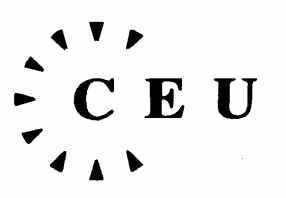

PROTECTION OF MINORITY SHAREHOLDERS DURING TAKEOVERS FROM EU PERSPECTIVE AND UNDER CZECH LEGISLATION

by Mgr. Peter Dráb

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LL.M. SHORT THESIS
COURSE: Corporations
PROFESSOR: Peter Behrens, Dr. habil.

Central European University
1051 Budapest, Nador utca 9.
Hungary

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ABSTRACT

This thesis identifies main aspects of protection of minority shareholders during takeovers from EU perspective and under Czech legislation. In particular, the thesis not only identifies level of protection attained in each target legal environment during takeovers and their completion but also tries to answer practical questions raised when considering reasonability of certain protective measures safeguarding the rights of minority shareholders.

In the light of the current statutory regulations it has to be said that there is still long way to go to achieve takeover friendly European level playing field which would not only attract foreign and local investors but also provide reasonable but not burdensome protection to investors.

From this point of view, it is more than paradoxical that EU on one side massively promotes free movement of capital and on the other side fears to adopt rules that would truly enhance takeover regimes which, in general, can be considered to be the most effective method of channeling funds and capital within economy.

As Jaap Winter[1] said: *"We all want to go to Heaven, but nobody wants to die."*

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[1] Jaap Winter was Chairman of the High-Level Group of Company Law Experts, on the passage of the European Takeover Directive

INTRODUCTION: WHY TAKEOVERS AS A METHOD OF ACQUIRING A PUBLIC COMPANY?

The most common method of "acquiring" (strictly speaking about gaining "control" by having significant ownership interest in company´s shares with voting rights[2]) a public company is to make a public offer for the target shares under the appropriate national takeover laws.

This is in contrast with merger agreements, which are rarely used for public M&A transactions in Europe (or at least in those countries with developed capital markets) for a number of reasons. First, the implementation of merger agreements requires the completion of a complex formal procedure: management reports, audits, shareholder resolutions and recordings in the commercial register. Shareholder litigation challenging the effectiveness of the merger is always a risk. A swift and flexible procedure, as required in most public M&A transactions, will often not be possible. Most important, dissenting shareholders of the ceasing entity can challenge the exchange ratio as being inappropriate.[3] The whole dispute and its impact on the financial effectiveness of the transformation (strictly speaking about obligation of ceasing entity to pay extra premium to all (not only dissenting) shareholders as decided by court) can be significant and can frustrate the whole process.

It is therefore more common to use mergers to simplify an existing group structure,

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[2] Control according to Czech law is defined as holding directly or indirectly at least 30% of the shares with voting rights which represent 30% of capital in a target company.

[3] *Scott V. Simpson, Hunter Baker, Michal Berkner, Ann Beth Bejgrowicz, Lorenzo Corte, Michael E. Hatchard, Piers Johansen, Matthias Horbach, Stefan Koch, Armand W. Grumberg, Arash Attar Rezvani, Pierre Servan-Schreiber, Philipp J. Wahl, Rainer Wachter, Francesco Ago, Michele Carpinelli, Filippo Modulo, Alexander J. Kaarls and Evelien W.I. Visser:* Future of Takeover Regulation in Europe; Copyright (c) 2006 Corporate Law and Practice Course Handbook Series;

e.g., as a second step after completion of a Takeover Offer. After control has already been obtained over a target, timing restraints are less important and the financial impact of a successful shareholder suit would be limited as only a few minority shareholders at the time of the merger would benefit from an adjustment of the exchange ratio.[4]

CHAPTER 1

1. BRIEF SURVEY UPON THE TAKEOVER REGULATION: EU DREAM OF FREE MARKET AND THE CZECH REALITY

How can EU become the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth? This is the question which has preoccupied member governments of the European Union over the last few years.[5]

Flexible flow of capital without intercommunity barriers is one of the basic prerequisites of dynamism in the economy. In this respect US record is superior – part of the explanation seems to be the existence of a set of policies and institutions, including large and well-organized financial markets, which serves as an effective mean

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[4] *Id*, p. 34
[5] For more see Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007; also Lisbon Strategy plan

of channeling funds to new enterprises, in dealing promptly with under-performing companies, and in facilitating the restructuring of industries.[6]

Looking for a balance between (minority) shareholders protection and free movement of capital EU has decided to abandon US model (strictly speaking about Delaware corporate law that gives almost unrestricted powers to managing directors to decide on takeover policy issues) and promote higher participation of shareholders. Thus one of essential questions to be discussed in this thesis is: "What are the proper powers of managing directors (managing board) and shareholders in transactions which result into change of control in the company? How to ensure that (minority) investors get as high premium as possible during takeovers?" I will also try to outline a balance between these issues and promotion of free movement of capital within EU presuming that takeovers are usually value enhancing (however, not always) transactions even to minority investors provided that the legislation sets fair rules and level playing field for the whole takeover process

It has been almost four years since EU Takeover Directive has been passed. EU expectations were high but unfortunately, most of them have not been met. The Directive now faces day-to-day reality of implementation by Member States. Despite some well balanced rules e.g. mandatory bid rule the practice in some member states has shown that regulation set forth by Directive is not sufficient. Thus, some of the issues laid down in the Directive e.g. facilitation of takeovers through restricting powers of managing board to frustrate takeover process to the detriment of (minority) investors

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[6] **Jeremy Grant,** European Takeovers: The Art of Acquisition, Euromoney books, 2006

ended in a compromise measure, which arguably, may do nothing to promote cross-border takeover activity and could even impede it.[7]

To sum up, in this thesis I will not only highlight the most important aspects of the EU Takeover Directive but also point out it's weaknesses from the view point of minority shareholders.

As the Directive leaves wide discretion powers to MS when transposing its provisions an example of transposition of the Directive into national law will be discussed simultaneously. The new Czech takeover legislation which was heavily influenced by German and Austrian law will be analyzed.

1.1 INTRODUCTION TO THE CZECH ACT ON TAKEOVER BIDS

The main intent of the Czech legislator was to liberalize takeover law and facilitate takeover process,[8] e.g. to remove some burdensome barriers with regard to obligation to launch mandatory bid, to introduce sell out rights etc.

