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CREDITOR PROTECTION IN THE MARKET FOR CORPORATE CONTROL

Dissertação de Mestrado em Direito da Empresa e dos Negócios

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UNIVERSIDADE CATÓLICA PORTUGUESA
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Orientadora: Mestre Daniela Baptista

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“*Para ser grande, sê inteiro: nada*
Teu exagera ou exclui.

Sê todo em cada coisa. Põe quanto és
No mínimo que fazes.

Assim em cada lago a lua toda
Brilha, porque alta vive.”

Ricardo Reis *in Odes*, 1933

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ABBREVIATIONS

Art. – Article

Arts. - Articles

CIRE - *Código da Insolvência e da Recuperação de Empresas,* enacted by Decree-Law nº 53/2004, of 18.03.2004.

CMVM – *Comissão do Mercado de Valores Mobiliários* (the Portguese Securities Market Commission)

CVM - *Código dos Valores Mobiliários,* enacted by Decree-Law nº 486/99, of 13.11.1999.

CJSTJ- Colectânea de Jurisprudência- Acórdãos do Supremo Tribunal de Justiça

CSC - *Código das Sociedades Comerciais*, enacted by Decree-Law nº 282/86, of 2.10.1986.

ff.- following

Ed. – Edition or "*Edição*"

EU- European Union

ECJ – European Court of Justice

LBO – Leveraged Buy-Out

MBO - Management Buy-Out

MS- Member-States

p. – page

pp. – pages

RLJ – *Revista de Legislação e Jurisprudência*

ROA – *Revista da Ordem dos Advogados*

Vol. - *Volume*

I. INTRODUCTION

1.1 Research Topic Outline

The market for corporate control is assigned the important *corporate governance* role of addressing the conflicts of interest between the company constituencies, by rendering directors and managers accountable to shareholders and pursuing efficiency goals. As a result of the acceptance of hostile takeovers in European jurisdictions, Directive 2004/25/EC[1] established a board neutrality rule that restricts the powers granted to board of directors[2] when facing a takeover attempt- and, consequently, its ability to determine the outcome of the bid. The Portuguese legislator *opted-in* this rule, thus not granting the board much discretion to adopt defensive measures[3]: its main influence on the acceptance or rejection of the bid is exercised through a report on the conditions and opportunity of the offer[4].

The allocation of the decision on the success of the takeover to the shareholders leaves, however, some unsolved problems, as the exclusive consideration of shareholder interests may lead to the adoption of riskier strategies, to the detriment of other constituencies. Creditors can be affected by a takeover: as a result of such control transaction, the newly-owned company's share value can drop, diminishing its asset base and rendering creditors' claims and bonds less valuable. Additionally, creditors can stand to lose out on changes in the company's strategy (especially in the company's risk profile) implemented by the acquirer, which is why they may be interested in deterring the takeover.

We will try to provide some contractual remedies which grant creditors some degree of control over the company and enable them to thwart an unwanted bid.

[1] EU Directive 2004/25/EC of the European Parliament and the Council of 21 April 2004 on Takeover Bids (hereinafter "Directive" or "Takeover Bids Directive").

[2] In art. 278º of the Portuguese *Code of Commercial Companies* of 1986 (hereinafter quoted as "CSC") three alternative models of managing and auditing stock corporations are provided: a one-tier system, which only comprises a board of management ("*Conselho de Administração*"); the traditional two-tier system (arts. 390º and ff. CSC), with a board of management ("*Conselho de Administração*") and a board of auditing ("*Conselho Fiscal*"); and a three-tier system (arts. 424º and ff. CSC), with a board of directors ("*Conselho de Adminstração Executivo*"), a supervisory board ("*Conselho Geral e de Supervisão*") and a statutory auditor ("*Revisor Oficial de Contas*"). *See* ANTUNES (2009, 35-38). The obligation of neutrality bounds the members of the board of management, in the one-tier and two-tier systems, and the members of the board of directors and of the supervisory board in the three-tier system. During this study, we shall use the expressions "board of directors", "board" and "management" to refer to either of those managing bodies, as our topic of research does not require a distinction between the three different systems.

[3] *See* art. 182º of the Portuguese *Code of the Securities Market* of 1994 (hereinafter quoted as "CVM").

[4] *See* art. 181º CVM.

Needless to say, the effectiveness of such solutions depends on the creditors' ability to negotiate the introduction of restrictive covenants in the lending agreements celebrated with the corporate debtor.

