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RULES OF FAIRNESS IN UK CORPORATE ACQUISITIONS

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Abstract

The fairness owed by directors to companies and shareholders when a corporate acquisition occurs is imposed, for UK buying or target public companies, by rules of Company Law, both statutory and judicial, and by special rules, normally provided by the market's regulators. These latter rules are issued on a statutory basis, as the Listing Rules of the Financial Services Authority, or on a self-regulating basis, as the City Code of the Panel on Takeovers and Mergers. This paper looks at the main rules of Company Law related to corporate acquisitions and examines the rules of the market's regulators concerning two core aspects: the choice of the best time of disclosure and the need of special approvals by a General Meeting to complete the acquisition or to frustrate it. The common principles and relevant differences between Company Law and market rules are focused. The analysis leads to observe that the rules of market's regulators on the relationship between directors and shareholders are often an evolution of legal principles, as the "proper purpose" doctrine or the ratification of special dealings of directors. Market rules are normally more detailed than Company Law rules, but they are often assisted by exceptions, sometimes directly provided and sometimes left to a discretionary power of a market Authority. It is possible to infer that the effectiveness of the detailed rules goes as far as the general principle implemented by them is respected. If an automatic application of the rule goes against the spirit of the general principle the system provides for the application to be waived.

On the mentioned specific topics, the insight shows that: the time of disclosure of a corporate acquisition must coincide with the first moment at which it is possible to deliver information to the public without seriously damaging the outcome of the transaction; the potential or concrete conflict of interest between directors and shareholders is the main reason justifying the imposition of an approval of the acts of directors by a General Meeting. Different dimensions of this conflict lead to different regulatory schemes on the adoption of the resolution: if the conflict is real and in effect (e.g.: transactions with a related party) the directors or the «substantial» shareholders of listed companies cannot exercise their rights to vote at the general meeting; if the conflict is only potential (e.g.: fears of losing the job with a new controller) they cannot decide as directors but they can exercise their rights as shareholders if they are owners of shares.

The paper examines the UK legal system but it can be relevant for all countries facing problems of regulation of financial markets, especially for European countries involved in the process of integration between markets and stock exchanges.

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1. Objectives of this work

UK regulation on the fairness owed by the directors to the shareholders of a company involved in a corporate acquisition is the main topic of this paper. The paper focuses on two core aspects of corporate acquisitions: the time of disclosure of the (agreed or proposed) deal and the actions of the directors, related to the deal, which must be approved by the shareholders[1]. The aim of the work is to clarify the contents of the relevant rules and analyse the cases, in order to understand their rationale. The rules contained in the Listing Rules, originally issued by the London Stock Exchange and recently broadly confirmed by the Financial Services Authority (FSA)[2], (from now on referred to as Listing Rules) and the rules contained in The City Code on Takeovers and Mergers (from now on referred to as City Code), together with some relevant rules of Company Law, are considered in this work.

Particularly, taken for granted that the rules issued by the market's regulators bind the freedom of the company's directors, it will be useful to highlight their relationship with the standing Company Law rules concerning duties of directors. It is not easy to understand if the two systems of norms are governed by the same general principles; an attempt to give first answers to this puzzle could be useful, especially if, as might be possible with the implementation of the new draft European Directive on tender offers, the law will play a more important role in the regulation of takeovers[3].

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[1] There are, of course, many other aspects of a corporate acquisition that are interested by rules of fairness binding the behavior of the directors, especially provided by The City Code on Takeovers and Mergers. For example, Rule 3 of the Code asks the boards of the offeree company and, when the offer is a reverse takeover or when they are faced with a conflict of interest, of the offeror company, to obtain competent independent advice and to made it known to its shareholders; Rule 4 contemplates also the directors between people whose dealings are restricted during an offer period; Rule 16, limiting the possibility of special deals with favourable conditions, binds not only the major shareholders of the offeree company but also the directors of the offeror, which cannot propose this kind of deals, and the directors of the offeree which must preserve the equal treatment of its shareholders and, if necessary, must call a General Meeting of the company; Rule 24 and 25 impose a full disclosure of the effects which the takeover can have on the emoluments or compensations of the directors of both companies. Other rules are present in the Company Acts: they are resumed at Section 2 of the paper (especially 2.2.4).

[2] With effect from May the 1st, 2000, the Official Listing (Change of Authority) Regulations 2000 designated as UK Listing Authority, the FSA, in place of the London Stock Exchange; the statutory provisions on the functions of the UKLA are now in the Part. VI of the Financial Services and Markets Act 2000, which has replaced the Part IV of the Financial Services Act 1986. A consequence of the change of the Competent Authority for the official listing of securities is the distinction between admission to listing, done by the Authority, and admission to trading, done by the Exchange: the two procedures will be performed together and, as confirmed by the Listing Rules and the Admission and Disclosure Standards of the London Stock Exchange it will not be possible to have listed securities not admitted to trading and traded securities not admitted to listing.

[3] See about this aspect B. Pettet, *Self regulation v. Public regulation: the future with the Directive* [2000] European Business Law Review.

Though the work is not a comparative analysis, it is addressed to Italian readers for two main reasons:

- the process of integration of the European regulated markets will probably enhance the importance of listing in UK and consequently of the rules applicable to companies listed in UK; if many European primary issuers will be listed in London, some rules would be directly applicable to overseas European companies and other rules, also if not binding for overseas companies, would be continuously compared with the domestic rules of other countries, being the rules of the country where the securities are mostly negotiated[4];
- the paper studies the links between the regulation of financial markets and the principles of the legal system of the country in which the regulation is issued, with a special attention to the principles of Company Law; these links can reveal the roots of the UK regulation and the reasons of "path-dependence"[5] which justify that aspects of the regulation of the markets, normally accepted in the UK context, are refused or not easily understood by the operators in different countries[6].

Surprisingly enough, the Italian readers will find that some general principles of English Company Law on the relationship between directors and shareholders are not far from the Italian principles – as revealed by the persistence of the "majority rule" and of the traditional doctrine that fiduciary duties are owed only to the company and not to the shareholders. On the other hand, they will see that the English Law began very early to issue special rules or exceptions to general principles enabling some kind of protection for minority shareholders, especially when corporate acquisitions of public companies

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[4] See for a first approach to this subject the Joint Statement on "iX-international exchanges" issued (August 2000) by the Financial Services Authority and the two German Authorities (BAWE and Hessisches Ministerium fur Wirtschaft), available on the Internet Site of the FSA.

[5] We use this expression in the sense attributed to it by M. J. Roe, *Path Dependence, Political Opinions and Governance Systems*, in *Comparative Corporate Governance*, (ed. by Hopt and Wymeersch), Berlin – New York, 1997, p. 165 –184, and by L. A. Bebchuck – M.J. Roe, *A theory of path dependance in corporate ownership and governance*, Stanford Law Review, 52, n. 1/1999, pp. 127-170.

[6] The point can be explained through the mention of two examples of apparent differences between the Italian and the UK regulations applicable to listed companies:

- Chapter 11 of the UK Listing Rules establishes that the transactions with related parties must be approved by a general meeting with the abstention of the related party itself and failure to comply with this rule can lead the company to a cancellation from listing; in Italy, in absence of a special rule for listed or publicly owned companies, the conflict of interests of the shareholders is faced only by the general rule provided by the civil code (art. 2373 c.c.), which can be used only by mean of a judicial complaint and only if there is an evidence of damage to the company;
- the Italian Administrative Courts (TAR Lazio, *ordinanza* 15.10.1999; Consiglio di Stato, *ordinanza* 29.10.1999) have denied, despite the opinion of Consob, that the Italian law (art. 104 D. Lgs. N. 58/1998) can be read as imposing a passivity rule to the directors of a "target" company in the time between the announcement of the takeover offer to them and to the market and the posting of the offer document; the UK City Code (general principle 7, rule 21) impose the "passivity rule" "at no time" after the announcement of the offer is made or after the board of the target company "has reason to believe" that the offer might be imminent.

occur. This research of new solutions for interests not protected by the "old" general principles, even if not always accompanied by good results, reveals a difference of path between the Company Laws of the two countries.

2. Legal duties of directors and their relevance for corporate acquisitions

2.1. Looking for a relationship between legal rules and rules of the market

We could consider several rules present in the Listing Rules or in the City Code as an example of the judicial and statutory English experience in drawing duties of directors and means of defence for an oppressed minority. The background of General Principles 8 and 9 of the City Code, for example, concerning the proper conduct of directors during an offer, does not seem very different from the basic assumptions that found the common law construction of the fiduciary duties owed by the directors to the company. We can find (General Principle 8) "good faith" and "oppression of a minority", as the respective qualifications of good or bad behaviour of the controllers, and also that any commitment with the offeror "may … result in a breach of the directors' fiduciary duties" (General Principle 9).

On the other hand, the rules of the market's regulatory bodies could be seen as an answer provided to the apparent difficulty of using the (common law or statutory) available instruments for the protection of the shareholder's interest, in litigation regarding the wrongdoing of the directors of listed (or big public) companies.

The second sentence of the Introduction to the General Principles of the City Code seems to emphasise that the behaviour of the directors who respect the Code will be less free than otherwise simply respecting the legal duties[7]. This principle has been used by the Panel, in a statement, with the purpose of refusing an allegation, made by the offeree company, that the pursuit of proceedings against the offer (an antitrust action in the US) was imposed by the legal duties of directors. The Panel considered the pursuit of the proceedings to not be consistent with the «passivity rule» established by General Principle 7 [8] and held that «whilst we accept the statement of the law by Mr. … (the legal adviser of the offeree), we consider that the action which may be taken by directors in fulfilment

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7. «While the Boards of an offeror and offeree company and their respective advisers have a duty to act in the best interests of their respective shareholders, these General Principles and the ensuing rules will, inevitably, impinge on the freedom of action of boards and persons involved in offers; they must, therefore, accept that there are limitations in connection with offers on the manner in which the pursuit of those interests can be carried out».

8. «At no time after a bona fide offer has been communicated to the Board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits». The «passivity rule» will be more closely examined at paragraph 4.3.

of their duties can be limited by the Code». Nevertheless the analysis of the specific case confirms that the background of the statement of the Panel is not seriously far from the *rationale* of the common law rules [9].

This is proof that we cannot realistically exclude the possibility of a contrast between legal rules and rules of the market and we consequently might find that sometimes what is unfair for the City Code or the Listing Rules would not be found improper or found to have caused an «unfair prejudice», by a Court.

Thus we cannot hope to find any general theories concerning the relationship between legal duties of directors and the market rules on their behaviour in a corporate acquisition. It would be probably better to use the legal duties as a background in the analysis of market rules, verifying on a case-by-case basis if there is coherence or opposition.