The main conceptual change in Czech takeover legislation is that Commercial code becomes only subsidiary legal source to the new Takeover Act which governs only takeover bids of listed companies. These rules will be applicable regardless of type of securities for which the bid is done. Meanwhile voluntary bid of the offeror can be related both to shares of listed and non-listed companies, mandatory takeover bids can be addressed to shareholders of listed companies.

Also other changes significant for purpose of this thesis should be mentioned:

[7] Jeremy Grant**,** European Takeovers: The Art of Acquisition, Euromoney books, 2006, p. 12
[8] Official report on Czech Takeover Act, general terms and conditions (Důvodová zpráva – obecní část)

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- Triggering thresholds on acquisition of ⅔ and ¾ of capital carrying ⅔ and ¾ of voting rights in target company were removed since these provisions were unreasonably burdensome for bidders. On the other hand new threshold of 90% of voting rights acquired by bidder was established due to operability of sell-out rights.

  This mandatory bid duty of the controlling person enables minority shareholders to exit the company under same conditions as majority shareholders who tendered for the bid at the time, when there are little hopes for the liquidity of their shares. Thus minority shareholders are released from potential pressure of majority investor to lock them in the company and force them to sell their otherwise non-liquid shares under disadvantageous conditions.

1.2 ACQUSITIONS – GOVERNING LAW IN CZECH REPUBLIC

With regard to recent dramatic changes in Czech legislation I consider useful to give the reader a brief overview of Czech takeover legislation first:

- Commercial code 513/1991 Coll. (further referred as CC) contains some general rules and principles on takeover law in Czech republic;
- As of April 1st 2008 a new Act on Takeover bids[9] is effective in Czech republic (enacted due to transposition of 13th Directive into Czech law). Act on Takeover Bids (ATB) is a *lex specialis* to Commercial code which means that CC as *lex*

[9] By the time of writing this thesis Takeover Act was passed by the Senate of the Parliament of the Czech Republic (second chamber of Czech Parliament); internal number assigned to the final version of Takeover Act passed by senate is 198/2008. Formally to become effective, Takeover has to be signed by the President of Czech Republic and published in official Collection. The act shall become legally effective as of 1st April 2008.

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generalis will contain only general rules applicable to all takeover bids done by any commercial company provided there are no special rules. ATB as *lex specialis* will govern only takeover bids of listed companies.

Enactment of separate Takeover act rather than amending Commercial code is caused by the fact that the recodification of Commercial code will not be finished by the time when 13th Directive shall be transposed into national law.

- Act on Civil Procedure 99/1963 Coll., (Občanský soudní řád)
- Securities act (Czech) 256/2004 Coll.
- Directive on takeover bids 25/2004

1.3 WHO IS MINORITY SHAREHOLDER?

It should be emphasized that Czech Uniform Commercial Code recognizes neither the term "minority shareholder" nor "majority shareholder." Thus it doesn't speak of protection of minority or majority shareholders as such during takeovers.[10] This concept is widely recognized also through OECD Principles of Corporate Governance (1994/2004), which state that takeovers should be regulated to protect interests of all shareholders.

The essence is that "strong" shareholder will probably not find himself in a disadvantageous position since he has enough powers to pass measures favorable for

[10] Obchodní právo 3 (Business law 3rd vol.), Stanislava Černá; Wolters Kluwer 2006, p. 169

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him during shareholders meeting or by other means and thus protect himself effectively without being in need of additional protection.

That is why legal theory began to label some rules and legal institutes as minorities protective.

Protection of minority shareholders during mergers and acquisitions is construed on the principle that no shareholder should be deprived of his rights against his will and that all shareholders should be treated equally. The existing body of legislation and judicial decisions safeguard fair treatment of all shareholders and provide effective remedies against abusive actions pertaining to expropriate minority shareholders.

However, ability (capacity) of the shareholder to take advantage of certain protective legal vehicles depends on the fact whether he meets basic quantitative or qualitative prerequisites required by law (e.g. CC sets 3 per cent threshold for minorities to request managing board to call extraordinary shareholders meeting).

CHAPTER 2

MANDATORY TAKEOVER BIDS IN GENERAL

Institute of Mandatory Takeover Bids is widely considered to be one of the building blocks of protection of minority shareholders during acquisitions of public companies and one of the main pillars of protection of capital markets as such.

When using term “company” it should be understood that takeover laws are predominantly targeting on listed companies, which shares are publicly traded on

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respective capital markets.

Because of the great dynamism of capital markets it is very difficult to regulate them with sound and innovative rules that attract investors to direct their resources to listed companies. Thus the ambition of legislators was not only to govern capital markets by "hard" laws but also through application of "soft" laws which work as self-regulative and can very swiftly react on changes on the market.[11]

2.1 DIRECTIVE 2004/25/EC OF THE EUROPEAN PARLIAMNET AND OF THE COUNCIL OF 21 APRIL 2004 ON TAKEOVER BIDS (13th DIRECTIVE)

"European-wide rules for takeover bids are considered vital to the objective of improving Europe´s competitiveness, notably facilitating cross-border consolidation of industry. The Commission´s aim is to create a vibrant takeover market, providing mechanisms for takeovers and changes in the management of poorly run firms, and reducing the scope for management to extract private benefits."[12]

My primary concern in this chapter will be the EU Directive 2004/25/EC on Takeover bids (also known as 13th Directive) which was enacted after 15 years of consultations. Unfortunately it´s enactment can hardly be labeled as successful since it ended up with compromise which is more than disputable.[13]

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[11] For more see general principles of Takeover Directive Art. 3

[12] European Commission Statement No. 13, 2002

[13] Although EC succeeded in adopting the Takeover Directive the adopted text was much different from the draft of Expert group. It was agreed not to harmonize target companies' defensive tactics, by making the rules regulating duties of the target´s company managing board during takeover (Art. 9) and breakthrough rules (Art. 11) optional for Member States (Art. 12). Arguably, most of the remaining provisions are little more than "housekeeping rules," clarifying matters such as the competent authority

The objective of the Directive is to ensure a level playing field for takeover bids in the EU. Thus, some of the principal questions in the debate were:

- As already mentioned, to ensure the existence of a level playing field[14] in the European Union concerning takeover bids and equal treatment of shareholders across EU Member States;
- The definition of the notion of equitable price to be paid to minority shareholders and
- The right for the minorities to exit target company under fair conditions. This should be maintained through mandatory bid rules, sell-out rules and indirectly also squeeze-out rules.

