

DEFENSIVE STRATEGIES AGAINST TAKEOVERS
IN COUNTRIES OF THE EUROPEAN COMMUNITY.

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A Takeover Bid (T.B.) or a Cross-Shareholding Agreement (C.S.A.) is a financial technique, which allows a company to be restructured either in a friendly way or in a hostile way. The cost is covered either by a cash transaction (T.B.) or by an exchange of shares or equities (C.S.A.). When the T.B. or C.S.A. is carried out against the wishes of the management, it is regarded as a hostile or unfriendly bid. The operation of T.B.s, widely adopted in the U.S.A., has reached Europe. The disappearance of frontier controls as well as the internationalisation of markets explains the increase in the number of firms seeking to regroup, in order to spread risk-taking more widely and in order to achieve viable market size. T.B.s which transcend national frontiers have increased. In 1991, Europe Of The Twelve dislodged North America as the preferred target for international bidders. In its White Paper on the completion of the Internal Market in 1992, the European Community Commission pronounced in favour of harmonising the laws of the member states as regards Takeover Bids or Cross-Shareholding Agreements. However, there are still obstacles in the path of those wishing to acquire businesses in a number of European countries. These defensive measures can be brought into force before a T.B. is launched or indeed during the course of the T.B. They can be a consequence of protective legislation but they are often the consequence of differences in culture, in the structure of capital financing and in economic climate.

That is why we shall begin by clarifying the different forms of T.B. in various countries, before studying the defensive strategies adopted, whether they be of a financial, a judicial, a statutory or of any other kind.

1. THE CONCEPT OF T.B.s IN THE COUNTRIES OF THE EUROPEAN COMMUNITY.

Within the countries of the E.C., the application and concept of T.B.s vary widely. T.B.s are almost unknown in Denmark, Greece, Spain and Portugal and these countries have no regulations concerning them. They are very rare in Italy, Germany, and the Netherlands, and fairly rare in Belgium.

In the Anglo-Saxon countries, T.B.s are strongly influenced by financial considerations whilst in Germanic or Latin countries they are more often guided by arguments of industrial logic or of increased market share. In France and in Germany, financial markets must serve industry whereas in the U.K., the City of London is regarded as a financial industry in its own right. In this country, most of the T.B.s are friendly and serve the purpose of welding together agreements mutually agreed upon by both companies. The fear of a T.B. is regarded as an encouragement to the management team to be more efficient. The shareholders have the right to choose the management team, since they hold the funds.

In the other E.C. countries, different interest groups in the heart of the business are taken into account; - the staff, the banks, the shareholders..... and the shareholders are no more than one group amongst the others.

2. STATUTORY DEFENSIVE STRATEGIES.

These strategies are based on measures inscribed in the statutes of the society. Their aim is to avoid, or delay, change in the control of management structures. And so, whoever launches a T.B., will not be able to bring his policies quickly into action or to proceed smoothly to disrupt activities. These strategies exist in most countries in which T.B.s occur, except in Great Britain. In that country, the management of a business is restricted in its mode of defensive reaction. It must convince its shareholders, institutional investors in most cases, that the offer is not satisfactory. The arbitrator is the Takeover Panel. This panel supports the notion that it is the shareholders who must choose who controls the society.

2.1. The arrangement of voting rights for shareholders.

There are several ways of arranging these: shares without voting rights or with multiple voting rights or with an upper ceiling.

a. Shares without voting rights exist in several countries. By issuing this kind of shares, the owners of the business can keep control. The loss of voting rights is compensated for by advantageous financial terms.

In France, there are investment certificates and priority dividend shares without voting rights. Similarly, in Germany and the Netherlands, there are shares without voting rights.

2.1.

- b. - The allocation of voting rights.

In France, the statutes of a society can give double voting rights to all nominative shares held for more than two years by the same shareholder. And so, in the case of a T.B., the bidding society will have to acquire twice as many shares, thus increasing the expense of the operation.

- c. - Restrictions on the voting rights attached to shares.

A society can restrict the voting rights attached to its shares. This restriction exists particularly in Germany and the Netherlands but also in France. This restriction is possible in the U.K. but in fact, is rarely used.

