to decide in light of the specificities of their own governance models.[17]
>
> In countries with active stock markets, it has proven appropriate or even necessary, for the purposes discussed above, to grant the supervisory authority or similar body discretion to decide on *ad hoc* dispensations. This is desirable to provide optimal flexibility ensuring the smooth functioning of the market by avoiding unfair or disproportionate consequences of the mandatory bid rule in individual cases. This is also desirable particularly in light of the interest of the parties concerned to be able to get an expedient and authoritative decision on what applies. Courts will generally not be able to provide this on sufficiently short notice. The discretion of the supervisory authority cannot of course be exercised arbitrarily but must always properly take into account the minority protective purpose of the mandatory bid rule. Predictability and transparency are key aspects, and a transparent teleological application of the power to grant derogations is necessary to enable an evaluation of whether the derogatory practices are in line with the Directive.[18]

This analysis shows that, despite the multiplicity of derogations of various sorts, it is not a problem *per se* that there are a lot of derogations and that these vary amongst the Member States. On the contrary, correctly applied, the derogations are legitimate and rather confirm that the Directive was right in allowing the Member States to derogate, statutorily or *ad hoc*, from the mandatory bid rule. Accordingly, the fact that the Commission's collection of additional information back in 2013 did not lead to any measures being taken is no surprise. Rather, on balance, the current regime seems to be sensible and should not be materially altered.

The fact that rules and practices on derogations from the mandatory bid rule vary significantly among the Member States could be viewed of course as a failure from the point of view of the interest of harmonization. However, in this field of the law, arguably, harmonization is not an independent value, whereas flexibility and adaptability at Member State level furthers the overall objectives of the Directives, provided that the flexibility and discretion is exercised loyally with the purpose of the Directive.[19]

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[17] See, for example, European Company Law Experts (ECLE), *Response to the European Commission's Report on the Application of the Takeover Bids Directive*, University of Cambridge Faculty of Law Research Paper No. 5/2014 and Oxford Legal Studies Research Paper No. 55/2014.

[18] ECLE (see the preceding note) has highlighted a few suggestions on how to safeguard predictability and transparency when supervisory authorities exercise discretion, including ensuring that decisions are published, adequately reasoned and effectively challengeable. In fact, unqualified statutory derogations, without the possibility of *in casu* review by the supervisory authority on the basis of an application for dispensation, perhaps leaves the *most* room for doubt on how minority protection is ensured in each individual case.

[19] The fact that some Member States may not be entirely enthusiastic about the merits of the mandatory bid rule (cf. note 5 above) of course is *not*, as such, a valid reason for a liberal dispensation regime.

4. The nature of the derogation – is the shareholder free to increase its holding further?

One aspect which was not explored in detail in the 2012 External Study is the *nature* of the derogation, i.e., what does it *mean* to have been granted an exemption or to rely on a statutory derogation? Is the shareholder free to increase its holdings further or does the mandatory bid rule strike again on further acquisitions or when reaching some second threshold of holdings? And if the shareholder reaches, say, 40 per cent in an exempt transaction, what applies if the shareholder then reduces the holding to, say, 35 per cent? Is the shareholder then entitled to increase again, back to 40 per cent, without a new exemption?

Again, all Member States have made or allowed for derogations from the mandatory bid rule to ensure the proper functioning of the market. But what, exactly, is the meaning of an exemption from the rule?

In our home Member State, Sweden, the substance of an exemption is merely that the shareholder may, due to the specific circumstances meriting the exemption, carry out *the particular exempt transaction* (i.e., the transaction leading to the 40 per cent holding in the example above) without having to make a bid for all shares. But, unless otherwise set out in the decision to grant the dispensation, the shareholder cannot acquire more shares outside the scope of that particular transaction. If the shareholder acquires one single share on top of the 40 per cent, the mandatory bid is triggered and a bid for all the remaining shares must be made.[20] This tight link to the exempt transaction even means that further acquisitions trigger a mandatory bid even if the shareholder has reduced its holding in the meantime.

The above is true as a principal rule in Sweden, but it does not always apply. For example, if a mandatory bid exemption is granted for a shareholder who inherits a controlling stake, and the diseased was free of any mandatory bid obligations (for example, because the diseased held the controlling stake already before the introduction of the statutory mandatory bid rule in 2006), the new shareholder will also be free to subsequently increase the shareholding. If you like, the new shareholder does not only inherit the shares, it also "inherits" the freedom from mandatory bid obligations upon any subsequent increase of the holding. This, however, is dependent on the terms of the specific *ad hoc* dispensation. Absent a provision in the dispensation to this effect, the principal rule described above will apply. In practice, the Swedish Takeover Panel will typically explicitly state *either or*, for the sake of clarity.