Thus, in following chapters I will also focus on the backbone of the minority shareholders protection rules consisting of mandatory bid provisions, squeeze-out and sell-out rights and the definition of the notion of an "equitable price" to be paid to minority shareholders. It is important to add that thirteen of the former fifteen member states agreeing on the Directive already had mandatory bid system.[15]

Directive contains some good rules particularly those on minority protection and some bad rules such as the jurisdiction clauses or rules on defenses against takeovers. For the scope of this thesis minority issues will be deeply discussed.

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and the applicable law in cross-border takeovers (Art. 4), providing procedural rules on how to conduct a bid and what to disclose (Art. 6, 7 and 8) or laying down broad and vague general principles on takeovers (Art. 3) For more, see: European Takeovers: The Art of Acquisition, Jeremy Grant, Euromoney Books, 2006, p. 119

[14] Disability to undertake takeover bids with the same expectations of success in various member states and inequality of opportunities for shareholders to tender their shares were generally referred to as the "lack of level playing field" in the area of takeover bids in EU.

[15] Report of the high level group of company law experts on issues related to takeover Bids, Brussels January 10th 2002;

As already indicated, I will analyze the new Czech Takeover act [16] that transposed the 13th Directive into Czech national legal system and focus on all legal vehicles afforded by Czech law to minority shareholders.

2.2 DISCLOSURE REQUIREMENTS AS PRECONDITION OF EFFECTIVE MANDATORY TAKEOVER BID RUELS – EU AND CZECH REGULATION

Companies which securities are publicly traded are subject to much stringent rules than non-listed companies. The biggest burden of listed companies comes with information duties towards investors and supervisory bodies. The rationale behind such bureaucracy is in higher need of protection of capital markets and investors. It should be emphasized that duty to notify competent supervisory body about reaching certain thresholds in share-capital is a necessary prerequisite for efficient operation of mandatory bid mechanisms.

Legal framework in Czech republic consists of Act on Trading on Capital Markets 256/2004 Coll. and Directive 88/627/ES. [17] The Directive sets disclosure thresholds for voting and cash flow rights which must be reported to national market regulators. Each acquirer of a company´s stock has to give due notice within seven days to competent supervisory body (National Bank of Czech republic) if his or her amount of shares equals, surmount or falls below certain thresholds (10 per cent, 20 per cent,

[16] Czech Takeover act (Zákon o nabídkách převzetí) was already approved by both chambers of Czech Parliament yet it by the time of writing this thesis hasn´t been published in official Collection.
[17] Art. 10 of Takeover Directive should be also mentioned asi t requires the disclosure of all takeover defences and devices adopted for commercial purposes which could be utilised as defences against hostile

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one-third, 50 per cent and two-thirds, respectively). Act on Trading on Capital Markets through provision of Art. 122 transposes these duties into national legislation.

Information on ownership thresholds are important signal for other shareholders or other potential investors. They notify shareholders on changes in voting environment of the company. Information duties on voting rights thresholds are also vital for effective execution of mandatory bid rules and thus protect minority shareholders in a way that enables them to exit the company under fair conditions.

Failure to provide information on reaching specific threshold in ownership of shares with voting rights results according to §122(4) of Act on Trading on Capital Markets to suspension of the execution of voting rights acquisition of which triggered mandatory disclosure duty.

2.3 PROTECTION OF MINORITY SHAREHOLDERS THROUGH MANDATORY BID THRESHOLDS

After acquirer notified relevant supervisory body about reaching certain threshold with regard to acquisition of share-capital with voting rights to the extent which enables him to control the company he has a duty to launch mandatory takeover bid.

A takeover bid is a public offer to shareholders of target company to enter into specific sales contract on securities with voting rights. The bidder declares his will to acquire 100% of shares with in the target or to increase his controlling stake in target

takeovers. Purpose of this clause is to facilitate the free flow of information, lower transaction costs and increase the efficiency of the takeover market.

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(voluntary bid) or declares his will to meet statutory obligations by submitting the bid (mandatory bid). The bidder has to provide fair consideration either in money or in sharer or as a combination of both.

Through provisions on mandatory bid thresholds Takeover Directive aims at preventing majority´s abusive conduct pertaining to the elimination or expropriation of the minority shareholders and eliminates partial bids for control. Every takeover bid has to be in line with basic principles specified in Art. 3 of Directive.

In Art. 5(1) the Takeover Directive imposes a duty[18] on Member States to adopt rules on mandatory takeover bid which mandate any natural or legal person who alone or in concert with third parties acquired controlling stake on share capital (in most Member States mandatory bid threshold averages around 1/3 of share capital) in target company. In practice, this gives shareholders a fair exit option and enable minority shareholders to participate in the control premium. It also adds to legal certainty, because bidders can predict their costs and prevents the controlling shareholder from extracting private control ex post a takeover.

Historically, prior to the introduction of mandatory bid thresholds, large shareholders in Europe were able to flip control stakes between each other without having to buy out minority shareholders at a premium.[19]

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[18] See also consequences ignoring the MBT, PKN Orlen/Unipetrol case, p. 23 of this thesis
[19] Jeremy Grant, European Takeovers: The Art of Acquisition, Euromoney Books 2005, p. 41

2.4 INTRODUCTION TO CZECH MANDATORY BID RULES – ART. 35 OF TAKEOVER ACT

As already mentioned in Chapter on introduction to EU Takeover Directive Member States may opt out significant part of regulation contained in the Directive and set vast number of exceptions.

Examining Czech Takeover Act it seems, that Czech legislator was trying to avoid rules which would enable companies to bypass mandatory bid rules, weaken position of minority shareholders or threaten operation of capital markets. It should be also noted that rules on mandatory bids were firstly incorporated into Czech law in 2000 by amendment of CC no. 370/2000 Coll. Thus the new Takeover act has not created completely new takeover bid institutes but rather more tightly harmonized existing rules with EU requirements.