For this reason it could be useful, as an introduction to the work, to have a brief look at the main cornerstones of English Law on the duties of directors and the enforcement of these duties, with the aim of showing which of the standing general rules can be effective in a corporate acquisition.

2.2. General overview of the relevant legal rules

The enhancement of shareholder protection has been sought, during last century and especially the last 20 years, through the evolution of the judicial statements on fiduciary and professional duties of directors and through the issue of new statutory provisions. Sub- Paragraphs 2.2.1. and (partially) 2.2.2. of the present paragraph point out the results of the relevant jurisprudence; sub-paragraphs 2.2.3 and 2.2.4. illustrate the statutory situation[10]. Decisions or statutory provisions directly regulating the duties of directors in presence of takeover bids or of corporate acquisitions are emphasised - even if they are not very frequent, their weight on the evolution towards a better protection of the shareholders is meaningful.

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9. The offer was made by Minorco Plc for Consolidated Gold Fields (Consgold) Plc and the statement was decided on 9th May 1989, see *Weinberg and Blank on Takeovers and Mergers*, (edited by L. Rabinowitz and others), loose-leaf, p. 10036 and forward. However, it must be considered that: 1) probably in that case, since the majority changed as an effect of the acceptances to the offer, the legal duties of the directors were changed too and were different from what the offeree company and its legal advisors thought; 2) the general policy of the Panel is to not interfere with the Court and legal decisions is, but in the mentioned statement it is clearly assessed that «in considering their view of *the best interests of the company*, directors must have regard to the requirements of the Code and the Panel». The first legal fiduciary duty of directors, established by the Courts, is of course to act in *the best interests of the company*.

10. The main sources of this brief exposition are L.C.B.Gower, *Principles of Modern Company Law*, V Ed (with contributions from B. G. Pettet and D.D. Prentice), 1992; P. Davies, *Gower's Principles of Modern Company Law*, VI ed., 1997; *Weinberg and Blank on Takeovers and Mergers*, just cited; *Gore-Browne on Companies*; (edited by A.J. Boyle – R. Sykes), loose-leaf; *Palmer's Company Law*, volume 2 (edited by G. K. Morse) loose-leaf; A. Hicks and S. H..Goo, *Cases and materials on Company Law*, 1994; *Modern Company Law for a competitive economy: the strategic framework*, Consultation document from the Company Law Review Steering Group, February 1999.

2.2.1. Fiduciary duties and their enforcement

Because of the traditional Equity approach, one of the most important fiduciary duties of the directors has been the duty of acting with honesty and good faith. The effectiveness of this duty needs (1) clearness on its contents and (2) the availability of a legal action against breaches.

(1) The extent of the judicial decisions clearing up the meaning of honesty and good faith is too vast for the objectives of the present work, but it is possible to take out from the whole collection some general principles whose application can occur in corporate acquisitions.

Obviously, the Courts have historically considered the duty of honesty and good faith breached by the performance of «ultra vires» acts (acts that the memorandum of association or the contracts of service excludes from the activity of the directors); an important present day evolution has been the qualification of the use for «improper purposes» of powers arising from the articles of association as a breach of fiduciary duties.

The «proper purpose» rule establishes something that is not far from the «passivity rule» present in the takeover's regulation issued by the Takeover Panel through the City Code. One of the traditional «improper purposes» found by the judges in the behaviour of the directors is actually their interference in the market for corporate control, through issuing or allotting shares, by increasing their salary or through benefits for the loss of position [11]. The verification of this interference has normally been made, in the quoted decisions, on the basis of an objective test, without any particular examination of the eventual subjective primary intention of the directors or of the eventual correspondence of the action of the directors, in favour or in opposition of a takeover, to the interest of the company: simply it has been considered improper that the directors have had the final word on the outcome of the proposed transaction[12].

(2) Two leading judicial decisions, Foss v. Harbottle (1843) and Percival v. Wright

11. The leading cases are probably Hogg v. Cramphorn Ltd (published in 1967, Ch. 254, but decided in 1963) and Howard Smith Ltd v. Ampol Petroleum Ltd. (1974) A.C., 821, concerning, for the former, the situation in which the directors allotted shares in order to avoid their dismissal by a takeover bidder and, for the latter, the opposite situation in which the directors allotted shares to a potential bidder although their shareholders were opposing a possible change in the control of the company. More recently the «proper purpose» doctrine has been applied to a case (Lee Panavision Ltd v. Lee Lighting Ltd, 1992, BCLC 22, CA) in which «the directors entered into a management agreement which had the effect of depriving the shareholders of their constitutional right to appoint new directors with full managerial powers» See Gore-Browne on Companies, page 27.013.

12. «It was not enough that the directors issued the shares in the honest belief that this was in the interest of the company. The power must have been exercised for its proper purpose. … The Court held that the fiduciary power to issue shares had been exercised for an improper purpose, i.e., to prevent a takeover». Hicks & Goo, cited, p.362, with reference to Hogg v. Cramphorn Ltd.

(1902), heavily restricted the actions available to the shareholders for the enforcement of the fiduciary duties of the directors.

The former allows only the majority of the company to bring an action for the breach of the bona fide duties of the directors (also called the majority rule, as in other European countries); the latter excludes the existence of fiduciary duties that the directors directly owe to the shareholders (also if considered as a whole).

Both the rules are essentially based on the normal qualification of the company alone, and not of the shareholders, as the principal to which the directors are bound by special bona fide requirements arising directly from the company's articles of association.

Although these two rules are still active, the common law has created some important exceptions which have strengthened the position of minority shareholders.

The exceptions to the Foss v. Harbottle rule are essentially based on the acknowledgement of a possibility of oppression of the minority, if the supposed wrongdoers are in control of the company and the plaintiff can present evidence of a fraud[13]. The rationale of this exception can be found in the theory that the Courts use when they confirm *majority rule*: the judges do not allow a derivative action brought by a single shareholder because the owners of the majority of the outstanding voting shares agree with the acts of the directors and are ready to ratify their behaviour, on behalf of the company.

This rationale for refusing a derivative action cannot be used if the behaviour of the directors is non ratifiable by a general meeting. This situation occurs – following the opinion of the Courts - when the majority of the shareholders are bringing the action but also when the owners of the majority are part of the wrongdoing of the directors, which can for this reason assume the characteristics of a 'fraud on the minority'.

The important evolution has been limited by a further condition: the consent of the majority of the independent shareholders to the derivative action, required by the Courts after the Smith v. Croft (No. 2) decision[14]. Also for this reason today «fraud on the minority has been largely subsumed in the statutory wider concept of 'unfair prejudice'»[15] established by the section 459 of the Companies Act and often more easily usable (see below par. 2.2.4).

The Percival v. Wright rule, for its part, has been laid aside in cases concerning mergers, acquisitions and issues of shares, which represent the typical situations in which the behaviour of the directors can directly affect the interests of the shareholders. In particular, the rule was established in a case in which the shareholders, selling their

13. See for the meaning of «fraud on the minority», Gower's (V ed.), cited, pp. 593-605. The traditional situation considered by the judges as oppression is «when the majority are endeavoring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company or in which the other shareholders are entitled to participate» (Lord Davey in Burland v. Earle, 1902). It's easier to use the «fraud on minority» motivation to sue the directors than to sue other shareholders, because only the directors are surely bound by a duty of acting «bona fide for the benefit of the company as a whole».

14. (1988) Ch. 114. For criticisms to this rule, see Gower's, VI Ed (P. Davies), cited, pp. 673-676.

15. Gower's (V ed.), p. 594.

securities to the directors, had had an effective role in causing damage to themselves [16]; there have been more recent decisions in which indeed the Court assessed a fiduciary obligation of the directors to exercise their powers in the interests of both the shareholders and the company.

This different rule has been used in the existence of a takeover offer, during which the position of the director relative to the shareholders becomes similar to that normally arising by virtue of an agency; in such a situation, the Courts established firstly the duty of the directors to inform their shareholders fully and correctly and the possibility of the shareholders to sue the directors if they don't respect this obligation [17].

Moreover[18], where the shareholders of a listed company alleged that a decision of the directors had determined the prevalence of an offer over the higher competing one and sued to prevent the implementation of the offer, the Court of Appeal confirmed the Foss v. Harbottle rule but affirmed at the same time a right for action of the shareholders which suffered a loss and can show that the directors decided without regard for their interest. Thus, acting "in their own right, and not in the right of the company … any one or more of the … shareholders" can stop the implementation of the offer or "sue such directors in order to recover the benefit of their own individual pockets the difference between the take-over value per share which they are constrained to accept and the higher take-over value which they lost the chance of accepting".

The existence of a kind of fiduciary obligation towards the shareholders has been confirmed in cases of allotment of shares for reasons other than the simple capitalisation of the company: in these cases the duty of the directors of not allotting shares for improper purposes has been identified as owed to the shareholders [19].

In other cases, even if confirming that the directors owe fiduciary duties to the company and do not owe fiduciary duties to individual shareholders, the judges have decided that the directors, in advising shareholders on a bid, «have a duty to advise in good faith and not fraudulently, and not to mislead whether deliberately or carelessly … based on the ordinary principles of law»[20].

By way of *conclusion* on this brief analysis, it is clear that the "proper purpose" doctrine

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16. They had proposed to the directors the selling of their shares and, after the acquisition, the directors sold all the shares for a higher price; the alleged (supposed) breach was the lack of information about the possible better deal.

17. See Gething v. Kilner (1972), which established (as reported by Gore-Browne on Companies, cited, 27.006) that «directors in supplying information to their shareholders regarding a take-over and expressing a view as to whether the offer should be accepted, have 'a duty toward their own shareholders which … clearly includes a duty to be honest and a duty not to mislead'. In the same way, Dawson International plc v. Coats Patons plc (1988), 4 BCC 305.

18 Heron International Ltd & ors v. Lord Grade & ors [1983] BCLC 244.

19. See the cases quoted in note 16 and Re a Company (1987), BCLC 82; John Crowther Group plc v Carpets International plc (1990), cited by Gore-Browne, pages 27.006 and 27.013.

20. Dawson International plc v. Coats Patons plc (1988) 4 BCC 305, see Hicks & Goo, p. 620. Lord Cullen adds «This, I may say, appears to be a more satisfactory way of expressing the position of directors in this context than by talking of a so-called secondary fiduciary duty to the shareholders».

and the rules assessed by the cases quoted in notes 16 to 19 provide a not irrelevant set of actions in the interest of the shareholders in the circumstances of a corporate acquisition, especially if being brought about by means of a takeover offer.