In this regard, too, the rules and practices of the Member States vary. Some Members States have a similar principal rule as Sweden, depending on the type of derogatory situation. This is true, for example, for France and similarly in Germany. Also, in some Member States the same would apply provided that the exempt transaction brings the shareholder's holdings to above 50 per cent. This is true, for example, in Ireland and Portugal. Conversely, in other Members

[20] In line with this, if the shareholder chooses to sell shares so that the shareholding then amounts to, say, 37 per cent, the mandatory bid rule is triggered upon the acquisition of one additional share – i.e., the shareholder is not afforded the right to move freely up and down as long as 40 per cent is not passed.

States, such as Germany, Spain and Finland, the principal rule would be that the shareholder is indeed free to increase its shareholding beyond where it ends up following the specific transaction triggering the mandatory bid rule.

It is apparent already from the above very brief overview that this is another aspect where the Members States have taken quite different views. Sometimes it is relatively clear cut: either the exempt shareholder is free to increase its holding further, or it is not. Sometimes, however, this depends on the circumstances, notably sometimes on the particular basis for the exemption.

This is an aspect which is not specifically regulated by the Directive. Arguably, defining the specific meaning of a dispensation should be addressed in light of the reference in Article 4(5) to the general principles in Article 3(1).

The shareholder should only be allowed to increase further if the other shareholders are still adequately protected, or if there is at least no significant disadvantages for minority holders that outweigh the reasons for allowing the controlling shareholder to do so. In fact, linking the dispensation to the specific exempt transaction may be seen as a tool to satisfy the interest of minority protection when derogating from the mandatory bid rule, and, conversely, when a derogation does entitle the shareholder to increase its holding further, the requirement of Article 4(5) for alternative minority protection may be stricter.

The line of reasoning described above, however, is not necessarily shared by everyone. One different view, which is valid enough to be considered, is that if a derogation is available or granted for a transaction whereby someone acquires control over a listed company, then that should be it in terms of satisfying the purpose of the mandatory bid rule. The shareholder, one could argue, was entitled to take control without having to make a mandatory bid because sufficient cause to merit a mandatory bid did not exist. Why, then, should the shareholder be obliged to make such a bid at some *later* point in time, when the shareholder *already* is in control and the other shareholders (and the market generally) have already adjusted to the fact that there is a new controlling shareholder and no exit right or share in any control premium?

The question of the nature of the derogation in the context of further acquisitions is somewhat linked to the *creep-up* problem discussed in the External Study and the 2012 Commission report (see Section 2.2 above). Clearly, if a shareholder reaches, say, 40 per cent on the basis of an exemption granted, but under the general mandatory bid regime is in any event obliged to make a bid upon each acquisition of a further share between 30 and 50 per cent, then no further inquiry into the exact meaning of the exemption is needed. Conversely, in a Member States without a creep-up regime (such as Sweden) the question of the nature of being exempt becomes more apparently important and reveals an additional dimension of complexity, and lack of convergence among the Member States, of the mandatory bid derogation regime.

5. Too many derogations?

Apparently, the Members States have chosen, for a wide variety of situations, to make use of the possibility offered by the Directive to statutorily derogate from the mandatory bid rule or to allow the supervisory authority or similar body to grant *ad hoc* dispensations. It has even been said that, in the context of the mandatory offer bid rule, "the exception is the rule".[21]

As noted already in the 2012 External Study, the mandatory bid rule in fact operates as an anti-takeover device.[22] Clearly, if an investor might be commercially interested in acquiring a controlling stake in a listed company but is unwilling or unable to finance an acquisition of *all* shares in the company, the investor simply will not put itself in a situation where a mandatory offer is triggered.[23] Cleary, also, an investor will not apply for a dispensation from the mandatory bid rule unless, under the practices of the supervisory authority or similar body, it is relatively clear that such dispensation will be granted.[24]

Further, importantly, the fact that there may be many situations where a dispensation is typically merited, the number of actually granted dispensations will of course be large if these situations also occur frequently in practice. This is likely to be the case where the ownership structure of the market in question is fairly concentrated (as in Sweden) and the control threshold determined at national level is low in light of such concentration (30 per cent in Sweden, compared to 40 per cent when the mandatory bid rule was introduced in Swedish law well before the implementation of the Directive).