However, there are rules on takeover bids that have not been covered by former legislative framework e.g. takeover act newly regulates practices of persons acting in concert and subordinates concerted practices that result into gaining control in target company under mandatory takeover bid regime or introduces sell-out rights which could not be enforced before.

In line with French, German or UK legislation mandatory bid threshold in Czech republic is set to 30 per cent of share capital. As shall be demonstrated further the bid shall be made at a price no lower than that paid to any other shareholder over a set period of 12 months.

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2.5 AVOIDANCE OF MANDATORY BIDS THROUGH CONCERTED PRACTICES; DEFINITION OF PERSONS ACTING IN CONCERT ART. 2.1(d) OF TAKEOVER DIRECTIVE ART. 2(9) ACT ON TAKEOVER BIDS

After Europe experienced many cases when parties acting in concert tried to circumvent mandatory bid thresholds[20] Czech legislator paid special attention when drafting provisions on MBT of persons acting in concert. Besides, it seems from the wording of Art. 2.1(d)[21] that MS do not have much space to depart from the provisions. Takeover Directive can be perceived as an important step towards common definition of acting in concert throughout the Europe.[22]

The basic definition of persons acting in concert contained in Art. 2(9) of the new Takeover Act in contrast with the previous legislative framework more precisely defines who is person acting in concert. According to official report to Takeover act persons acting in concert can be only those who have direct control (this include third parties who control these persons) over voting rights in target company and third persons who control them. This means that for the purposes of MTB law recognizes only vertical structure within a concern.

[20] Clear example of circumvention of MTB is demonstrated in case of the acquisition of control of Beiersdorf by Tchibo in 2003 when Tchibo by means of concerted practice managed to escape the duty set forth by German Takeover Code to make MTB to all outstanding minorities. Thus, the main issue in the case was: "Whether the cooperation between several parties with the objective to acquire a controlling stake constitutes a concert party action in itself, or whether the concept of "acting in concert" also requires an agreement among these parties to coordinate their conduct beyond the acquisition of shares e.g. by exercising their voting rights. For more see Case study: The acquisition of control of Beiersdorf by Tchibo; Grant and Kirchmaier (2004)
Other examples are SAI/Fondaria (2001) or Banca Antonveneta (2005), see case study Brothers in Arms, The Economist, 13th August 2005

[21] "…persons acting in concert shall mean natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid."

[22] Erik Bomans and CharlesDemoulin: Acting in concert – First conclusions from two recent takeovers and the Takeover Directive, p. 6

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Concept of mandatory bid thresholds in case of concerted practices is based on principle of individual examination of whether each person acting in concert gained controlling stake in target company or not. This means that duty of mandatory takeover bid will not be triggered in case of concerted practice when shareholder controlling 50 per cent of shares with voting rights acts in concert with person holding 1 per cent of shares. However, duty to submit mandatory bid duty arises if a group of persons acting in concert is established and due to this fact each person of the group acquires controlling stake on voting rights in target company (e.g. each of two shareholders acting in concert will as a matter of their common activities reach controlling stake of 30 per cent of voting rights).[23]

2.6 LEGAL PROCEEDINGS TO ENFORCE CLAIMS OF MINORITY SHAREHOLDERS UNDER TAKEOVERS ACT – REMEDIES GRANTED TO MINORITY SHAREHOLDERS UNDERS CZECH LAW

Protection of shareholders with emphasis to minority shareholders is safeguarded through Articles 50-52 of Takeover Act which impose liability for non-performing the takeover bid (art. 50) and misrepresentation of facts during takeover bid (art 51). In addition shareholders have right to sue for increase of the premium paid for the shares.[24]

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[23] Art. 35, 36 of ATB
[24] Procedural rules governing actions for damages and for increase of price paid as a consideration during takeover and squeeze-out are contained in Act on Civil Procedure 99/1963 Coll., Art 83 (2d)

It should be added that bidder and persons acting in concert are jointly and severable liable for any damages incurred by shareholders of target company which were caused by conduct foreseen in art 50-52.

2.7 ART. 50 – REMEDIES AVAILABLE TO MINORITY SHAREHOLDERS IN CASE OF BREACH OF MANDATORY BID DUTY.[25]

As stated above according to Art. 50 minority shareholders can bring an action and claim for damages if the obliged person didn't meet his statutory duty to announce takeover bid. Only persons who were owners of securities in target company at the last day of the due period (within which takeover bid shall be announced) are legitimate to bring an action. Thus, the right to claim for damages is not transferable on other acquirers after the lapse of period.

Due period to bring the action is construed as subjective with purpose to strengthen position of shareholders who suffered damages (action shall be brought no later than six months since the time when plaintiff learned about mandatory bid obligation).The court has to publish information about the commencement of proceedings on its website and official notice board. Other persons entitled to bring an action have additional three months period (to previous six month period) to do so since the moment of publication.

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[25] Articles 183b, 183c, 183e, 183f, 183g and 183h of Commercial Code governing mandatory takeover bids of listed companies as well as remedies available to shareholders have been derogated and new provisions were inserted in the Takeover Act.

Once the judicial decision awarding damages is rendered to one claim it becomes binding for all remaining claims referring to the breach of the same takeover-bid-publication duty.

2.8 ART. 53: SANCTIONS FOR FAILURE TO SUBMIT MANDATORY TAKEOVER BID ACCORDING TO ART. 50

The new Act on Takeover bids imposes heavy sanctions for breach of duty to submit mandatory bid. If omitted, starting since the moment of gaining the control in target company to the extent that establishes duty to submit mandatory tender bid, the company which gained control is by operation of law suspended from performing its voting rights attached to certain kinds of shares. Suspension of the right to perform voting rights can be healed by additional submission of mandatory tender bid.

Sanction under which all voting rights assigned to shares in the target company and held by the bidder are suspended may result in chain reaction which can be launched by minority shareholders. Despite the fact that the bidder owns controlling stake in target company, practically, due to the suspension of his voting rights his position is weaker than position of minorities particularly in situations when minority shareholders manage to call extraordinary shareholders meeting.

This means that if the bidder tries to circumvent the obligation of mandatory takeover bid to detriment of minority shareholders all his measures in this respect can be very radically overturned by defending minority.