2.2.2. The evolution of the duties of care, skill and diligence

Another important step of the evolution towards the protection of the company and the shareholders has been the recent rejection of the, traditional, almost non-professional consideration of the work of a company's director[21]. Traditionally, «heavy duties of loyalty and good faith» were linked with «light obligations of skill and diligence»[22]; essentially the change of the insolvency regulations through introducing a restricted duty of skill assessed by section 214 (4) of the Insolvency Act 1986, has led the Court to new positions – the main constituent of these positions is that the director must act as «a reasonably diligent person having both:

a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as those carried out by that director in relation to the company, and
b) the general knowledge, skill and experience, that that director has».

The behaviour of the directors is thus analysed by mean of a test, which is based firstly on an important objective standard of evaluation, provided by letter a); the second criterion, which points on the subjective sphere of the director, becomes in fact only an integrative provision.

The use of this test can be seen as the law in force concerning the duties of care, skill and diligence of the directors[23]. Probably, its explicit extension to matters different from the regulation of insolvency will be carried out, in the near future, through an improvement of the statutory provisions concerning directors: this seems to be the intention of the Government, as shown in recent consultation documents[24].

For the moment, the general use of minimum standards of conduct for directors of companies consistent with the market and community expectations is eased also by another statutory provision concerning the crisis of the company: sections 6-9 of the

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21. Cleared by the historical leading case, Re City Equitable Fire Insurance CO (1925) Ch. 407, with the famous proposition that «a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of *his* knowledge and experience».

22. Gower's (VI ed., P. Davies), p. 640

23. Such an assessment has been recently used, e.g., by the Judge Hoffmann in the cases Norman v. Theodore Goddard (1991) BCLC 1027 and Re D'Jan of London Ltd (1994) 1 BCLC 561. Their importance is strongly evidenced in the recent documents of DTI concerning Company Law Reforms, see, e.g., *Modern Company Law: a strategic framework*, cited, chap. 7, paragraph 7.16 and annex H. The first change in the position of the Courts was realised with the case Dorchester Finance v. Stebbing (1989) BCLC 498 (but decided in 1977), see Gower's (VI ed. P. Davies), cited, 641-642.

24. Proposals concerning a possible statutory provision about duties of care are present in the document cited in the previous note and, more clearly, in *Company directors: regulating conflicts of interest and formulating a statement of duties*, Consultation Document of the Department of Trade and Industry, 1998, Part 15.

Company Directors Disqualification Act (CDDA) 1986, which establish that directors «unfit to be concerned in the management of a company» must be disqualified for two years by a Court decision. The events that might demonstrate unfitness can also occur without insolvency (section 9), and concern the behaviour of all kinds of directors (executive and non-executive; senior and junior; irrespective of whether or not they are employees of the company). Several recent CDDA cases have added to the dual test, being based on the Insolvency Act provision «an emphasis on internal control and an explicit account of director's supervisory functions»[25].

2.2.3. The «unfair prejudice» remedy

With regard to the statutory framework of rules, an improvement in the protection of shareholders has been granted by the «unfair prejudice» remedy, found in sections 459-461 of the CA 1985, as partially substituted by the CA 1989. The latter Act stated that this petition can be presented also for acts or conduct unfairly prejudicial to the members generally considered, and not only to a minority.

The «unfair prejudice» petition can be seen to be the simplest legal instrument for bringing to the Courts a complaint on behalf of shareholders against the directors or controllers[26]; if the Court considers the allegations to be well founded it «may make such order as it thinks fit for giving relief in respect of the matters complained of» (s. 461(1)). Section 461 (2) indicates some of the possible contents of the order; among them being, for example, the purchase of the shares of the prejudiced members at a fair price, the possibility of a winding up (but only after complying with the requirements concerning advertising[27]), the (very rare in the practice) authorisation of a derivative action on behalf of the company. The first is largely the most popular order asked for by the petitioners; it is interesting to note that sometimes, for small companies with serious problems of stability, the Court can consider a winding up to be more equitable than a forced acquisition of the shares.

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25. Walters A., *Director's duties of care, skill and diligence: the impact of the Company Directors Disqualification Act 1986*, Draft distributed during the lecture delivered at the Institute of Advanced Legal Studies, University of London, on November 29, 1999, p. 29. The author observes also that «there is clearly scope for the company law duty to converge with other regulatory standards in the fields of banking, financial services and securities regulation». The mentioned recent cases are Re Barings (no. 5) 1999, 1 B.C.L.C. 433 and actually Re Landhurst Leasing plc 1999, 1 B.C.L.C. 286. In Bishopgate Investment Management Ltd v. Maxwell (No. 2) 1993 B.C.L.C. 1282, Hoffman L.J. said, inter alia: «the law may be evolving in response to changes in public attitudes to corporate governance as shown by the enactment of the provisions consolidated in the Company Directors Disqualification Act 1986".

26. See D.D. Prentice, *The Theory of the firm: minority shareholder oppression: sections 459-461 of the Companies Act 1985*, in Oxford Journal of Legal Studies, 1988, 55-91, in particular 78 where is exposed that «the traditional reluctance of the judiciary to become embroiled in the affairs of companies should only operate, if at all, within a very narrow ambit when applying section 459" and that, as clarifies by several decisions, it isn't «necessary for a petitioner to point to 'any actual irregularity or to an invasion of his legal rights». For this reasons the remedial «can cover a range of conduct which is undoubtedly unfairly prejudicial but which is not illegal in the sense of involving some independent legal impropriety».

27 See Re Full Cup International Trading Ltd [1995], BCC 682.

Nevertheless, the Courts are very careful in the application of the «unfair prejudice» remedy to public listed companies. In such companies it has been found that there is less personal interest in the conduct of the company and for this reason it is very difficult to find «legitimate expectations» of the members that can lead to a special protection with the external help of the judges. This position, however, can sometimes lead to a protection of the interest of the generality of the shareholders against the acknowledgement of privileges to single shareholders [28].

The methods used by Courts for striking out the petitions in the, not frequent, cases concerning public and listed companies, limit the use of section 459 as a means for enforcing, in public companies, secret agreements or contested special rights not provided by the articles of association, but do not deny the possibility of using the remedy.

On the other hand, it has been found that the «unfair prejudice» remedy cannot be used as a means of enforcement for breaches of the market rules. [29]. This position represents a confirmation of the separation of regimes: the Courts maintain the possibility of deciding on the effective presence of an actual prejudice and unfairness even if the market's rules have been breached; on the other hand, the rules of the market are autonomous from the legal rules and provide specific means of enforcement. While often the market rules do not ask for the evidence of a prejudice to the shareholders (or a part of them) and can qualify the forbidden behaviour as generally unfair, the Courts deciding on the granting of a section 459 relief need to find, in a specific situation, effective prejudice and apparent unfairness and, further, cannot justify any relief on the «mere fears» of future prejudice, but only on present acts and damage.

We cannot exclude the possibility that the remedy could be used for a «breach of the articles, breach of directors' duties or other illegality» in public companies [30], especially in the presence of exceptional breaches, if the special test concerning the presence of prejudice and unfairness is positive. In the implementation of this test the analysis of non-compliance with the market rules will be, in any case, useful and probably inevitable [31].

Further, the legislator's intention is in the direction of including the public companies in the scope of the «unfair prejudice» remedy, as shown by the above-mentioned change operated by the Companies Act 1989, that substantially allows the use of the remedy in the relationship directors/shareholders, which previously was seriously doubted. In public listed companies, this relationship, if there is not a controlling shareholder, is the most important source of possible criticisms from the investors on the conduct of the

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28. In Re Blue Arrow plc (1987) 3 BCC 618 the listing of the company has been used for excluding that the directors were bound by a not fully disclosed agreement with a President / shareholder who was the petitioner («there was no room for any legitimate expectation founded on an agreement between the directors and not disclosed to those placing the shares with the public», Vinelott J.); in this case the striking out of the petition was substantially in the interest of the public of investors.

29. See Re Astec (BSR) plc (1999) BCC 59: Parker J. said that «members of the public buying shares in a listed company could expect that all relevant rules and code of practice would be complied with in relation to the company, but that expectation could not rise to an equitable constraint on the exercise of legal rights conferred by the company's constitution (of which the Listing Rules, City Code and Cadbury Code formed no part) so as to found a petition under s. 459».

30. See Gore-Browne on Companies, page 28-031.

31. Reading the motivations of the quoted Re Astec we can find such analysis.

undertaking.

2.2.4. Other relevant sections of the Companies Act 1985: liability, removal of directors and disclosure of any payment

To complete a fast insight on the relevant statutory rules concerning duties of directors we observe that the provisions of the Companies Act 1985 concerning directors are essentially rules regarding their appointment or removal (Part. IX of the Companies Act 1985, then CA 85, Ss. 282-310) and the disclosure of their dealing activities and their pay (Part X of the CA 85, Ss. 311-347). There are nevertheless two provisions that concern the matter of the fiduciary duties owed to a company by the directors.

The first (which does not seem to have big effects on the daily practice of the financial markets) is section 309, whose purpose is probably to add to the fiduciary duties created by the common law a new duty created by Parliament: to have regard to «the interests of the company's employees, in general, as well as the interests of its members». This duty, as provided by subsection (2), is owed to the company and «is enforceable in the same way as any other fiduciary duty owed to the company by its directors». The latter sentence can be read as an indirect statutory confirmation of the legal strength of the «other fiduciary» duties established by common law.

The second, and most important, is section 310, that declares void any provision «whether contained in a company's articles or in any contract with the company or otherwise, for exempting any officer of the company or any person (whether an officer or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him, in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in respect to the company»[32].

Some of the other mentioned statutory norms in force might be interesting in the takeover context. Among them is (section 303) the permission to remove directors «by ordinary resolution» of the company, normally carried out by a general meeting of the voting shareholders. Consequently the new controllers can legally sack a director, or even all of them, without any further explanation; however section 303, subsection (5), clearly does not allow this action to affect any «compensation or damages payable to him in respect of the termination of the appointment as director». So, the shareholders can easily sack but, if they do not give evidence of a breach of the legal duties, they will have to pay the extra-compensations generally provided by the service agreement of the directors.

A second interesting rule is provided by section 314; this rule imposes the full disclosure of any payment made to a director of a company «by way of compensation for loss of office or as a consideration for or in connection with his retirement from office» whenever there is a transfer of shares resulting from a general or a partial offer. The provision is consistent with the general obligation of disclosure during a takeover that we find in rule 24.5 of the City Code: «unless otherwise agreed with the Panel, the offer

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32. See, for a discussion of the borders for the application of this section (also with respect to possible exceptions), Gower's (VI ed.P. Davies), pp. 623 - 626.

document must contain a statement as to whether or not any agreement, arrangement or understanding (including any compensation arrangement) exists between the offeror or any person acting in concert with it and any of the directors, recent directors, shareholders or recent shareholders of the offeree company having any connection with or dependence upon the offer, and full particulars of any such agreement, arrangement or understanding».