General company law rules, as well as insolvency and capital markets rules might grant creditors some protection - before or after a takeover. Nevertheless, we will only make a brief reference to such mechanisms, as the size limits applicable to this study require it to be concise.

1.2 The Research Question

The problem to which the present study is addressed is whether there is room for the consideration of creditor interests in the event of a takeover that can render directors accountable towards them. It will focus on the Portuguese approach to the problem of creditor protection in the event of takeover, although some references will be made to other legal systems.

A vague reference is made by the Takeover Bids Directive to the consideration of the interests of other constituencies in such cases; in the Portuguese jurisdiction, art. 64º CSC refers to non-shareholder interests that directors must take into account when managing the company. Nevertheless, most of the Portuguese and international literature seems to consider that during a takeover directors are only required to pursue the interest of the shareholders in maximizing the company's share value, which is why we considered this topic of interest. A change of control is one of the most important decisions for the company, affecting all of its constituencies including its creditors, who are some of the most important financers of the company. At the end of this survey it will be demonstrated that a *stakehodler view* of the company interests should be adopted during a takeover, and directors should be held liable for not exercising their influence on the outcome of the bid to protect creditors' claims and rights.

1.3 Methodology and Research Methods

The starting point of our research was our interest on the topic of *corporate governance* in the market for corporate control, especially on what concerns the adoption of post-bid defensive measures by the target board. A preliminary research aimed at analysing the differences between takeover regulation in continental jurisdictions, such as Portugal, Belgium, France, Germany, and common law

jurisdictions such as the U.K., and the U.S., namely on the interests that the board of directors is required to promote. Such research was conducted in September and October 2013, being that the conclusions were drawn on a Research Proposal. The specification of the research question for this study helped us outline the topic of our research.

The sources used for this dissertation consist on monographs, legal journal articles, working papers and studies, as well as online sources, from national and international authors. The comparative analysis of the solutions adopted by other jurisdictions for the protection of non-shareholder constituencies was an important part of the methodology used. The research also included consultation of national and European legal instruments, of national corporate governance codes of best practice and of existing case law from Portuguese courts and the ECJ. Another relevant contribution was an interview to Mr. Ward Möhlmann, from the European Commission DG Internal Market and Services, regarding the same topic.

The reason for this study to be presented in English relates to the fact that most of the research was conducted at the Katholieke Universiteit of Leuven, during an Erasmus Internship Program, under the supervision of a professor from the same University.

1.4 Structure of the Study

The present study will be structured as follows. Chapter II analyzes the phenomenon of the market for corporate control and possible motivations of takeovers, namely the ones which might harm the interests of non-shareholder constituencies. Chapter III will be dedicated to the Portuguese rules which establish specific duties for corporate directors during a takeover and will also describe some defensive measures that, if adopted by the target company, could benefit creditors. The adoption of the board neutrality rule might accentuate agency problems arising in the relationship between creditors and shareholders, as generally shareholders will only consider the price offered when accepting the bid, to the detriment of creditor interests. We shall return to the obligations of corporate directors in Chapter VI. Chapter IV explains the differences between two types of creditors: the ones which have the bargaining capacity to establish contractual remedies to protect their interests, and the ones who lack such capacity. This assertion is developed in Chapter V, which is devoted to the risks

corporate creditors bear in the event of a takeover. The considerations developed in Chapters III and V will provide us the necessary background to turn finally to the crux of our study. The general duties that bind directors shall be approached in Chapter VI, which specifically focuses on the interests that the management must take into account when advising the shareholders on the bid. We conclude that although a *stakeholder view* should prevail, there is a tendency in Europe to adopt an *enlightened shareholder* approach during a takeover, which is why Chapter VII will try to provide some additional contractual remedies available to creditors and that might grant them the power to prevent an unwanted change of control.

II. TAKEOVERS AND THE MARKET FOR CORPORATE CONTROL AS CORPORATE GOVERNANCE MECHANISMS

To properly access the effects of takeovers in the position of corporate creditors, it is important to consider that hostile takeovers are considered "*the most dramatic of all the corporate governance devices*"[5], and are crucial to mitigate conflicts of interest emerging between the diverse constituencies of publicly held corporations[6]. Relevant literature assigns the market for corporate control a *corporate governance disciplining function* as well as an *efficiency function*[7]. Such roles have different consequences according to companies' ownership structures.