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2.9 CASE STUDY: ACQUISITION OF UNIPETRO BY PKN ORLEN[26] – SUSPENSION OF VOTING RIGHTS DUE TO FAILURE TO SUBMIT MANDATORY BID.

According to Czech takeover laws Polish PKN Orlen gained control in Czech Unipetrol on 24th May 2005 (63% of shares with voting rights at 98,9 CZK per share). Consequently, after reaching threshold PKN Orlen was obliged to launch mandatory bid within 60 days following the day that PKN gained control i.e. latest till 25th July 2005. June 30th 2005 PKN submitted mandatory bid prospect to Czech supervisory body for approval(Commission for Securities). July 2005 14th Commission found that the price 109 CZK per share was not fair and rejected the prospect (due to gross flaws in appraisal, which did not prove fairness of offered price; average market price within last 6 months before PKN gained control was 120 CZK). Takeover bid laws strictly prohibit to launch mandatory bid without prior approval of official Supervisory Body. July 25th 2005 due period within which PKN was obliged to make mandatory bid to minority shareholders expired.

By operation of law all voting rights controlled by PKN were suspended and minorities found themselves in position, which theoretically allowed them to gain control in the company i.e. change articles of incorporation, remove members of the managing board, decide on purchase of shares for higher price etc.

In line with Czech Commercial Code minorities could possibly undertake following measures:

[26] For more see official report of Commission for Securities (Komisie pro cenné papíry) from 29th September 2005;
http://www.sec.cz/export/CZ/Informace_verejnosti_a_mediim/get_dms_file.do?FileId=2734.

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- Minority shareholders who were holding remaining 33% of shares could call shareholders meeting (CC sets 30% threshold to call the meeting. However, the minimum quota to adopt any changes in articles of the company is set to 50 per cent of all shares with voting rights unless articles of company provide higher quota). CC also provides, that in cases when shareholders meeting does not reach quota for adopting resolutions (due to insufficient presence of shareholders with voting rights) immediately (within 15 days) after the failure of previous meeting so called "substitute shareholders meeting"[27] can be initiated. During substitute shareholders meeting most of decisions can be adopted by the mere majority of present (not all) shareholders of the company.
- Qualified minority shareholder/shareholders (Art. 181 CC) who own at least 3 per cent of shares can request managing board to call extraordinary shareholders meeting. In case of refusal by board of directors, minority shareholder can turn to court to mandate him to call the meeting. Although the drawback of this option is that it takes sometimes more than month until court approves extraordinary shareholders meeting it puts acquirer under substantial pressure to submit as soon as possible a new mandatory bid which would reflect fair value of shares.

Soon, PKN realized seriousness of the sanction and decided to immediately submit new mandatory bid prospect for approval to Commission for Securities. PKN offered significantly higher price - 139 CZK per share (increased by 35 per cent).

[27] See Art. 185 (3) Commercial Code 513/1991 Coll.

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Consequently, Commission for Securities approved mandatory bid prospect submitted by PKN which unblocked PKN´s voting rights.

PKN Orlen/Unipetrol case clearly demonstrates, how mandatory bid rules together with sanction of suspension of voting rights can be efficient in forcing the bidder to pay fair value to minority shareholders.

2.10 PROCEEDINGS UNDER ART. 51 – MISREPRESENTATION OF FACTS IN TAKEOVER BID

Other vehicle designed to strengthen mandatory bid duty is anchored in Art. 51 of Act on Takeover bid, which main goal is that information in the mandatory bid afforded by bidder are true and accurate.

Thus, any misrepresentation of important facts in takeover bid which as a matter of fact could cause damage to shareholders in target company will result into liability of bidder and persons acting in concerted practice. Legal capacity to instigate proceedings is formulated in relatively broader way – any person who was a shareholder during the period in which the takeover bid was binding can bring an action. Liability is construed as subjective which means that bidder can be liberated if he proves that there was no intention on his side. Proceedings cannot be commenced later than one year after the person got knowledge that the information in the takeover bid were misleading or otherwise improper. Similarly to As a sanction all voting rights are suspended.

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2.11 FRUSTRATION OF TAKEOVER BID BY MANAGING BOARD PRINCIPLE OF BOARD NEUTRALITY, PHENOMENON OF HOSTILE TAKEOVERS

"Hostile takeovers are but gangsterism and the law of the strongest."
François Mitterand, former president of France, 14 February 1989

Despite a few well-known cases such as Vodafone´s acquisition of Mannesmann, hostile takeovers are rare in most of Europe. There is still lack of consensus about the effects of hostile takeovers among EU politicians. Especially, when it comes to national "blue chips" for most of them the fact that their national champion could be acquired by foreign raider through hostile takeover drives them mad.

Not surprisingly, practitioners and professionals dealing with acquisitions are on the other side of the barricade...

Art. 9 of the Directive confirmed the shareholder decision-making principle, thus preventing post-bid defenses by boards which are not specifically authorized by shareholders and thus limits the board's power to raise obstacles to hostile takeovers to the detriment of shareholders' interests. [28] It safeguards shareholders against opportunistic behavior of the incumbent management and ensures that it is indeed the owners who decide on the future of the company.[29] However, as a matter of compromise board neutrality rule became optional for Member States to adopt despite a general fact that takeovers as value enhancing transactions for shareholders are likely to endanger the jobs and status of board members and thus cause conflict of interests.

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Maybe a little surprisingly (but with big relief on the side of investors) Czech republic through the new ATB in Art. 15 strictly prohibited members of managing board to undertake any measures that could lead to frustration of takeover bid without prior consent of the shareholders meeting. On the other hand, management board can actively look for counter bids, which are more profitable for the stakeholders.

Quota of shareholders votes for approving frustration of a takeover bid should not be less than quota of shareholders votes for change of articles of company. This means, that upon this rule minority shareholders with blocking minority can prevent majority from adopting rule that would frustrate takeover, bid which they consider to be value enhancing for the company.