Finally, the rules (sections 320-322A) on the interested dealings of directors can be important to understand the rationale of some special rules of the Takeover's regulation, as we shall see below (paragraph 4.1 of the present paper, where the rules are also exposed).

3. The time of disclosure as a rule of fairness

3.1. The general problems

The problem of the determination of the best time of disclosure of an acquisition concerns the relationship between shareholders and directors, both of the acquiring company and of the target company. If both the companies are public and their shares are traded in a regulated market, the deal might involve very many different interests and a wider range of rules will apply to the transaction. Nevertheless, several rules that we will see below are relevant also in smaller interest-involving situations; in particular the rules of the City Code apply to «offers for all listed and unlisted public companies considered by the Panel to be resident in the United Kingdom, The Channel Islands or the Isle of Man … it also applies to offers for private companies considered to be some resident» when particular conditions (essentially concerning the distribution of the shares) are present.

The directors of the acquiring (or offering) listed company have to deal with the market's need (and so also of their shareholders, the debtholders and the potential investors) for fast and complete information on every operation that can change the business or the accounts of the company or affect the price of the shares or of the other securities issued by the company. When the acquisition is the result of a private deal, the information could normally be given after the stipulation of the agreement with the counterpart but, as we shall see, in some situations the agreement must be conditional on the approval of the shareholders of the acquiring company. If the acquisition is the result of a public deal, especially a takeover offer but also, for example, the participation in a public auction, the proper conduct of the market depends on information being made available before the acquisition is completed, and probably since the very first step.

The directors of a target company are affected by a problem of getting information to the market when potential buyers of the total amount or a relevant part of the capital of the company approach them. In such a case, their contractual position is suddenly transformed from being agents of the company to being agents also of the shareholders, who are the real counterpart of the potential buyer[33]. Consequently they must inform their shareholders as soon as possible about the existence of the opportunity, but they also have to check their movements in order to avoid damage to the closing of the possible operation and in order to avoid the creation of false expectations. The latter problem (the risk of false expectations) does not only affect the relationship between directors and shareholders but also, in a listed company, the attention to the proper conduct of the market of the issued securities and the risk of market manipulation. Finally the directors often face a problem of conflict of interests if they disagree with the strategy of the potential future controller.

Moreover, there are some situations that we can call «cross-reference». These occur when the directors of the offeror company, who decided to launch a takeover offer, have to bear in mind the interest of the shareholders (and potential investors) of the offeree company whenever there is a serious risk of creation of a false market or of disparity of information between them.

On the assumption that this is an accurate assessment of the problems of agency and protection of investors involved by the announcement of a corporate acquisition and especially of a corporate acquisition carried out by a takeover offer, we can now see better what answers the market's rules give.

3.2. The offeror's directors duties

3.2.1. The general obligation of disclosure and its practical implementation by the Listing Rules, the Admission and Disclosure Standards and the City Code

The directors of a listed company, which has acquired or is going to acquire another company, are bound, as normal for all the relevant operations that they do, by the general rule of disclosure. This is one of the cornerstones of the good and fair conduct of regulated markets.

In the British environment the rule is provided by section 9.1 of the Listing Rules, and it is almost identical to the one present in Schedule C of the European Directive 79/279 concerning listing requirements[34], that the Listing Rules issued by the Financial Services Authority are implementing in the UK, as requested by section 153 of the Financial Services Act 1986 and by section … of the Financial Services and Markets Act 2000.

In the circumstances of an acquisition that could affect, for worth or nature or simply because this is the opinion of the directors themselves, the price of the securities issued by the company, the puzzle arising from this rule is to understand at which point the operation is ready to be publicly announced, becoming a «development» in the sphere of

33. The singularity of the situation allows to overcome the traditional doubts concerning the possibility of qualifying the shareholders as principals of the directors; see the judicial decisions quoted in notes from 16 to 19.

34. «The company must inform the public as soon as possible of any major new developments in its sphere of activity which are not public knowledge and which may, by virtue of their effect on its assets and liabilities or financial position or on the general course of its business, lead to substantial movements in the prices of its share».

activity of the company which may lead to a mandatory disclosure.

The crossed reading of the chapters 9[35] and 10 of the Listing Rules and of the rule 2 of the City Code can help us in the solution of the puzzle; one of the results of this examination will be the unveiling of a substantial identity of spirit between the rules of the two market's Authorities. In general, the obligation provided by the Listing Rules arises when the «development» happens and this moment does not need to be a closed operation.

Nevertheless, in presence of an operation prepared through reserved talks and negotiations the obligation is clearly waived (rule 9.4 of the Listing Rules and section 3.4.of the Admission and Disclosure Standards) until the agreement of its terms is completed, as long as the directors and the other persons involved (in a restricted number and of the nature exactly indicated by rule 9.5 and section 3.5) are confident in their capacity of ensuring the secrecy throughout this period. If they acknowledge that the segregation of information is or can be breached, with possible effects on the price and on the regularity of the market, they must keep the Authority, the Exchange and the investors (all through the Company Announcements Office) informed «without delay», although they can «at least» do only a «warning announcement» that «the company expects shortly to release information».

If the operation is a transaction, in the meaning of chapter 10 of the Listing Rules, and so mainly if it is an acquisition or a disposal of assets, «without delay after its terms are agreed» (rule 10.31) there will be also the further disclosure imposed by the rules present in chapters 10 and 11[36]. Agreement of terms evidently does not mean that the related contract has been signed or the deal closed, but only that the main aspects of the operation have been decided.

A maximum level of disclosure is provided for «Class 1 transactions»[37] and for «reverse takeovers»[38], which require (rules from 10.37 to 10.43) the publication of an announcement, containing more information than that asked by the general provisions

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[35] The same obligations imposed by paragraph 9 of the Listing Rules are provided by section 3 of Part 2 of the Admission and Disclosure Standards of the London Stock Exchange, which, from the 1[ST] of May 2000, regulate the admission of securities to trading. Section 3 of Part 1 of the same Standards states that the Exchange will take "primary responsibility for real-time monitoring of its markets" and it is the Authority will take "primary responsibility for investigations relating the non-disclosure of price sensitive information". All the obligations of disclosure are improved by mean of a notification to the Company Announcements Office, which is a department of the Exchange responsible for operating the Regulatory News Service.

[36] Only the FSA Listing Rules regulate this special matter.

[37]. Defined (section 10.4.c) as «a transaction where any percentage ratio is 25% or more». The «percentage ratio» are (section 10.5): the involved gross assets divided total gross assets of the company, the profits or turnover attributable to the involved assets divided by the profits or the turnover of the company, the consideration divided the aggregate market value of the listed company, the gross capital of the company or business being acquired divided by the gross capital of the company. All these elements of the percentage ratio are defined by section 10.

[38]. «An acquisition by a listed company of a business, an unlisted company or assets where any percentage ratio is 100% or more or which would result in a fundamental change in the business or in a change in board or voting control of the listed company» (section 10.4.d).

contained in the chapter 9 and the posting of a circular to all the shareholders, containing the same and further specific information.

These transactions must also (and we will see better below, paragraph 4.2) be approved by the shareholders in a general meeting, and this may happen before the related contract is entered into, or after, if the effectiveness of the agreement is «conditional upon such approval being obtained».

With respect to information contained in the circulars, if the transaction is a takeover offer the Listing Rules regulate with particular provisions the kinds of dates concerning the financial effects of the aggregation that the circular must expose. The rules acknowledge the difference between takeover offers which are recommended by the directors of the offeree company, when a larger amount of information is available to the offeror and there is a higher chance of success of the bid, and takeover offers not recommended, when the information on the effects of the aggregation might be less complete, but the offeror is obliged to integrate the information owed to its shareholders within a restricted number of days after the offer is declared wholly unconditional (sections from 10.45 to 10.47).

The City Code (rule 3.2) adds that when the offer is a reverse takeover (or when the directors of the offeror are faced with a conflict of interests through their interest in the affairs of the offeree[39]) competent independent advice is necessary, whose «substance must be made known» to the shareholders of the offeror company.

3.2.2 The special rules concerning the «announcement of a firm intention to make an offer»

When the transaction, as a takeover offer, can be realised only through public negotiations, the general rule of disclosure would theoretically require that an announcement be made when the decision to carry out the operation is taken, because in such a moment there is a «development».

A trace of this principle of immediate obligation is present in the rules and in the practice of the City Code - as a general principle supporting the surveillance of the behaviour of offeror and offeree companies[40].

Nevertheless, when the offeror has decided to carry out the acquisition by means of a takeover bid, and if the directors of the potential bidder are seriously interested in having the consent of the directors of the target, the rules also give time for reserved talks to discuss the deal between the potential bidder and target, before the former decides whether or not to announce a firm intention to make an offer. Normally, we can suppose

39. «A conflict of interest will exist, for instance, when there are significant cross-shareholdings between an offeror and the offeree company, when there are a number of directors common to both companies or when a person is a substantial shareholder in both companies» (not 3 of rule 3.2.).

40. See, e.g., Rule 23 of the Code, stating that «information must be available to shareholders early enough to enable them to make a decision in good time» and that «the obligation of the offeror in these respects towards the shareholders of the offeree company is no less than an offeror's obligation towards its own shareholders».

that in such a case the effective terms of the offer will be decided by the offeror only after the talks have finished.

Rule 2.2. of the City Code allows the directors of both companies to remain silent, but imposes tight limits. Essentially, the information must be kept within a restricted number of persons (six is the figure showed by the Panel practice) from the interested Boards and direct consultants, and they must be sure that there will not be rumours or untoward movements in the market due to their activities or any leaks of information. If these restrictions are not respected, the directors of the target company (but not the offeror) can satisfy the obligation also through an announcement that «talks are taking place».

The rule presents important similarity with the aforementioned rules 9.4 and 9.5 of the Listing Rules, but with a narrower space for silence. Actually, respecting Rule 2.2., the directors must disclose or, at least, consult the Panel (letters c and d) also when there are only «rumour or speculation» in the market or when the number of informed persons increases; the Listing Rules always mention the existence of possible effects on the price as a condition for the arising of the duty of disclosure, and define the persons that can be informed of the talks before the disclosure only by reference to their profession, without express attention to the number. Further, the minimum required content of the «warning» announcement is that «talks are taking place» (rule 2.4 City Code) which seems to be something more than «the company expects shortly to release information [which may affect the price]», as the rule 9.4 of the Listing Rules allows.

It is important to note that, in respect of rule 2.3. of the Code, if the bidder chooses to try to find an agreement with the Target's directors before launching an offer, it thus passes on to them the duty of checking, as first responsible persons for the information of the shareholders, if an announcement is required. This could be a (slight) incentive in favour of agreed bids.