Firstly, it is considered to be a key mechanism to render directors and managers accountable to shareholders, as takeovers can be executed with the purpose of removing an underperforming board. If the company's shares are being traded below the fair value of the same assets[8], it may become an acquisition target[9]; potential buyers will target poorly a performing firm and make an attempt to acquire the company, replacing the

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[5] ARMOUR and SKEEL (2007, 1733).

[6] According to art. 13º CVM, publicly held or open corporations ("*sociedades abertas*"), as opposed to privately held corporations ("*sociedades fechadas*") are defined in general as stock corporations whose equity capital is open to public investment. They are ruled by the CSC rules applicable to stock corporations and by the relevant provisions of the CVM, which to some extent overlap with company law. *See* ANTUNES (2009, 11-12).

[7] DAVIES, SCHUSTER and DE GHELCKE, Emilie, (2010, 12-19).

[8] That is, the value the shares would have if the company was managed efficiently.

[9] The expressions "target company" and "target" shall be used in this study to refer to the company which is likely to be taken over by a bidder. The board of such company shall be referred to as the "target board".

current board by another which will enhance its performance. Additionally, if directors and managers have reasons to suspect that a hostile bidder[10] might take control if they run the company badly, such threat will *ex ante* induce them to minimize the costs and inefficiencies in order to maximize the company's value. In the *market-oriented* takeover regulation, adopted in the U.K. and the U.S systems of corporate governance[11], takeover regulation is centred on this idea[12].

The disciplining effect of takeovers is basically a remedy against shareholder apathy, which is why in Continental Europe, where more concentrated ownership structures prevail[13], takeovers serve mainly efficiency goals- when the potential acquirer seeks to exploit synergies by combining the target company's assets with the ones from another firm. The primary goal of takeover regulation in such jurisdictions is the protection of minority shareholders (by the prevision of exit rights[14] and of a sharing rule for the control premium[15]) and stakeholders against the substantial influence of the controlling block[16].

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[10] The expressions "bidder" and "potential acquirer" shall be used as references to the investor who attempts to acquire the company by means of a takeover.

[11] Terminology used by ARMOUR and SKEEL (2007, 1728).

[12] In the U.S., defensive measures can be used if they are justified in accordance with the *business judgment rule*. However, this standard is only applicable if the directors prove that that there was a "*reasonable threat to corporate policy and effectiveness*" and that the measure adopted was a "*proportionate response*" (see cases *Unocal* and *Unitrin* of the Delaware courts). Most States have codes of laws which grant the board a significant discretion to use defensive tactics (*see* paragraph 23-2-35-1(d) of the Indiana Code on footnote 150). In the U.K., takeover regulation is driven by the preponderance of institutional investors, which explains why it is strongly oriented towards protecting the interests of shareholders and offering good investment protection (*see* Rule 21 of the *Takeover Code*). *See* ARMOUR and SKEEL (2007, 1735).

[13] According to WYMEERSCH (2012, 2) the Takeover Bids Directive was conceived in a time when the dispersed ownership model was the company paradigm.

[14] *See* art. 196º CVM. For a definition of the shareholders' exit right, *see* BAPTISTA (2005, 84).

[15] From the side of the sellers, by imposing a duty to share the control premium with the non-selling minority; and from the side of the potential acquirer, by imposing a duty to offer to buy the non-controlling shares at the same price as that obtained by the controlling shareholders. *See* Art. 194º, n.º2 and 197º CVM and DAVIES and HOPT (2009, 257-260).

[16] Takeover regulation in European countries was harmonised by the EU Takeover Bids Directive. The Directive allows three major options for national legislators: adopting the board neutrality rule or the breakthrough rule, or both; refusing to adopt one of rules, or both of them, while allowing companies to spontaneously comply with such rules (*opt back into* the provisions[16]); adopting either of the rules, or both, but give the companies the power to escape those rules if the potential acquirer is not subject to the same restrictions (*reciprocity exception*). Germany adopted the second option, thereby allowing the board to adopt defensive measures upon approval by the supervisory board, or upon a preliminary general authorization by the shareholders (*Vorratsbeschüsse*, in § 33, 1 (1) and (2) of the *WpÜG*). Portugal (*see* the explanation in Chapter III, point 1) and France (see arts. L. 233-32 (I) and L. 233-33 of the French *Code de commerce*) have adopted the third option. *See* VASSOGNE, LOY and CARDI (2009, 299-302) and VENTORUZZO (2006, 32, 50-51, 66).