Note: Resolutions of shareholders' meeting may normally be passed by a simple majority of the votes cast at the meeting. For certain decisions a 75% majority of the votes or of the participating capital (a qualified majority") may be required by the articles. A qualified majority of the capital represented at the passing of the resolution is required by law also in cases: merging of the company into another company, mergers and consolidations

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CHAPTER 3

EQUITABLE PRICE AND FAIR CONSIDERATION

"*The value of the shares is not important because people are not interested in buying*

[28] Jaap Winter, Chairman of the EU High Level Group of Company Law Experts: The good, the bad and the ugly of the European Takeover Directive, 2005

our shares and we are not interested in trying to promote the value of our shares"

Vincent Bollore, French corporate rider, on his family´s publicly listed company

(Simons and Silver, 2003)

Regulation of the offer price is a vital element of equality treatment. It is standard practice to require that the mandatory bid to all shareholders at least equals to the highest price paid or agreed to by the bidder, or any party acting in concert with him, in a set number of months prior to the bid. Also, Takeover Directive provides that a mandatory bid must be made at an "equitable price" and precisely defines such notion in line with above mentioned.[30] Directive also provides for some flexibility allowing MS to adjust decisive period to minimum 6 and maximum 12 months before the bid was submitted.

Unfortunately also in this case, Member States can specify in their takeover legislation that national supervisory bodies can depart from provisions of Takeover Directive under preconditions foreseen by national law provided that principles specified in Art 3(1) of Takeover Directive will be applied. Thus, Czech legislator also decided to give its supervisory body (National Bank of Czech republic) powers which ipso iure allow to abandon rules on equitable price specified in the Directive.

The backbone of the fair price regulation is based on a principle that if the bidder subsequently purchases shares in the target at a higher price, he must extend this to all shareholders and offer them higher price as well.

[29] Report on the implementation of the Directive on Takeover Bids, SEC (2007)268, p. 5

[30] Directive 2004/25/EC on takeover bids; Art. 5(4): "The highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by MS, of not less than six months and not more than 12 before the bid referred to in paragraph 1 shall be regarded as the equitable price. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him purchases securities at a price higher than the offer price,

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A bidder may offer:

- Cash;
- Liquid shares admitted to an organized market;
- A combination of any of these.

Minority shareholders are entitled to receive a fair cash compensation, the amount of which is to be determined by the main shareholder and to be reviewed by an auditor. Minority shareholders may within one month following the publication of the registration request a review of the cash compensation offer in court; any court decision will extend to all minority shareholders of the stock corporation. No minimum holding period or minimum shareholding is required to request court review (although the court may hold against the requesting minority shareholders as regard the costs of the litigation).

3.1 DEFINITION OF EQUITABLE PRICE UNDER CZECH LAW

In accordance with Article 5(4) of Directive a bid price offered for the shares of target company shall not be lower than premium price set by bidder.[31] If the premium price could not be specified (e.g. in cases when the controlling stake in target company was acquired indirectly through acquisition of a company controlling target) then price offered[32] for the holders of shares in target shall not be lower than the average price on

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the offeror shall increase his offer so that it is not less than the highest price paid for the securities so acquired.

[31] According to Art. 43(3) of Czech Takeover Act premium price should be the highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period of twelve months before the bid.

[32] Board should consider actual price, historical trading prices, future assessment based on historical

relevant market over a period of 12 months.

3.2 PROCEEDINGS ON FAIR PRICE BEFORE NATIONAL BANK OF CZECH REPUBLIC

Since April 1st 2006 the National Bank of Czech republic has become sole supervisory body over securities market, insurance market and credit unions market. Thus a unified surveillance which encompassed also takeover bids has been established. NBC is also appropriate (competent) body to approve publication of mandatory takeover bids (voluntary bids are not subject to NBC approval) and some other regimes through which takeover bids are regulated.

Czech ATB further specifies that all prior economical considerations (including operations between bidder and persons acting in concert) provided for shares of target company shall be taken into account when setting premium price. If premium price to any extent consists of nonmonetary consideration the bidder should state the value in and set forth grounds of valuation of the bid price. (see art. 3)

Bidder and persons acting in concert have duty to inform National Bank of Czech republic about all measures related to transfer of shares of target company together with request for approval of publication of the bid. One of mandatory attachments to the request shall be among other justification of the height of bid price (the form of justification is left on the bidder, however, NBC can request for justification

performance, risk assessment See PLI's Sixth Annual Institute on Securities Regulation in Europe: A Contrast in EU & US Provisions; TAKEOVER LAW AND PRACTICE; Copyright (c) 2007 Practicing Law Institute; David A. Katz, p. 30

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in form of appraisal).[33] It is not possible to publish mandatory bid without prior approval of NBC. It should be emphasized that NBC that does not review the amount of consideration but only reasons that justify it.

As Directive grants member states and national supervisory authorities wide discretion powers in administration of equitable price and also in determining the circumstances and the criteria justifying a discount it is interesting to examine the proceedings on adjustment of premium price at NBC.

NBC as the only supervisory body on capital markets in Czech republic can by operation of law review mandatory takeover bids and amend the price offered by bidder.

According to Art. 44(1) NBC can adjust the bid price in taxatively defined situations foreseen by legislator mainly if there is a strong indication that premium price proposed by bidder or the average market price are not fair (due to low liquidity or market failures).

According to Art. 44 of Takeover act NBC can change value of the consideration in order to obtain "equitable" price. This can be done only in situations foreseen by the legislator and described in Art. 44(1) i.e..:

- premium price was heavily affected by speculative market price decrease or by market deformations or other circumstances.
- average price of the securities was heavily influenced by their own unusually low liquidity;
- Premium price was negotiated outside regulated market and with regard to other commercial relations between contractual parties

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Appraisal of the premium is mandatory if the consideration is provided in other form than cash.

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- During the last two months there was a significant change of economic situation in the target company.

  In line with the Art. 5(4) of the Directive the NBC has to take into account current market price of shares on relevant capital market when reviewing the bid price. Optionally, NBC can follow (however is not bound by) expert opinion submitted by the bidder. NBC can waive off the right to impose this duty. In case of any reasonable doubt NBC can appoint it's own expert appraiser and confront both opinions.

  In my opinion, the fact that NBC is entitled to scrutinize premiums in all mandatory bids plays an important role in (minority) shareholders protection during takeovers. It should be emphasized that premium paid for shares in target company is solely managed by bidder (majority shareholder) who will always tend to adopt most advantageous solution for him.