If the choice of the directors of the offeror is less inclined towards co-operation, or if they suddenly interrupt the talks in order to go ahead with their operation, rule 2.2 (a) requires them to make a public announcement when they communicate to the Board of the target the firm intention to make an offer.

Thus, the rule does not deny to the offeror a time of silence about its intentions after the moment in which the decision (to launch a bid) is taken. The limits of this «right» of silence are the same (provided by rule 2.2. of the Code) as those we found in the situation in which talks are in course. The difference is that in this situation the directors of the offeror and its advisers must pay special attention to rumours and the conduct of the market of the interested shares; any lack of attention, and consequently even a simple rumour or untoward movement of the shares, without any announcement or consultation with the Panel, can lead to a breach of the Code. In the practice of the Panel the respecting of this rule seems to be strongly checked and has been enforced in some important cases; the operators that are usually first found guilty for the breach of the rules concerning the time of the announcement are the professional advisers of the offeror. [41]

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41. As revealed, e.g., by the decision taken in the case Petrocom Group plc/James Wilkes plc, 1992, in which the adviser of the offeror has been found "primarily responsible for a breach of rule 2.2 (c) by not making a prompt announcement on behalf of Wilkes on 20 January when, following

Faced with a unilateral (not previously agreed) takeover, «the terms» of the operation can be considered «agreed» (with the effects of disclosure established firstly by the Listing Rules) when the details of the offer are established by the offeror, but the exact definition of this moment is in fact in the hands of the offeror. Both the market's regulations, and the City Code in particular, do not deny this room to move but aim to increase the possible liability of the directors and of their consultants if it is badly used; this liability is not, of course, a legal liability but can lead to sanctions put in place by the market's authorities.

3.2.3. The duty to make only serious announcements

As we saw, the announcement of the intention to make an offer is sometimes a choice and sometimes an obligation of the offeror's directors; if these directors prefer to approach the offeree company before the diffusion of an announcement, the obligation of making an announcement can be imposed on the latter.

Both the announcement and the 'reserved approach' must respect a general duty of seriousness.

The duty is drafted by the General Principle 3 of the City Code and transformed into a power of the directors of the target company by rule 1 (c) of the Code. The former clarifies that «an offeror should only announce an offer after the most careful and responsible consideration»; the offeror and its financial advisers must have «every reason to believe that it can and will continue to be able to implement the offer». The latter gives to the board of the offeree approached by an offeror the entitlement «to be satisfied that the offeror is, or will be, in a position to implement the offer in full».

The analysis of two statements of the Panel[42] concerning compliance with the principle of seriousness of the announcements can lead to a good understanding of the rules.

The Panel firstly clarified the main aims of its positions.

> «Compliance with this principle is of great importance. The offer's announcement inevitably has a profound effect upon the market. The share price of the offeree company will be affected and, in consequence, if the offer is subsequently withdrawn - for whatever reason - many people may have dealt on the basis of expectations which are not fulfilled. Against this background General Principle 3 attempts to reduce to a minimum the number of offers which are withdrawn by placing upon potential offers and their advisers an obligation to exercise due care before making an offer»[43].

Later, the statements confirm that the principle assesses a rule of fairness imposed on the directors and their consultants: «It is a duty to display that standard of skill and care

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a week-end of inconclusive talks, there had been an untoward movement in the Wilkes share price".

42. The statements concern the «Proposed offer by WM Low and CO PLC for Budgens PLC», 1 August 1989, and the «Proposed offers by Luirc Corp. for Merlin International Properties Limited.», May 1, 1991. All the statements are in Weinberg and Blank, p. 10013 and 10127.

43. The sentence is extracted by the statement of the Panel concerning the «Proposed offer by WM Low and CO PLC for Budegns PLC», 1 August 1989, p.6. The same words can be found in the other statement.

which would ordinarily be expected of someone exercising or professing to exercise the particular skill in question»[44].

We can compare this standard with the one required by the more recent judicial decision concerning the standards of skill and care of the directors, inspired, as we saw above (par. 2.2.2), by the Insolvency regulations. Both standards are distinguished by an objective test. In the Panel statement this test consists in what may «ordinarily be expected of someone exercising or professing to exercise the particular skill in question»; in the recent judicial position it consists in what «reasonably may be expected of a person carrying out the same functions as are carried out by that director in relation to the company».

The two objective definitions of the standards establish very similar rules: the difference in wording can be attributed to the larger range of situations to which the Panel provision is applicable, regarding not only the directors but also the advisers and the auditors of the company. The most important aspect in common between the two definitions is the relevance of the particular function or the particular activity being exercised by the interested person; this means, for example, that a director with executive functions concerning the financial conduct of the company will be expected to have excellent financial skills, whilst a financial adviser endorsed by the company as a consultant will be expected to show the level of care and skill typical of the industry to which the adviser belongs - normally corresponding to the best professional standards of the industry.

Nevertheless, the direct reference in the Panel statement to the «skill» exercised or professed to exercise allows the Panel to nail the adviser for any breaches: he is endorsed for advising in a specific operation and he must have, for this reason, not only generic excellent financial skills but the special skills needed, for example, in a corporate acquisition deal or for the preparation of a takeover offer.

The position of the adviser is essential in the Panel's practice. In the mentioned statement concerning WMLow, for example, the Panel did not criticise the offeror itself for the breach of General Principle 3 and of the standards of care, «by the offeror's side», but only its adviser (SGWarburg), because «it is they who, on behalf of their client, should prior to any announcement of an offer, have been requiring or at the very least pressing hard (the target's directors previously informed) for essential information»[45].

We said that the rule assessed by the General Principle and partially specified by rule 1 © is essentially a rule of fairness, and is consequently general and abstract. The mentioned statements of the Panel detail the abstractness in two different particular situations.

The specified narrower rules laid down by the two cases can be exposed as below:

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44. WM Low/Budgens, p. 7.

45. Ibidem, p. 11. It's interesting that in the mentioned case it happens an exceptional event: the directors of the offeror recommended to their shareholders, who must authorise the deal as asked by the Listing Rules, to vote against the offer that they had announced, because new information concerning the level of borrowings of the target company led to a reconsideration. The panel decided against the offeror's side, «conscious of the need to avoid judging with the benefit of hindsight», essentially because «in this case the parties were in regular contact and proceeding towards a recommended offer», ibidem, p.9.

1. When an offeror is heading towards a recommended offer, which for its dimension or for other reasons needs the authorisation of the general meeting of the offeror itself, the directors and their advisers must ensure that they announce the offer only if they have all the information that they need to be able to recommend that the general meeting give a positive vote (rule arising from the WMLow/Budgens case).

2. When the offer is for cash and the offeror is a newly formed company without sufficient capital requirements (for example an off-the-shelf overseas company) General Principle 3 is respected if the Offeror and its advisers have, at the time of the announcement of the offer, an irrevocable commitment to furnish the funds from a bank or another party upon whom reliance can reasonably be placed (rule arising from the Luirc/Merlin case).

The second rule states that, in this particular situation, at the moment of the first announcement of the firm intention to make an offer, there is a stronger obligation than the one normally applicable at the moment of the publication of the offer document. Generally at the moment of the first announcement, the presence of a financial adviser is seen, by the rule 2.5 (a) of the Code, as sufficient to ensure that the offeror will be able to implement the offer; when the offer document is posted, it, as rule 24.7 establishes, does not have to contain an irrevocable commitment by a party to produce the funds, but must only «include confirmation by an appropriate third party (e.g. the offeror's bank or financial adviser) that resources are available to the offeror sufficient to satisfy full acceptance of the offer»[46].

The detailed rule 9.6., which regulates the relationship between mandatory offers and dealings of directors, is an expression of the same principles. The directors of a company can cause, by selling their shareholdings in the same company, a passing of the threshold that obliges the making of an offer (30%) only if they: (1) are sure that the new controller has an effective intention and the capability of fulfilling the general offer asked by the rule 9 of the Code; (2) manage the company during the offer, without leaving their position until the end of the offer.

The instruments used by the rule are different from the ones used by General Principle 3: there are specific subjects and specific obligations. The subjects are in this case the directors of the Target but only because they are acting in concert with the new controller and potential offeror. The means used are the imposing on the directors/sellers of a duty of providing, as a condition of the sale, the fulfilment, by the purchaser, of the obligation of making a general offer and the fixation of an exact day until which the directors must guarantee their services.

Nevertheless, the aim of the rule is, as in General Principle 3, that an offer (in this case mandatory) must be announced only if the potential offeror is seriously ready to do it.

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[46] The rule clarifies also that this party «will not be expected to produce the cash itself if, in giving the confirmation, it acted responsibly and took all reasonable steps to assure itself that the cash was available».

3.2.4. "Last words": the deadlines of the offer and of its revision

There is another interesting point that shows the relevance of the time of disclosure in the relationship between the directors and shareholders, and generally for the protection of investors, when a corporate acquisition occurs.

In the context of a takeover, the directors of an offeror (but we will see that the situation is similar for the directors of the target) are expected to ensure full disclosure of the relevant information. Checking that this occurs, with only the traditional instrument of pre-examining the documents that contain information, or other kinds of controls available to Authorities, is certainly not easy. For this reason the Panel normally does not authorise the documents before their publication[47]: the interested parties must disclose information according to the General Principles and the rules of fairness of the Code and the Panel can verify on a case-by-case basis if the documents have been correctly written and published.

Furthermore, the regulation must bear in mind that usually the parties interested in a takeover might always change their mind, or be preparing several «second best» solutions.

In such a scenario, the regulation of the times for the disclosure can be a helpful instrument. Since we know that the parties might change their position, all information on prices, profit forecasts, and asset valuations made by them can be doubted. In this sense, the establishment of, inevitably artificial, deadlines to the possibility to change proposals or opinions can help the market and the shareholders to come quicker to a complete understanding of the actual situation, and to decide on the outcome of the offer. For these reasons, the regulators agree that changes of opinions and proposals are possible, and also that «late discoveries» of a hidden fact concerning the interested companies might occur, but, primarily in the interest of shareholders and investors, impose deadlines before which "last words" must be pronounced.

We can find in the Code several examples of «last» days; the rules are always assisted by the possibility of «consulting» the Panel for exceptions, but the traditional (for the UK takeover's regulation) acknowledgement to flexibility does not change the importance of respecting the time provisions.