In France, B.S.N. in Sept. 1992, decided to lock the door on its capital funds by fixing a ceiling value of 6% on the voting rights of all shareholders (12% in the case of those with double voting rights). ALCATEL ALSTHOM had already restricted this right to 8% and 16% to double vote shareholders, just as LAFARGE COPPEE had done in 1989 and PERNOD RICARD.....

In Germany, a number of societies add to their statutes a clause which specifies that no shareholder can hold more than a certain percentage of voting rights. The agreed ceiling is fixed at 5% (Deutsche Bank, Bayer, Veba) and at 10% (Dresdner Bank, Phoenix).

In Germany, the right to register nominative shares constitutes an extremely effective mode of protection. Without the consent of the management and shareholders, P.T.B.s are bound to fail. A law concerning shareholding (Aktiengesetz) dated 1.1.1966, regulates takeovers and acquisitions as well as the internal running of businesses and it allows them to protect themselves against undesirable takeovers by means of the internal regulations (Satzung) with which each business must equip itself. More than a third of German societies whose capital stock is made up of nominative shares, require them to be listed in a book, so that their owner can exercise his right to vote. Admission to this list, and thereby recognition of the new shareholder, is the sole prerogative of the general management, who can by this mechanism, deprive a shareholder of his rights, if it judges such a step to be desirable. This rule means that the management can select its own shareholders. This mechanism is frequently found in family businesses as well as in the insurance sector. Groups such as Allianz, Colonia, Aachner and Munchner are endowed with nominative shares which must be recognised by their respective general managements. Some recent decisions taken by German courts, confirm the legality of this defensive procedure as a defence against T.B.s.

(1. In May, 1992, the court in Hannover, disallowed the cancellation by the Continental A.G. group, of an anti-T.B. clause which limited to 5% the voting rights of a shareholder no matter how many shares he held. Similarly in May, 1992 the A.G.F. sought to have its voting rights (presently standing at 9%) raised to be equivalent to its level of participation in capital stock (26%) in the Germany company A.M.B. The German judge accepted in his decree that acknowledging voting rights would be against the interests of A.M.B.)

2 - CONTROL OF THE MANAGEMENT COMMITTEE.

The main measures concern the powers of the executives, and restrictions on the possibility of dismissing them.....

a. Spreading out executive powers over a period of time.

This technique allows only a few of the executives to be replaced at a time, whenever a General Meeting is held. This delays the moment when control can be exercised by the raider, or at least it does in the case of a partial offer.

b. Limits on the possibility of dismissing executives.

It may be foreseen that an executive cannot be dismissed without a good reason. This is possible in France and especially in Germany. In France, changing a society into a Limited Company with a management committee, affords better protection for the executives since then, they can only be dismissed on a request from the supervisory council.

c. Opportunity to convoke a General Meeting of shareholders.

Convoking such a meeting can constitute a valid means of defence by the targeted company during a T.B. A raider can use this opportunity to try to change the Management Committee. This happens often in the U.S.A.

It is possible in France where the majority shareholders can convoke a general meeting, and also in Great Britain, but in the latter country, it is very little used.

d. Golden parachutes.

These deal with contracts concluded between a company and its executives as a result of which high sums of money are paid to the executives if there is a change in control of the company not approved by the management committee.

In Germany, this method is possible within certain limits, provided that the sums concerned do not exceed a certain figure. In Great Britain golden parachutes will shortly be forbidden.

3. Recognition of the shareholding body.

Statutes can acknowledge the need to provide information at the cost of the shareholders up to certain thresholds of participation. These thresholds, however, in France, cannot be below 0,5% of capital. On the other hand, nomination of the shares enables the shareholders to be better known.

111 - DEFENSIVE STRATEGIES OF A FINANCIAL NATURE.

Their aim is to make the acquisition too expensive for the would-be predator. What they do is they influence the significance of the capital stock or the structure of the historical investment.

1. - The increase in capital or the growth of capital support from the stock exchange.

a. - The increase in capital before the T.B..

If a parent company owns several branch companies quoted on the Stock Exchange, it may absorb them by proposing a C.S.A. in such a way as to avoid funds escaping. It can proceed to increase capital with a preferential rights issue to existing shareholders; it can offer shares or a range of equities based on subscriber bonds.....Lafarge Coppee put into operation a scheme whose purpose was not to prevent any attempt at a T.B. but simply to make the attempt more expensive; any T.B. launched against the group, will have to include its three branch companies: Cementia in Switzerland, Asland in Spain, and Laforge Corporation in the U.S.A.

b. - The increase in capital during the period of a T.B.