3.3 ART. 52 ACTION FOR INCREASE OF THE PRICE PAID FOR THE SHARES

Low price paid for acquired shares does not constitute invalidity (voidness) of the contract formed on the basis of takeover bid. However, if the process of setting a fair price does not comply with provisions of Art. 43 according to art. 50 offeree can suit for difference between price paid and fair price under Art. 43. The court is not bound by the decision of NBC on valuation of fair price.

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CHAPTER 4

PROTECTION OF MINORITY SHAREHOLDERS FOLLOWING THE SUCCESSFUL COMPLETION OF A TAKEOVER

4.1 SQUEEZE-OUT RIGHTS – TRANSPOSITION OF ART. 15 OF TAKEOVER DIRECTIVE INTO CZECH LEGISLATION

Provisions on squeeze-outs anchored in Art. 15 of Takeover Directive shall be applied in cases when bidder (regardless whether on grounds of mandatory or voluntary bid) acquired substantial part of share-capital in target company. EU Directive defines squeeze-out threshold as a situation where the offeror holds securities representing not less than 90 per cent of the voting rights in the offeree company or where following acceptance of the bide offeror has acquired not les than 90 per cent of the offeree company´s capital carrying voting rights and 90 per cent of the voting rights comprised in the bid. However, the threshold should not be higher than 95 per cent.

The acquirer has the right to ask remaining shareholders who did not tender for their shares to sell their shares at equitable price to him. This right becomes available for the bidder if he reaches 90% threshold of voting rights on share capital and aims to allow a bidder to gain 100 per cent of the equity to simplify accounting and administration.

Although squeeze-out rights may at first sight appear as purely bidder protective also minority investors who have not tendered their shares in the offer can benefit from

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these rules. Squeeze-out enables minority shareholders to exit the company at the same conditions as the owners of controlling stake.

4.2 JUSTIFICATION OF SQUEEZE-OUT

Company shareholders are in the most MS jurisdictions considered as investors. There is a wide policy consensus on investor protection, in particular, the protection of minority investors through disclosure requirements and the provision of a valuable exit opportunity for minority investors at the same price as controlling shareholders guaranteed by sell-out and squeeze out rights.

Since squeeze-out rights in fact lead to expropriation of minority shareholders in cases when the bidder reaches threshold value on his controlling stake in the target company (90 per cent of the capital carrying voting rights and 90 per cent of the voting rights in the offeree company) the EU Commission by foreseeing potential abuses of majorities shaped pack of rules which aim to protect minority shareholders. However, the wording of Art. 15(5) [34] leaves room for setting a price different from the tender offer price. As discussed below, Czech example shows that some Member States can have extensive problems with setting just rules and mechanisms on equitable price.

Property rights of shareholders are in most of Member States guaranteed by national constitutions and also by European Convention on Human Rights. In general, it is

[34] Art. 15 (5): "MS shall ensure that a fair price is guaranteed, That price shall take the same form as the consideration offered in the bid or shall be in cash. … Following a voluntary bid, in both of the cases referred to in paragraph 2(a) and (b), the consideration offered in the bid shall be presumed to be fair where, through acceptance of the bid, the offeror has acquired securities representing not less than 90 per

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strictly prohibited to deprive anyone of his property rights without proving that the there is a reason of public interest to do so and that the owners of the are compensated by appropriate consideration.[35]

There have been many disputes in various Member States[36] which were settled in a way that squeeze-out right cannot be incompatible with constitutional provisions protection property rights and European Convention on Human rights. The outcome of the court proceedings was that there is a strong public interest to squeeze out minority shareholders.[37] There is indeed a general and public interest in having companies efficiently managed on the one hand, and securities markets sufficiently liquid on the other hand. So long as the squeeze-out right applies only when the minority is fairly small and appropriate compensation is offered, the use of squeeze-out to address these public interests is proportionate.[38]

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cent of the capital carrying voting rights comprised in the bid. Following a mandatory bid, the consideration offered in the bid shall be presumed to be fair."

[35] The Takeover **Directive** stipulates that the squeeze-out price is fair if it is the same as the consideration offered in a voluntary bid in which the offeror has acquired securities representing at least 90% of the voting shares or a mandatory bid.

[36] See for example :

- Decision of the German Supreme Court of 7 August 1962, Feldmühle.
- Decision of the French Supreme Court of 29 April 1997, Association de défense des actionnaires minoritaires et autres against Société Générale et autres, Recueil Dalloz 1998, pages 334-338.
- Decision of the German Supreme Court of 27 April 1999, DAT/Altana.
- Decision of the German Supreme Court of 23 August 2000, Moto Meter.

[37] For more detailed information see Report of the high level group of company law experts on issues related to takeover Bids, Brussels January 10th 2002; p. 65

[38] *Id* at p. 66

4.3 BATTLE FOR JUSTIFICATION OF SQUEEZE-OUT RIGHTS IN CZECH REPUBLIC – SETTING UP A FAIR PIRCE

Probably the hottest debate in the country was caused by allegedly unfair rules setting equitable price for shares during squeeze-out[39] procedure. Current rules enable majority investor to expropriate minorities under conditions that can be labeled as unfair i.e. price offered as a consideration for shares is usually lower that the market price. In this paragraph I will closely examine provisions that are problematic from the viewpoint of minority shareholders.

First of all, it should be noted that on March 27th 2008, in the time of writing this thesis, the Constitutional Court of Czech republic (further referred as "CCC") in it´s decision justified squeeze-out rights.[40] Proceedings were instigated by a group of senators (members of second Chamber of Czech Parliament) claiming that current rules are contradicting fair price principles contained in EU Takeover Directive, European Charter of Human Rights and Basic Freedoms and violating International Treaty on Protection of Investments.

Even though the decision is in line with decisions of constitutional courts in other Member States it does not solve the problem of fair pricing during squeeze-outs. According to Articles 183i – 183n of Czech Commercial Code majority investor controlling at least 90 per cent of shares with voting rights has the right to request the managing board to call shareholders meeting on which shall be decided about transfer

[39] Art. 181i and following of Commercial Code; The new Takeover act does not solve valuation problems during squeeze-outs, which have emerged under current legislative framework. This is due the fact that Constitutional Court was reviewing the grounds of squeeze-out rights and their compatibility with Czech Constitution. Thus the legislator adopted only „transitory" rules that necessarily transpose EU Directive into national law.