For the offeror the most important deadlines are that:

- within 28 days of the announcement the offer document must be posted (rule 30.1); the exact time can be considered as a specification of the general rule of fairness established by Rule 2.7: «when there has been an announcement of a firm intention to make an offer, the offeror must, except with the consent of the Panel, proceed with the offer unless the posting of the offer is subject to the prior fulfilment of a specific condition and that condition has not been met»;
- within 46 days of the posting of the offer document the offeror can revise its offer (rules 32.1 and 31.6); note 1 to rule 32.1 also clarifies that, if the deal is an exchange

[47] An interesting exception is the «approval in advance» of the circular containing the proposals to the General Meeting, if a potential controlling shareholder is seeking a waiver from the mandatory offer (Rule 9) through the Whitewash procedure (Appendix 1 to the Code).

offer and an announcement of events regarding the life of the offeror company could increase the value of the offer «an offeror will not … normally be permitted to make such announcements after it is precluded from revising its offer».

Furthermore, in the Code there are several provisions that «nail» the offeror to its words: for example, the offeror is not allowed (unless in «wholly exceptional circumstances») to increase the consideration or the dimension of the offer if it, or some person on its behalf, has pronounced a «no increase statement» (rule 32.2); in the opposite situation, when the offeror intends to improve its offer and wants to make public its intention, it cannot issue a public statement «without committing itself to doing so and specifying the improvement» (rule 19.3). In this latter provision we can find the same «ratio» of rules concerning the seriousness of the initial announcement of the intention to make an offer: be aware of the relevant effects of your announcement on the market and on the life of the interested companies and do it only if you are rationally sure of your intentions.

3.3. The duties of the target's directors

3.3.1. The general rule of disclosure and the fiduciary duties

As we saw above (par. 3.1), if the target of a corporate acquisition is a public company, then the directors of this company are normally bound by the same general rule of disclosure valid for the buyer/offeror. We saw also (par. 2.2.1.) that if the directors of the potentially acquired company are approached by the offeror then they can suddenly become agents of the shareholders because, despite the fact that the offeror has begun talks with them, the real counterpart of the proposed deal will be the shareholders of the company.

On this situation the requirements arising from the common law fiduciary duties are more evidently important for the directors of the target company than for those of the offeror.

There is a particular situation examined by the Courts that shows how wide the scope is of the fiduciary obligation of the directors: even if the decision on the choice of a hypothetical buyer is left to them by the articles of association, this choice must be fair and cannot, at least without very serious reasons, prevent the shareholders from making the best deal[48].

In general, when a proposal of acquisition of a relevant amount of shares of the company is presented to its directors, the duty of a good director is to communicate to the shareholders, as soon as possible, the existence of the possible deal and to understand the real worth of the proposal[49]. Any lack of disclosure and any behaviour with the effect of reducing the ability of the shareholders to evaluate the deal could be considered as a use of the powers arising from the articles of association for an «improper purpose». Any

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48. The decisions, cited in Gore-Browne, 27.006, have been held for private companies (e.g.: Munro v. Bogie 1993 GWD 14-912 or Savoy Corpn Ltd v. Development Underwriting Ltd, 1963, NSLR 138) but the rule can be considered a general one.

49. See the decisions quoted at previous Notes from 16 to 19.

different action, with possible effects on the outcome of the proposed offer, might need new permission and consequently a new decision from the shareholders (or, if we prefer to use the terminology of organic theory, from the organ that elected the directors: the general meeting), as we shall see in the paragraph 4.

3.3.2. The possible period of silence

The trade-off between mandatory disclosure and the need to preserve the effective ruling of the deal can lead the directors of the target to a period of silence before the disclosure of the possible development for the shareholders; we have seen that this situation can normally happen when the offeror's strategy uses preventive talks with the directors or the Board of the Target company.

Rule 2 of the City Code, as we have seen, tries to resolve this trade-off and, in particular Rule 2.3. divides the responsibility for disclosure between the offeror and the offeree, leaving the duty to make an announcement to the directors of the latter - if they have been informed by the directors of the former. The events that can lead to disclosure are the same as those mentioned above for the directors of the counterpart (for example: untoward movements on the market; circulation of rumours; increase in the number of people in the know). For the directors of the offeree it can be easier to make only a partial announcement, without, if possible, mentioning the name of the potential offeror, if they think that this is best in consideration of the level of the talks (Rule 2.6).

But also after the first announcement has been made by them or by the offeror, the directors of the potential target company can maintain a somewhat reserved position; the rules of the Code allows them breathing space for the preparation of a complete and exhaustive answer to the bid. Actually, Rule 30.2 gives them 14 days following the posting of the initial offer document, in which to give their first complete recommendations to the shareholders and Rule 31.9 gives them 39 days, extendible to 46 if the offer is revised, to announce new events (such as «trading results, profit or dividends forecasts, asset valuations or proposals for dividend payments») that can affect the opinion of the directors or influence the decisions of the shareholders.

The initial date for the counting of these days is, as said, the posting of the offer document; consequently, the directors of the target have, in a normal situation, more than a month after the first announcement for preparing a complete opinion on the offer (28 days is the time given to the offeror for the posting of the offer document by Rule 30.1). However they cannot abuse this possibility because they must, as imposed by the same Rule 30.2, «advise the shareholders of its views on the offer as soon as practicable after publication of the offer document». It cannot be excluded that acceptances of the offer are decided by the shareholders before having the complete recommendations of their directors, but they know that there will be at least a week between the publication of the recommendations and the first closing date (day 21, Rule 21.1).

The time left to the directors of the offeree company can really be considered as a period of silence if the deal is not a recommended takeover. If they are involved with the offeror in the preparation and organisation of the deal they will be substantially obliged to cooperage with the other party in the writing of the offer document and in giving the shareholders complete and immediate information.

4. The approval of the shareholders as a rule of fairness

4.1. When the disclosure is not enough: the need for the shareholder's approval in Company Law

The previous section considered the standing rules concerning the time of disclosure of a (realised or planned) corporate acquisition, with particular interest to the context of a takeover; the analysis has shown that in the regulation of financial markets there is a general rule of disclosure, applicable whenever a corporate acquisition occurs, but also that the obligation of disclosure is governed by rules of fairness binding the directors of the involved companies. These rules of fairness share important common points with the general principles of fairness, assessed by Company Law, which govern the directors' behaviour.

The present section 4. considers another aspect of the regulation of the behaviour of the directors: when the disclosure and the fairness applied to the disclosure are not sufficient for the protection of the shareholders. The fairness owed to the shareholders requires, in such situations, more than just a good choice of the timing of the disclosure: the directors must leave their shareholders with an informed 'last word' on what the company must carry out.

The reason for this might be that the dimension or the effects of proposed deals are too important and the interests of the shareholders are too directly involved to be able to leave the decision to the discretionary powers of the managers. The instrument used by UK Law in these situations is especially the approval of the behaviour; this approval can come before or after the relevant act or the relevant agreement, but the act cannot have legal effects and the agreement cannot be executed if the approval is not obtained.

The possibility of a late approval of the behaviour can probably be related to the traditional importance that the *ratification* by a General Meeting has in the English Company Law. Ratification is a traditional instrument used to prevent the directors from being liable for their actions; in the traditional statement held in the case of North-West Transportation Co. Ltd (1887)[50] Sir Baggallay wrote, for example, that «a director of a company is precluded from dealing, on behalf of the company, with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may a conflict, with the interests of those whom he is bound by fiduciary duty to protect … Any such dealing or engagement may, however, be affirmed or adopted by the company».

50. 12 App Cas 589, Privy Council.

Thus, the company, with a majority vote from the shareholders can do or validate that which the directors may not. This rule has been created by Courts with respect to situations related to conflicts of interests of the directors; a similar rule is provided by sections from 320 to 322A of the Companies Act 1985 for transactions characterised by risk of conflict of interests, if its value is over a certain amount, and for transactions done by the directors out of the power given to them by the constitution of the company.

In particular, section 320 requires that the sale or acquisition by a company of «non cash assets», whose value is over a specified amount[51], to or from directors (also of its holding company) or persons connected to them must be «first approved by a resolution of the company in general meeting». The arrangement entered into in contravention of section 320 «is voidable at the instance of the company» (section 322); however - s. 322 (2) © - the arrangement is not voidable if «the arrangement is, within a reasonable period, affirmed by the company in general meeting». This ratification does not exclude the liability of the directors «to account to the company any gain» and «to indemnify the company for any loss or damage», but the ratifying company probably would not bring any judicial action against them.

Section 322A states, for its part, that any transaction in which the parties include a director, also of the holding company, or a person connected to him is voidable, if «the board of directors, in connection with the transaction, exceed any limitation on their powers under the company's constitution». Paragraph (5)(d) of the section plainly shuts off this provision if «the transaction is ratified by the company in general meeting, by ordinary or special resolution or otherwise as the case may require». As in Common Law, the «ultra vires» acts of the directors can be ratified.

The rule of shareholder's approval or ratification as a condition for the completion of specified acts of the directors has been extended to different circumstances, such as the promotion or frustration of a takeover offer, always being characterised by the largeness of the deal that the directors are conducting or by a strong possibility of conflict of interests between directors and shareholders.

For example, in the context of a takeover, the directors might have self-interests in the acquisition of another company because they aim to increase their power, or might refuse an offer because they are afraid of losing their power: both situations could encourage them to ignore the interests of the shareholders and for this reason the transfer of decisional power to the shareholders could be useful. As we saw (sub-par. 2.2.1), these such cases founded the judiciary «proper purposes» doctrine, in particular with respect to the issue of shares used by directors as a means for helping or frustrating a takeover offer without attention to the willingness of the shareholders; it is indeed uncontested that a problem of «proper purpose» does not arise if the act has been authorised or ratified by a, correctly called and held, General Meeting.

Thus, the rule which imposes that particular acts of the directors must be conditioned by the approval of the shareholders is a traditional rule of Company Law; on the other hand, this rule has been gradually improved, to meet with the increasing skills asked for

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51. The value is more than 100,000 pounds or more than 10% of the company's assets and not less of 2,000 pounds, section 320(2).

directors of companies in the modern economy. In recent years this rule, which was at one time only a formal requirement often easily absolved, transformed into a rule of fairness, considered essential for good corporate governance and enforceable by the company and by single shareholders.

Particularly, the way in which approval may be obtained has been improved with respect to the interest of the independent shareholders. The Courts and especially the market authorities are nowadays extremely aware of the problem of conflicts of interests and consequently there are rules, for example of the Financial Services Authority (of the London Stock Exchange before 1 May) and of the City Panel, establishing that the majority authorising or ratifying the acts of the directors must be calculated without the votes of the interested directors or of the interested third parties.