However, these assumptions are not necessarily true due to high transaction costs, shareholders' incomplete information and the pressure to tender[17]. Also, corporate control transactions are executed for a variety of reasons and while the two mentioned above tend to enhance social welfare, other motives are purely value-decreasing[18]. Bidders might be driven by empire-building purposes (self-interest), thus overpaying for a takeover which will imply the sole creation of value for the acquiring company's shareholders or a higher compensation of its directors. Another tactic a corporate raider can use to generate large amounts money is to purchase enough shares in the target company to threaten a change of control, thereby forcing the company to buy its own shares back at a higher premium in order to suspend the takeover (the operation by which the company buys its own shares back constitutes an anti-takeover strategy known as the *Greenmail or Goodbye Kiss*[19]). Furthermore, stakeholders who are outsiders can stand to lose out on changes in the company's strategy (especially on the company's risk profile) implemented by the new board[20].

III. SPECIFIC DUTIES OF THE BOARD DURING A TAKEOVER

1. The Portuguese board neutrality rule[21]

Like some European jurisdictions[22], Portugal had established a *no frustration rule* before the implementation of the Takeover Bids Directive, which is why the changes introduced in our jurisdiction only concerned the adding of the reciprocity

[17] The European Commission has stated, in its *Report on the application of Directive 2004/25/EC, on takeover bids* (2006,4), that although in theory takeovers promote economic efficiency, economic analysis shows that in practice such assumption is not necessarily true. See also the *The Takeover Directive Assessment Report* (2012, 278-279).
[18] ARMOUR and SKEEL (2007, 1739).
[19] SILVA (1996, 238).
[20] Some examples of anti-takeover measures are provided in the next point. *See* pp. 14 and ff.
[21] Some authors prefer to use the expression "*non-frustration rule*", arguing that the board is prohibited from frustrating the takeover before the shareholders have had an opportunity to decide whether they would like to accept or reject the bid, rather than a merely neutral position. In fact, the board is allowed to seek other offers (*white knight defence*) and is required to elaborate a report expressing its opinion on the merits and conditions of the bid. *See* VAZ (2013, 177-179), LEITÃO (2007, 66) and CÂMARA (2011, "As Ofertas", 185). Other authors adopt the expression "*passivity rule*"- *See* SILVA (2012, 783-800).
[22] Namely, Spain, Italy, France, Austria and the U.K. *See The Takeover Directive Assessment Report* (2012, 65- 66).

exception[23]. The Portuguese legislator has established a general principle on the limitation of the powers of the target board during a takeover process[24] (board neutrality rule)[25] in art. 182º of CVM.

The board neutrality rule implies that during the course of a bid, the board of directors of the target company must refrain from taking any actions that materially change the company's net asset situation – namely, the issue of bonds and other securities that grant the right to their subscription or acquisition and the execution of agreements that aim to dispose of important parts of the corporate assets[26] -, are not included in the company's *day-to-day business*[27] and significantly affect the objectives announced by the bidder[28].These three cumulative criteria apply from the moment that the target board becomes aware of the decision of the bidder to acquire the company[29] to the moment when the end results of the bid aw assessed of when the bid procedure ends, whichever occurs first[30].

The decision on whether to accept or reject the offer made by the bidder is consequently outside of the scope of the board of directors' functions[31]. Art. 182º CVM

[23] Upon the implementation of the Takeover Bids Directive, Portugal added the reciprocity exception, which allows the board of national companies to build up defences against companies which are not subject to the board neutrality rule. The purpose of this exception is to establish a level playing field for Portuguese companies. *See* arts. 182º, n.º 6 CVM and art. 12º, n.º3 of the Takeover Bids Directive.

[24] It should be noted, however, that the board neutrality rule only applies to takeover bids launched over more than one-third of the securities of the same category as those that are object of that bid. *See* art. 182º, n.º1 CVM.

[25] The board neutrality rule is established under art. 12º, n.º2 of the Takeover Bids Directive. SILVA, J., (2012, 799-800), criticizes this option, arguing that Portugal should adopt the board neutrality rule as a *default rule*, while giving Portuguese companies the option to derogate this rule by a modification of its articles of association. This solution was adopted in Italy by *Decreto Legislativo 25 Septembre 2009, n.146, Disposizioni integrative e correttive del decreto legislative 19 novembre 2007, n. 229, recante attuazione della direttiva 2004/25/CE concernente le offerte publiche di acquisto*, in force since the 1st of July 2010.