This technique, used when faced with a hostile T.B., allows the rapid inclusion of friendly shareholders.

In Great Britain, the agreement of 50% of the votes at the General Meeting must be obtained. An increase in capital during a T.B. is forbidden in Italy and in Belgium.

In France, the law of the 2nd. August 1989 states that permission to increase capital must have been given before the takeover bid.

German law allows the General Meeting to authorise the management to increase capital at any time within a maximum delay of five years to a limit of 50% of existing capital, by cancelling the preferential rights issue based on subscription, from which the shareholders benefited.

The conditional increase in capital is the one which, depends on putting into effect certain conditions decided upon by the General Meeting: a distribution of shares to employees, subscriber bonds.....

2. - The organisation of a hard or firm core.

a. Forming a hard core.

Businesses can rely on a hard core of internal or external shareholders to their business. Several techniques are used : stock options, equities based on subscriber bonds, shares.....

This system is fairly expensive for investors. It can also cause bad effects and lead to the loss of independence for the business. In France, the Société Générale affair shows that friends can sometimes be attracted by tempting offers.

It is essential to stress the part played by the banks in Germany as a means of defence against T.B.s. In Germany it is hard to find one important business in which banks do not hold a significant investment. Moreover, banks receive open access to the certificates deposited in their vaults. They can exercise these rights and then they play a decisive role when general meetings are held. For example, on their own behalf, at their general meetings, the banks can, thanks to this system of open access, hold more than half the voting rights. Often the bank holds the right to participate in the business, is at the same time the bank for the business, is represented in the heart of the controlling organism and plays the role of broker on the financial market for negotiations concerning the business. It is clear then, that the bank will not accept a T.B. against this business.

b. - Shared participation.

The cross transfer, matched or not, of a re-purchasing clause allows companies the benefit of full autonomy. This method is used in France, Germany, the Netherlands and Italy.

In France, cross transfers, matched or not, of re-purchasing clauses, can create the benefit of a kind of autonomy. In Germany, the share holding body is very concentrated. Only 10% of shares are held by individuals. Businesses are bound together by a complicated system of participation. A limit of 50% is fixed on each participation and on condition that reciprocity does not cause dependency. It is therefore possible to hold in fact, 25% of one's social capital.

c. - The white knight, or the intervention of friendly groups.

The term "white knight" describes the friendly company which agrees to make a higher bid in the course of a T.B. or C.S.A. Thus, the shareholders will not be tempted to offer their title deeds to the T.B. company. One finds this in Great Britain as well as in Germany and France..... This type of defence was used by Navigation Mixte at the time of the T.B. made by Paribas in 1989. But this method can come up against the notion of a concerted action. If it is considered that the groups acted "in concert", they have to accept the same obligations as regards threshold boundaries and can be obliged to make a public bid themselves and this acts as a brake on this mode of defence.

3. - Self tenders.

This defence, which consists in reducing the flotation of shares liable to be transferred, is current in the U.S.A. However, it can bring the targeted company into debt.

It is used in France but within certain limits. Quoted companies can buy back their own shares in order to control the rate. But this operation, which needs the authorisation of the shareholders, must be notified in advance to the C.O.B. and is limited to 10% of the company's shares. The buying back of its shares is not possible during a T.B.

In Belgium, banking-legislation allows banks to buy up to 10% of their capital "in cases of serious and imminent danger". That is what the Brussels bank, Lambert of Belgium asked its shareholders to do in order to protect itself from a potentially hostile T.B.

In Great Britain, buying back its shares during a T.B. is possible but rare.

4. - The transfer of assets.

In order to discourage a raider from carrying out a T.B., the targetted company can sell off some of its assets (crown jewels). It can also grant a buying option to one third who will be able to exercise this option in the case of a friendly T.B.

In France, this technique can be used on condition it is brought into effect before the T.B., unlike the U.S.A., where it can take place at any moment. One can quote the example of the transfer of its insurance assets by Navigation Mixte to the German company Allianz in such a way as to make the takeover of control by Paribas less attractive.