This is not the general rule in common law and in the Companies Act 1985. The exclusion of the vote of the interested directors was, for example, denied in the cited case North-West of 1887; the Courts also assessed the possibility of a legal action brought by a minority based on the presence of «unfair or improper means» for the adoption of the decision by the General Meeting, or of «oppressive» behaviour by a majority «towards those shareholders who oppose it» (neither found in this specific case). This latter is still in fact (together with the possibility of an "unfair prejudice" relief) the legal instrument available for opposing the possibility of a meaningful participation of the interested person in the vote which authorises the directors. The rule, as we briefly saw in paragraph 2.2.1, can be summarised as below:

- if there is a controller of the company and the controller (or someone acting in concert with him) is a self-interested director or a third party interested in the relevant operation, the supposed wrongdoing cannot be ratified by the company with a majority vote (this is why it is called «non ratifiable» behaviour); indeed, if the vote of the controller were allowed, then all oppression of the minority could be legalised at the General Meeting;
- if the supposed wrongdoing which has caused loss or damages to the company is non ratifiable behaviour, the derivative action against the directors can be brought by a minority of the shareholders;
- this possibility has been limited by the Smith v. Croft decision, requiring that the action must be authorised by the majority of the minority shareholders.

This rule against the «oppressive» power of directors and controlling shareholders in General Meetings does not seem very effective, especially where, as in public companies, the shares are distributed among many investors and traded on a secondary market. In particular situations a possible different remedy can be the «unfair prejudice» petition that we saw above (par. 2.2.4.); for public and listed companies the defence against the risk of unfairness in the delivering of the authorisation by a General Meeting can be found in the special rules of the market.

It will now be seen that the rules of the market authorities confirm and improve with detailed provisions, principles that the judicial tradition of Company Law has previously adopted.

4.2. The approval of the offeror's directors acts in the Listing Rules

The plainest manifestation of the rule of shareholder approval is in the Listing Rules. It provides, in chapters 10 and 11, the list of transactions that need such approval and rules of fairness that must be respected in the adoption of the decision by the General Meeting.

The relevant operations are the «Class 1 transactions» and the «reverse takeovers» in chapter 10 and the «transactions with a related party» in chapter 11. As Chapter 10 clarifies, the relevant «transactions» are principally acquisitions or disposals by a listed company; obviously the acquisitions can be of other corporate entities or of business or assets and, if related to companies, can be private acquisitions or takeover offers; in the latter situation Chapter 10 provides for special requirements of disclosure, especially with respect to offers which are not recommended by the board of the target company (paragraphs 10.45 to 10.50).

The special rules for «class 1 transactions» and «reverse takeovers» are established in paragraphs 10.37 to 10.39. According to the general information requirements, which are shared with the Class 2 transactions (percentage ratio of 5% or more), the company (as we saw above, par. 3.2.1) must dispatch an explanatory circular to the shareholders and must obtain the «prior approval of its shareholders in general meeting». For class 1 transactions it is possible that related agreements are entered into before the positive vote of the shareholders in the general meeting, but it must be a condition of any agreement that it will not have any legal effect without that vote. This latter possibility is not explicitly established for «reverse takeovers»; probably the more serious effects on the life of companies that this kind of transactions cause has encouraged the regulators to pay more attention to the timing of the successive steps of the deal.

Normally, if the transaction is a takeover offer, the dispatching of the circular and the organisation of the general meeting are realised after the publication of the «firm announcement to make an offer» and before or at the same time as the posting of the offer document.

Chapter 11 lays down the essential rules of fairness concerning the adoption of the decision by the meeting. This chapter enlarges the scope of transactions that need shareholder approval, giving relevance to all the transactions with a «related party», as defined[52], with some exceptions. The most important exception waives the approval for «small transactions», whose percentage ratio, as referred to in paragraph 10.5, is less than 5% (paragraph 11.8)

The integrative rule on this kind of transaction is that the company must, where applicable (and so, if the related party is also a shareholder or has been given authority by a shareholder), «ensure that the related party itself abstains, and takes all reasonable steps to ensure that its associates abstain, from voting on the relevant resolution»

[52]. The definition, given by paragraph 11.1 of the Listing Rules, is quite complex. In general, directors, shadow directors, shareholders who own more than 10% of the issued capital («substantial shareholders»), an associate or a related party within them are considered as a «related party». The meaning of associate, the criteria for the calculation of the shareholding, the relevance of past directors and other detailed aspects are explained in paragraph 11.1.

(paragraph 11.4.d). The general rule is substantially the same as the one assessed by chapter 10: the company must «obtain the approval of its shareholders either prior to the transaction being entered into or, if it is expressed to be conditional on such approval, prior to completion of the transaction» (paragraph 11.4.c).

Thus, if a relevant corporate acquisition is proposed or agreed between a listed company and a related party it must be approved, before or after the formal contract is entered into, by the shareholders in general meeting without the vote of the related party itself, whether this is a director, a substantial shareholder or a third person associated with them.

If the counterpart of the acquisition is not a related party the deal must be approved by the shareholders without any special rule concerning the adoption of the resolution: the directors can vote if they are shareholders ('qua members»); if the company is controlled by a shareholder or several shareholders acting in concert they can vote and determine the positive result of the meeting. Of course all the applicable rules concerning «oppression of minority» or «unfair prejudice» are callable by the defeated shareholders but they do not have additional instruments given to them by the rules of the market. In such cases, and with the aim of protecting the disinterested shareholders, the rules of the market add integrative requirements of disclosure of all the relevant information for a rational decision on the merits of the proposed transaction and on the future of the investment in shares of the interested company.

4.3. The approval of the target's directors act in the City Code: the passivity rule

Fully consistent with the traditional principles of Company Law, and especially with the «proper purpose» doctrine we examined above (par. 2.2.1.), is the «passivity rule» assessed by the City Code, in particular by General Principle 7[53] and Rule 21, which specifies what the General Principle establishes[54]: the obligation imposed by these rules on the directors during a takeover offer relates more to the relationship directors\shareholders than to the relationship offeror\offeree. Also in this case the market authority has clearly laid down detailed rules with the aim of reducing the risk of misunderstandings by the interested parties of what fairness means in a takeover bid, especially if the offer is not recommended.

The meaning of the regulation can be well understood using the words of some statements of the Panel itself:

> «This Principle is fundamental to the Code. It cannot always be easy for the management of a target company to distinguish its own interests from those of its

53. See the text in note 7.

54. In the specific rule there is a list of possible frustrating actions, that surely come into the scope of the General Principle and there are some exceptions provided. These latter are essentially justified by the existence of a formal contract entered into before the time of application of the passivity rule. If a formal contract does not exist, the rule can be waived in presence of an obligation or other special circumstances, only with the consent of the Panel «to proceed without a shareholders meeting».

shareholders; this is potentially damaging in circumstances where the two do not necessarily correspond. One of the principal objects of the Code is to enable the shareholders in the target company to have an opportunity to consider an offer for their company on its merits on an informed basis in an orderly and limited timescale»[55].

«[General Principle 7] prevents action being taken by directors which may bring the interests of management into conflict with those of shareholders. It is an important element in securing that shareholders be given the opportunity to consider a bid for their company. It is because of respect for the interests of shareholders that frustrating action is permitted if, but only if, it is approved by shareholders»[56].

The main aim of the «passivity rule» is therefore to keep the decision concerning the results of the offer in the hands of the shareholders[57].

The contents of General Principle 7 and Rule 21 of the City Code can be examined from different points of view: scope, period of relevance, eventual special majority.

Scope of the passivity rule. The different wording of General Principle 7 and Rule 21 has led to some doubts about the real scope of the «passivity rule». The duty of acting only with specific approval of the shareholders has a general value and the relevant operations cannot be limited to the ones listed by Rule 21. As the Panel said: «Rule 21 set out certain specific frustrating action which must not be taken without the approval of shareholders. … The Rules are not, however, exhaustive of the situation in which the General Principles can apply[58]». Thus, the behaviour of the directors is bound primarily by the General Principle and the specific rule, as ever in the Code, must be seen as a sort of help in the choice of the correct path: its use as a «safe harbour» would be unfair[59].

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55. Taken out from the statement on the case Hoylake Investments Limited/B.A.T. Industries plc, September 15, 1999, see Weinberg and Blank, pp. 10102-10103.
56. Taken out from the statement on the case Minorco/Consolidated Gold Fields plc, May 9, 1989. See Weinberg and Blank, p. 10038.
57. This is the conclusion also from an American perspective «The British regulatory system … ensures that shareholders, not management, have the ultimate say on whether a takeover proceeds», L. A. Bebchuck .- A. Ferrell, *Federalism and Corporate Law: the race to protect managers from takeovers*, Columbia Law Review, 1999, p. 1193. As universally known this is not the main principle stated by the American law on defensive tactics; the American standing regulation can be taken from the Principles of Corporate Governance of the American Law Institute, that represent an effort of synthesis of the best principles arising from the practice of Courts and of State and Federal lawmakers. Principle 6.02 (a) establishes that «the board of directors may take an action that has the foreseeable effect of blocking an unsolicited tender offer, if the action is a reasonable response to the offer». Some disputes exist about the burden of proof of the reasonableness or unreasonableness of the response: in the ALI principles this burden is placed on the party challenging the action of the directors; in the Delaware current law (established by the decision Unocal v. Mesa Petroleum Co. of 1985 and Paramount Communications, Inc. v. Time, Inc. of 1990, that can be read with commentaries in Gilson R.J. - Black B. S., *The Law and Finance of Corporate Acquisitions*, New York, 1994, p. 821 and after) this burden is placed on the defending directors.
58. Statement of the Panel on Minorco/Consgold (May 9, 1989), in Weinberg and Blank, p. 10034.
59. The position of the Panel on this subject is well clarified by the following text, taken out from the statement of the Appeal Committee of the Panel concerning the application of General Principle 7 and Rule 21 in the offer of CE Electric UK plc for Northern Electric plc (statement 1996/20, December 23, 1996):

The problem has effectively arisen with respect to legal actions, which are not considered in the list provided by Rule 21. The Panel stated in the quoted case Minorco/Consgold that «litigation could become a tactical weapon intended to prevent a bid from being considered on its merits. All this could take place regardless of the views of the shareholders who own the company. We think that, in principle, this would be highly undesirable and potentially gravely damaging to the orderly conduct of bids. In saying this, we are not suggesting that it may not be appropriate to take legal proceedings which frustrate a bid. All we are saying is that the shareholders should be entitled to decide whether such actions should take place»[60].

It is important that the decision of the Panel was founded on a detailed analysis of the substance of the particular proceedings, which showed that the action taken by the board of the offeree company could effectively result in the frustration of the offer. The Panel used an objective test, which led to the conclusion that «in the present case, the form of injunction is unequivocally framed so as to prevent Minorco from implementing its offer and so would have the effect of precluding its success irrespective of the wishes of shareholders»[61]. Actually, not just any legal proceedings should be seen as frustrating action, but only those actions which can directly cause the offer to lapse.