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of all remaining shares to hands of majority investor. To adopt a resolution on expropriation at least 9/10 of all shares with voting rights representing at least 9/10 of company´s capital shall approve it. Resolution shall also determine offer price and due period. Prior approval of transfer of all shares to majority shareholder issued by National Bank of Czech republic is mandatory attachment to resolution of shareholders meeting. Otherwise the resolution is deemed void.

Article 183i (5) provides that NBC has to always review fairness of the appraised price and to prevent any measures which could be detrimental for minority investors. In case of doubt NBC had to prefer interests of minorities. However, practice has shown that NBC acted only in cases of gross inadequacy and the whole procedure was restricted to formal review of valuation. Since April 1st Art. 183i (5) which was also applicable to non-listed companies has been derogated. Currently, NBC is obliged to review only squeeze-out prospects of listed companies.

The other "ugly" part of squeeze-outs in Czech republic is that there are no rules, which would guarantee that consideration paid for shares is fair and equitable.

Squeeze-out rights were introduced in Czech republic in 2004. Since then majority investors in around three hundred[41] companies took advantage of their squeeze-out rights and other estimated six hundred are planning to do so as well. Total costs of majority investors on expropriation of minorities are reaching 10 billions CZK (300 mil.

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[40] The CCC´s decision hasn´t been published by the time of writing this paragraph (29th March 2008). Only short press release available.

[41] For more info on statistics visit www.cekia.cz; ČEKIA Czech Capital Information Agency a a leading domestic provider of corporate databases and economic information

EUR). The biggest company that has launched squeeze-out was ČEZ, a.s. with 2 bill. CZK paid to minority investors.[42]

It should be emphasized that the issue of fair valuation method has not been solved through provisions of new ATB since legislator was awaiting ruling of the CCC. The new ATB left most of the old squeeze-out rules contained in Commercial Code unchanged.

Thus, according to currently effective provisions it is sufficient if majority shareholder who holds at least 90 per cent of shares with voting rights appoints his own appraiser that will quantify "fair price." Minority shareholders do not have a right to require company to pay for opponent appraiser chosen on their own what means that by the operation of law majority shareholder can simply force minorities to accept price set by "his" appraiser. The fact that price could be set by only one appraiser chosen by majority was widely criticized by professional practitioners as being abusive and favoring majority. This was proven in practice when appraiser chosen by majority shareholder usually determined "equitable" price to detriment of minority shareholders.[43]

The other very liberal rule[44] is that majority shareholders attains property rights to shares immediately upon mere registration of the resolution of shareholders meeting in companies register. Majority shareholder retains title even if minorities bring an action for increase of consideration.

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[42] ČEZ, a. s. the largest electricity producer in the CzechRepublic, founded in 1992 by the National Property Fund, the whole ČEZ group has become a leader on the Central and Southeastern European electricity market

[43] According to ČEKIA estimations damages that minority shareholders suffered due to unfair valuation rules on squeeze-outs are reaching 3 billions CZK (115 000 000 EUR).

[44] Art. 183l (3) Commercial Code, 513/1991 Coll.

4.4 DARK SIDE OF JUDICIAL REVIEW OF VALUATION PROCEDURES

As set forth in Art. 183k of CC minority investors who do not agree with the price paid as consideration for their shares during squeeze-out are entitled to bring an action and instigate proceedings before independent court. Action can be filed since the moment when shareholder was notified about shareholders meeting during which squeeze-out should be approved.

Judicial decision on value of consideration is binding for the company with regard to all other minority shareholders (who were not parties to the dispute) who´s rights on fair price were affected during the squeeze-out. This provision attempts to motivate minorities to join their forces and commence proceedings despite high costs of legal services. Thus, minority shareholders can pick a single "representative" who will instigate proceedings and share the costs together with instead filing an action on their own expenses.

The bad new is, that the average length of court proceedings in Czech republic is somewhere between five and eight years what sheds bad light on effective enforcement of lawful interests of minority shareholder

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4.5 SELL-OUT RIGHTS[45]

From the viewpoint of minorities, sell-out rights are complementary to squeeze-out rights in the sense that they enhance position of minorities in companies where bidder already controls substantial part of share-capital (90 to 95 per cent). In short, sell-out rights can be used by the minority shareholders themselves (contrary to squeeze-out rights which are attributable only to majority shareholder) to force the acquirer of the 90 to 95 per cent share capital to buy their shares for a fair price. It shall be presumed that consideration previously offered in mandatory bid is fair. Fair pricing provisions on sell-out shall be based on provisions similar to Art. 15 on squeeze-outs. This means that the price shall be paid in the same form as the consideration in the bid or shall be in cash.

If the bidder acquired shares through voluntary bid the price paid as consideration is deemed to be fair provided that the acquires at least 90 per cent of capital representing voting rights in offeree company.

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[45] Art. 16 of Takeover Directive

CONCLUSION

The thesis has endeavored to present legal devices existing in the Czech republic as well as current EU legislative framework that minority shareholders can use in order to safeguard their interest and possibly strengthen their position in the target company in case of acquisitions, focusing on the change of corporate control and throughout the squeeze-out and sell-out rules. On the example of Czech republic I tried to demonstrate the importance of liberal takeover rules to a small country and also point out some bad experiences in particular unfair squeeze-out rules.

15 years took European legislators to draft and adopt Directive on Takeover Bids and now we have result. Result which arguably can not be the one which could mean breakthrough in approach towards takeovers, approach to true freedom of movement capital… After 15 years we have a result that does not mean much.

Apparently, this kind of debate is totally beyond scope of this thesis but there is one question that keeps coming on my mind regardless the issue: “How is it possible that Europe (btw. The Europe which wants to be the world´s most progressive and dynamic economy) is not able to reach solid consensus not in a year, not in two but in 15!

To sum up, there is no level playing field on European Takeovers. Therefore, it is big challenge for each and every Member State to face takeover regulation with courage and with no compromises. Otherwise the true free movement of capital will remain a dream and Lisbon Strategy will become a scrap of paper.

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