5. - The poisoned pill.

In France, properly speaking, there is no such thing as a poisoned pill. But means do exist to allow the capital of a company to be diluted and to make the takeover of control more difficult: O.B.S.A., options. B.S.N. for example created a company, Gémofin, which disposes of 120 million francs worth of O.B.S.A. and can at any time bring into play 1.2 million subscriber bonds and thus increase its capital by more than 20%

111. - DEFENSIVE STRATEGIES OF A JURIDICIAL CHARACTER.

1. - The company statute

The value of a T.B. for the initiator of the operation, (the raider) is to be able to manage the company and to change its executive staff.

In France, the creation of a company in a limited partnership based on shares, allows it to keep its management team in control, however the capital is divided out.

The technique of forming a limited partnership, characteristically separates the power of controlling the limited partnership from the holding of shares. The managers of an Ltd (Limited Company), unless specifically stipulated in the statutes, are undismisable, unless with the unanimous agreement of its management. This technique has been adopted by a certain number of large companies in France: Castorama, EuroDisney, Yves Saint Laurent, Siparex, La Carbonique... More recently, in May 1992, the Jean Luc Lagardere group became a limited partnership based on shares, M.M.B. Holding; which holds 51% of the voting rights in Matra Hachette. This limited company will play its defensive role against external forces since the blocking minority, one third of the capital, is held by the Lagardere family and its allies.

In Germany, a fairly small number of limited companies exist and the number of companies quoted on the stock exchange is poor, bearing in mind the strength of the German economy. Moreover, company law allows structures which protect anonymous companies from P.T.B.s. A management system on two levels exists, the consequence of which is that even if a raider could succeed, he would not be able to influence control over the company and so any interest in a P.T.B. is removed. The Supervisory Council, (Aufsichtsrat), is appointed for 4 years by the General Meeting and can only be revoked by a three quarters' majority. Half of the seats in the Aufsichtsrat are reserved for staff representatives. The other half is controlled by the shareholders with voting rights, i.e., in essence, the big banks like the Deutsche Bank, the Dresdner Bank and the Commerzbank, and the businesses with a share of the capital. The executive arm of the businesses, the management team (Vorstand) is under the control of the supervisory council. The members are nominated and revoked by the supervisory council. Moreover, there is shared management control. Therefore, even in the hypothetical situation where a new shareholder could get rid of the management team, he would be prevented from selling assets and from trying to bring into effect new structures with the support of a minority of shareholders. Moreover, the Federal Cartel Office can prohibit operations, if it considers that the operation would result in market domination.

- 2. the setting-up of control holdings not quoted on the stock exchange.

It is possible in France, in The Low Countries as in Great Britain, to set up a linked sequence of holdings, by adding new investors at each level, thus increasing financial leverage. Control of the main holding allows retention of majority control of the quoted company with reduced capital.

- 3. Auto-control.

Auto-control is the means whereby a company can ensure control of itself by using as intermediaries one or more companies which it already controls directly or indirectly.

In France, since the 1st. July 1991, auto-control shares have been stripped of their voting rights. Therefore "direct" auto-control is prevented. However, indirect auto-control through branch companies in which there is at least a 50% holding, remains feasible and is practised. A linked sequence of minority shareholdings allows groups to be formed (The Rivaud Group).

The Twelve have voted for a written formula which aims to restrict opportunities for a company to buy its own shares, directly or indirectly by the subterfuge of using branch companies, with the aim of protecting it from T.B.s. The directive is said to accept that the branches of joint-stock companies will be able to continue holding shares in them but that these shares will be divested of the right to vote in the management meetings. This text will come into force from January, 1995.

V. - OTHER MEANS OF DEFENCE.

These group together a variety of practices, as for example, taking measures to keep the shareholders loyal, or taking shares in a credit company or making shareholder agreements.

- 1. - The stability of the shareholding body and the salaried shareholders.

In order to prevent T.B.s, companies have an interest in having a stable body of shareholders. That is why businesses not only give out dividends but also free shares to keep their shareholders loyal.

Establishing a block of shares for the benefit of the salaried staff of the company, can also constitute an effective means of defence. In fact, staff often feel threatened by a T.B. which could entail restructuring and eventually lead to job losses. They will not willingly hand over their shares to a raider.