What has been stated by the Panel on the legal proceedings question shows the essence of the principle: every act which can in fact directly frustrate the offer without the shareholders' consent can be considered unfair and inconsistent with General principle 7. There is no need for the consent to be given before the action is brought but the approval must intervene before the frustrating effect on the offer is produced.

Coherent with this principle is the different resolution stated on the, also previously cited, case Hoylake/BAT Industries. In such a different situation the Panel considered that the activity of lobbying with the competent authorities on the antitrust issues concerning the offer did not involve a breach of General principle 7. Actually, a lobby cannot be considered as an action which can directly frustrate the offer; indeed it involves the issuance of simple opinions, without any legal effect and refers to persons not pushed to a decision by the activity of the lobby. Moreover, in the Panel's view, «irrespective of its effectiveness the lobbying of politicians is a democratic right which it would be

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«The Code is based upon a number of General Principles, which are essentially statements of good standards of commercial behavior. They are, however, expressed in broad general terms and the Code does not define the precise extent of, or the limitation on, their application. The Panel applies them in accordance with their spirit, to achieve their underlying purpose. It is impracticable to devise rules in sufficient detail to cover all circumstances which can arise in offers. Accordingly persons engaged in offers are made aware that the spirit as well as the precise wording of the General Principles and the ensuing rules must be observed. Moreover, the General Principles and the spirit of the Code will apply in areas or circumstances not explicitly covered by any rule». See Weinberg & Blank, p. 10157.

60. Statement cited, p. 10036.

61. Ibidem, pp. 10037-10038.The authors of Weinberg and Blank comment: «There is no need for shareholder approval to be obtained in respect of litigation which *cannot* have the effect of frustrating an offer which has been made. Moreover there is no requirement that such approval be sought as a pre-condition to the bringing of litigation … given the obvious need for speed in bringing such action». See, also for further commentaries, Weinberg and Blank, p. 4209.

inappropriate for the Panel to inhibit[62]».

Period of relevance. The time of application of the «passivity rule» is one of the essential features for its comprehension. The «d-day» is established without regard to the public knowledge of the offer and without regard to the existence of a legally binding commitment of the offeror: what is important is the knowledge that the directors of the potential target company have about the offer and the seriousness of the intentions of the offeror.

Thus, the directors cannot perform frustrating actions «at no time» after a serious possibility of a «bona fide» offer appears to them. Again, the period of relevance confirms the nature of the «passivity rule»: it is a duty owed by directors to shareholders, not a rule which establishes a favour of the regulations for the offeror against the offeree. Theoretically, although the shareholders can be not aware of the existence of the possible offer, the freedom of the directors is restricted. However, the general possibility of ratification allows the directors to carry out immediate defensive actions, especially if they are confident in a confirmation of trust by the General Meeting.

Obviously, it is not easy to define exactly what «bona fide offer» means. Certainly a transaction for which the offeror is working seriously, fully respecting, or fully prepared to respect, the relevant market and Company Law rules concerning authorisations, announcements, independent advises would be considered «bona fide». Moreover the burden of proof of a supposed wrong faith is on the acting directors of the Target and thus they must demonstrate that the promises given to the market by the proposed offer have less probability to be respected or that the offeror is acting only with a disturbing intention.

Special rules for the adoption of the resolution. There are no special rules or majority for the approval of the resolution on defensive tactics. However, if the defensive tactic is realised through a transaction with a related party then obviously the special rules concerning this kind of transaction will be applicable.

A further limitation on the vote of interested persons can be found in Rule 18 of the Code, which regulates «the use of proxies and other authorities in relation to acceptances». This rule bans the appointment of proxies as a term of the acceptances to an offer. The ban is not effective only if the offer has become wholly unconditional: thus the offeror cannot exercise the right of vote connected to shares assented to the offer, unless the positive outcome of the offer has been previously obtained. A consequence of this rule is that the offeror cannot vote as a proxy in a general meeting, held under General Principle 7 and Rule 21, to decide on the authorisation of defensive tactics. This rule does not affect the possibility of voting with the shares personally owned by the same offeror.

62. Ibidem, p. 4210.

5. CONCLUDING REMARKS

The analysis leads us to some final comments. The first two of them are more directly related to the contents of the rules we examined in Paragraphs 3 and 4. The other three concern the alternative between general rules and detailed rules and the relationship between Company Law and securities regulation, which are problems presently posed in all the European countries facing (as Italy, for example) the increasing relevance of financial markets in their economy.

1. *Flexibility of the rules concerning the time of disclosure*. Paragraph 3 shows that, in general, the time of disclosure of a corporate acquisition must coincide with the first moment at which it is possible to deliver information to the public without seriously damaging the outcome of the transaction. However, the possibility of a late delivery of information in the interest of the outcome of the transaction is banned whenever there is a serious risk that the good conduct of the market would be badly affected by the silence.

In fact, if the acquisition is private, but public companies are involved, the moment of mandatory disclosure is normally identified with the conclusion of an agreement on the terms of the transaction between the parties, also if this agreement is not legally binding. Until this moment the publication of information can disturb the negotiation in course and can cause some confusion on the market. If there is a violation of secrecy the delivery of only partial information is possible but the parties must ensure a fast conclusion of their negotiations.

If the acquisition passes through a public transaction (and so mainly if it is a takeover offer) the moment of mandatory disclosure generally comes when the acquiring party (or the directors of the acquiring party) decides to launch the offer, after gathering sufficient information to be able to rationally put aside any residual doubts about the start of the offer. Before this moment they can carry out all the steps they suppose necessary in order to be sure of their intention - for example, they can decide whether or not discuss the terms of the offer with the directors of the target company - and they must carry out all the steps they need in order to ensure the fairness and accountability of their announcement. On the other hand any wasting of time can lead, if particular events occur, to an anticipated disclosure on the burden of the potential acquirer or, sometimes, of the discussing directors of the target. This disclosure can be temporary or incomplete (e.g. the announcement of a possible offer) if there are talks in course between different parties, but it must be complete if only one party (the potential acquirer) is governing the situation.

2. Shareholder approval as a rule of fairness. Paragraph 4, highlighted also by the rules of Company Law exposed in paragraph 2, shows that the need for the approval of the shareholders for some important transactions is essentially a rule of fairness, which binds the directors. The rule can be read as: whenever they understand that a transaction will change the nature of the investment or will have a direct effect on a deal proposed by a third party to the shareholders, the directors must ask for a new authorisation. The percentage ratios and the list of affected operations given by the rules are only an application of this general principle.

The potential or concrete conflict of interest between directors and shareholders is the main reason justifying the imposition of an approval at the General Meeting. Different dimensions of this conflict lead to different regulatory schemes on the adoption of the resolution: if the conflict is real and in effect (e.g.: transactions with a related party) the directors or the «substantial» shareholders of a listed company cannot exercise their rights of voting at the general meeting; if the conflict is only potential (e.g.: fears of losing the job with a new controller) they cannot decide as directors but they can exercise their rights as shareholders if they are owners of shares.

3. *General rules and detailed rules*. In the text of the examined rules of market authorities it is possible to see a continuous balance between flexibility and detail; there are general rules of fairness and disclosure (for example, the General Principles of the City Code, the general rule of disclosure established by chapter 9 of the Listing Rules) but there are also specific rules that allow different behaviours with respect to different situations (for example, if a takeover offer has been previously discussed with the offeree or not; if there are untoward movements on the market or not) and, finally, there also rules that contain lists of relevant facts or actions (for example the list of frustrating actions in Rule 21 of the City Code), often useful for activity on the market of the interested persons, but not exhaustive.
The detailed rules are often assisted by exceptions, sometimes directly provided and sometimes left to a discretionary power of the market authority. Actually, in general the effectiveness of the detailed rules goes as far as the general principle implemented by them is respected. If an automatic application of the rule goes against the spirit of the general principle the system provides for the application to be waived.

4. *Company Law and securities regulation*. The «rationale» of the rules on the relationship between directors and shareholders respectively established by the standing Company Law and by the market regulators seems to be very similar, but often the contents of the rules are quite different.
Three examples of this are: the difficult application of the unfair prejudice remedy in a public listed company (Par. 2.2.3); the different regulation of the vote of related parties in the approval or ratification of directors' dealings by general meetings (Par.4.1); the explicit existence of the «passivity rule» only for the companies to which the City Code is applicable (Par. 4.3.).

In the first case, the attention to the interest of all the shareholders in their particular position of investors, typical of the regulation of financial markets and listed companies, decreases the value of a remedy founded on the personal position of the shareholder and on the risk that this personal position can be seriously damaged by a particular use of the constitution of the company by dominant shareholders or directors.

In the second case, the value that financial markets award to the rapid resolution of legal problems has led to the improvement of the general principles of Company Law through a simple rule: «the related party should not be permitted to vote at the meeting» (Introduction to chapter 11 of the Listing Rules). This objective system is more easily applicable than general rules of protection of shareholders issued by the Courts, such as the «duty of not contract in conflict of interests» or the impossibility of a ratification with oppression of minority.

In the third case, the common law had created, with the "proper purpose" rule, a serious obstacle to the over-reaction of directors to hostile takeovers. The traditional rule denies to the directors the freedom to act with the purpose of favouring or disfavouring a takeover bid, without any further examination of what would be the interest of the company; the decision on the outcome of the takeover is actually left to the shareholders. It seems more effective, for example, than the rules still standing in the American context (quoted in note 57), as the complex mediation between interests recently established by the Delaware Courts with the «reasonable response» doctrine or the complex examination of the «primary purpose» of the action (if it has been the interest of the company or the interest of the directors themselves) that was the prevalent position of the American Courts until the cited Delaware decision.

Even so, the evaluation of the market authorities and namely of the City Panel has been that the good conduct of the market and the protection of the investors are not enough secured by the legal rule, whose application can be often doubtful. For this reason a narrowed passivity rule has been provided, a list of certainly relevant defensive actions has been made, and an exact indication of the relevant time of application has been laid down.

The sense of all these three examples is the same: the presence of the companies on the market creates a need for clear and rapidly applicable protection of disinterested shareholders, also in the corporate organisation. This justifies a different sharing of powers between directors and shareholders, in favour of the shareholders[63]. This situation is particularly apparent whenever a corporate acquisition, in which the company is actor or target, is carried out.

The UK solution for this need of special regulation has been, especially in the context of corporate acquisitions, the issue of particular rules by the market authorities. Obviously, this kind of solution can be effective only if the enforcement system of the authorities is effective.

[63]. The prevalent attention to the interests of the shareholders is confirmed also by rules that explicitly give importance to other kinds of interests. For example, the General Principle 9 of the City Code finds in «the shareholders interests taken as a whole, together with those of employees and creditors, which should be considered when the directors are giving advice to the shareholders». This, the interest of different stakeholders is considered but only for advising the shareholders to which the final resolutions are left.

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