Is, then, the prevalence of a large number of granted dispensations from the mandatory bid rule an indication of a derogatory regime that is too liberal? Sometimes it is indeed argued that the fact that so many derogations are granted and so few mandatory bids are made is an indication of something being wrong with the mandatory bid derogatory regime. We argue that this is not the case. The above offers a few explanations. Indeed, national derogations from the mandatory bid rule affect the *effectiveness* of the rule, in that the rule applies in fewer instances than would otherwise have been the case. But this is by no means problematic if the instances where the mandatory bid rule is disapplied are such that, properly taking into account the interests of the minority shareholders, upholding the rule is not merited.[25] We have so far not found any

[21] See ECLE (see note 17 above), p. 7, and Skog & Sjöman, *No Rule, Just Exemptions? Mandatory Bids in Sweden and the EU*, (2014) European Company and Financial Law Review 393.

[22] External Study, p. 18: "Legal and economic analysis shows the intrinsic contradiction between the mandatory bid rule, which acts as an anti-takeover device, and the board neutrality rule, breakthrough and squeeze-out rules, the purposes of which are to facilitate bids."

[23] This is the key reason for why it can be debated whether, ultimately, the mandatory bid rule is at all in the best interest of the shareholders and the overall objectives of the Directive, cf. note 5 above.

[24] And if the investor *is* willing and able to acquire the entire target company, the investor will typically choose to make a *voluntary* bid, thereby avoiding the restrictions associated with a mandatory bid.

[25] On the contrary, it is problematic if national rules do *not* provide for derogations in such situations. One example is where a shareholder formally passes the control threshold but there is another shareholder with a larger, controlling, holding. Not all Member States provide for an exemption in this situation, which is clearly over-restrictive and therefore counter-productive in light of the overall objectives of the Directive.

indications of significant deficiencies on an overall level in this regard, although, of course, the current state of play has by no means created harmonization across the Member States.

6. Concluding remarks

The Member States have made use of their mandatory bid derogative powers in very different ways. Some derogations are *ad hoc*: they may be granted by supervisory authorities or approved by the shareholders pursuant to a so-called whitewash procedure. Other derogations are statutorily defined. The derogations can be categorized in different ways. Each category has its own rationale. Many derogations are entirely unproblematic. The best example is probably when a mandatory bid is indeed formally triggered but there is, in fact, no real change of control and hence no reason whatsoever to uphold a device intended to protect shareholders on a control shift.

The typical purpose of other derogations is to balance diverging interests, and not to uphold the mandatory bid rule in a situation where it is deemed to be in the best interest of the collective of shareholders to let a transaction take place without prompting a mandatory bid. These situations are not conceptually problematic either but require more careful attention because a weighing of pros and cons is needed in order to properly take into account the interests of the shareholders. This sometimes merits requiring the exempt transaction to be approved by the shareholders in a majority-of-the-minority resolution (a so-called whitewash procedure). In other cases, such as in rescue operations in an imminently bankrupt company, the reasons militating in favour of a dispensation from the mandatory bid rule may be sufficiently strong to merit a dispensation on the basis merely of the ordinary *ex post* minority protection afforded by general corporate law. According to the view taken in some Member States, this may particularly be the case if the derogation applies exclusively to the exempt transaction and does not entitle the shareholder to subsequently increase its holding further without triggering a mandatory bid.

Sometimes it is argued that the fact that so many derogations are granted and so few mandatory bids are made is an indication of something being wrong with the derogatory regime. Indeed, national derogations from the mandatory bid rule affect the effectiveness of the rule. But this is not problematic if the instances where the mandatory bid rule is disapplied are such that, properly taking into account the interests of the minority shareholders, they do not merit upholding the rule. We have not found any indications of significant deficiencies on an overall level in this regard. On the contrary, it would be more problematic in light of the overall purposes of the Directive if derogations were *not* offered for such situations.

Of course, the current state of play has not created convergence across the Member States. This, however, should come as no surprise. The mandatory bid rule as such is a minimum harmonization provision. It leaves it to the Member States to set the control threshold(s), to define more precisely what the equitable price is, and to define which parties are to be deemed to be acting in concert for purposes of the rule. It also leaves it to the Members States to define derogations from the rule, and to allow *ad hoc* dispensations by the supervisory authority or similar body, provided that the principle of minority protection on a change of control is duly taken into account in one way or the other. It further leaves it to the Member States to define what the substantive meaning of a derogation is. Again, though, none of this is a bad thing as long as the Member States use the flexibility afforded by the Directive in a loyal way, duly taking into account the overall purpose of the Directive and the purpose of the mandatory bid rule, and apply the rules so as to make sense in the context of local corporate governance models, the structure of the local stock markets, and local protections afforded by general corporate law.

The appetite among the Member States for amendments to the Directive is likely to be very limited to say the least. When it comes to the regime for derogations from the mandatory bid rule (provided that one accepts the premises for the existence of the mandatory bid rule in the first place), we do not see any pressing regulatory concerns that would argue in favour of trying to improve this appetite.

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