In France, a company can buy back its own shares in order to distribute them to its staff. These shares can be sold within a period of 5 years.

In Germany, businesses can rely on the company's staff, which holds shares which cannot be sold for 5 years.

2. - Membership of a privileged sector.

For some T.B.s, sharing or controlling a credit company is subject to prior approval of the Committee of Credit Companies. That is why the retention of a bank by certain large French groups may be regarded as a defensive measure against T.B.s. This is the way the Compagnie du Midi defended itself against a hostile attack from Generali: The Compagnie du Midi had pleaded in court that the shares acquired by Generali must be divested of voting rights until the approval of the Committee was given on the banking regulations. That allowed the Compagnie du Midi time to organise its defence.

3. - Agreements between shareholders.

Agreements between shareholders are used to establish a controlling block. This method is used in France, Italy, Germany....

The principal shareholders come to an agreement by which they will have a pre-emptive right or an option to buy whenever shares belonging to any one of them is up for sale. These agreements are possible in France, but must be publicized.

In Italy, the large Italian groups have altered the structure of their shareholding body in order to keep raiders at a distance. They have increased their share in the capital of businesses. If a single shareholder does not have a majority, the main shareholders form a consortium which makes the company impregnable.

4. - The intervention of a "White Squire".

The "white squire" does not seek control of the company. The company issues some shares favouring an increase in capital to the advantage of the white squire on condition that the shareholders give up their preferential subscription rights. These deeds can be commitments that can be converted into shares, commitments with subscriber share bonds, options to buy, shares..... This form of defence is often used in France. The general meeting can also (a law of 1989) obtain the express permission of shareholders to arrange an increase in capital in the course of a T.B. But in this latter case, the preferential rights of shareholders can be revoked, which limits the chance of defence in the course of a T.B.

5. Counter-attacking a T.B.

This is a strategy of last resort. It can take place when a public takeover bid has been proposed. The business will then, anyway, lose a part at least of its independence. These are counter - T.B.s against the initiator of the attack. (PACMAN). This solution assumes that the targeted company has the financial means to launch a counter-attack and that the company initiating the T.B. is viable.

6. Recourse to justice.

This constitutes for the targeted company a gain in time which can be very valuable. It can be used in all countries where T.B.s can take place. Other measures allow delays in putting a T.B. into effect, by legal injunctions which can plead that the rules concerning threshold transgression have been disregarded or that the T.B. is the result of fraudulent misuse of confidential information and that there has been an inside leak. The targeted company can also plead that the T.B. is of a kind to reduce competition.

7. - Intervention by the public authorities.

The British Government can block T.B.s which are not in the national interest, but this possibility has never been used. The United Kingdom is one of the most liberal countries as far as T.B.s are concerned.

In Germany as in France, assumption of control is impossible in sectors in which the State holds a majority stake. In the other regulated sectors, the State reserves the right of veto. In the banking sector, The State exerts a certain degree of control. In general, all important amalgamations are subject to the control of the Federal Cartel Office (Bundeskartellamt, B.K.A.) In France, (all plans to concentrate resources can be subjected to the Ministry of the Economy if the proposal is likely to reduce competition.

Directors of companies in the European Community dispose of a whole range of measures to protect themselves from hostile P.T.B.s. The strategies brought into operation vary according to the countries involved. In Great Britain, there are few obstacles to a change of ownership and control. In France, there are severe difficulties blocking a change of ownership, but on the other hand, control passes smoothly to the new owners if a new majority is established. In Germany, there are also obstacles to a change of ownership, but, even if ownership of the business has changed, there are numerous obstacles to a change in control. In a wider European market, the need to achieve a size which allows economies of scale, will motivate raiders to seek new businesses to acquire.

Countries which up to now have been hostile to T.B.s may become more receptive to the idea. For example, in Germany, problems of succession to the business may encourage transfers. Moreover, businesses in Eastern Germany might become future targets for T.B.s when they are quoted on the market. Harmonisation of national legislations on the European level will certainly arouse interest but it is essential to realise that obstacles to T.B.s are not only to be found in the sphere of regulations but are often of a cultural nature and changes will surely be slow to come into force.

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