[26] Art. 182º, n.º2, *b)* CVM.

[27] VAZ (2013, 225).

[28] Art.182º, n.º2. This limitation of powers is extended to the directors' actions carrying out decisions taken before the relevant period and that have not yet been partially or completely carried out. *See* art. 182º, n.º2, *c)* CVM.

[29] That is, when the target company receives the preliminary announcement of the bid. *See* art. 182º, n.º2, *a)* CVM. *See* CÂMARA (2011, *Manual,* 590, and 2011, "As Ofertas", 185).

[30] Art. 182º, n.º1 CVM. Some authors, such as ENRIQUES (2009, 22-27) criticize the option of EU policymakers on setting the board neutrality rule as a default rule. The same author argue the EU should adopt a neutral approach towards takeovers and help individual companies define their degree of control contestability, namely by requiring MS to establish in their national laws that companies can grant directors a veto power on takeover bids. KIRCHNER and PAINTER (2010, 45-51) propose a *European modified business judgment rule* which would allow the target board to adopt defensive measures that are linked to the "best interest of the company, and particularly its shareholders "during a takeover attempt. The burden of proof should be on the side of the board, unless its actions are authorized by the shareholders.

[31] *See* art. 405º, n.º1 CSC.

ensures that the market for corporate control functions efficiently[32] and allows shareholders to sell their shares and to exit the company should they consider the offer is wealth-enhancing - the addressees of the bid are the shareholders, which is why they are the ones who decide on the merits of the bid. The flip-side of the coin is, however, that the limitation of the powers of the board to build up defences for the company might lead to a lower premium to be offered to the shareholders in return of their shares. The incentive for companies to enter the market for corporate control (which is higher if they are allowed to shield themselves from changes of control), and the fact that Portuguese companies became more vulnerable to takeovers from companies which are not subject to the same limitations are other consequences[33].

There are, however exceptions to this rule, regarding actions that correspond to the fulfilment of obligations undertaken before the acknowledgement of the takeover bid and actions authorized by a resolution of a shareholders' general meeting exclusively convened for that purpose[34]. The board does not need, however, an authorization of the shareholders' general meeting to seek competing takeover bids (*white knight defence*)[35] or to adopt the *people pill*. In the situation of a hostile takeover attempt, the expression *white knight* refers to a company or individual which will launch an alternative bid at a higher price[36] with the purpose of preventing the hostile bidder from taking control of the target or to induce him to make another offer which is more favourable to the shareholders. The *white knight* will have the support of the management[37]. The *white knight defence* is allowed by art. 182º, nº3, *c)* of the CVM and by art. 9º, nº2 of the Takeover Bids Directive as an exception to the board neutrality

[32] *See the OECDE Principles of Corporate Governance* (2004, 19), where it is stated, in *Principle II. E* that "*Markets for corporate control should be allowed to function in an efficient and transparent manner*". It is clarified that "*Anti-take-over devices should not be used to shield management and the board from accountability*".

[33] VAZ (2013, 140-14) and SILVA (2012, 799-800).

[34] The general meeting is only empowered to legitimate the board for the practice of those acts if it is convened and held during the relevant period. The shareholders' resolution can only be taken by the *qualified* majority required by arts. 383º, n.º2 and 386º, n.º3 of the CSC (corresponding to at least 2/3 of the votes expressed) for the modification of the company's articles of association PINTO (2009, 630).

[35] See art. 182º, n.º3, *a), b)* and *c)* CVM. Alternative bids are regulated in the CVM on arts. 185º, 185º-A and 185º-B.

[36] According to art. 185º, n.º5 of CVM, the price of the offered by the *white knight* must be at least 2% higher than the one offered by the hostile bidder and cannot contain clauses which make it less favourable.

[37] Nevertheless, the legal prohibition on financial assistance in the acquisition of its own shares is applicable to the target company, which is why the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários*, hereinafter "CMVM") has formally understood that the board cannot provide, even if only partially, financial assistance to any competing takeover bid. *See Parecer Genérico da CMVM sobre os deveres de comportamento na pendência de Oferta Pública de Aquisição (OPA)*, I.2.

rule, mainly because when the board seeks alternative bids it aims at getting a higher premium for shareholders in return of their shares. The *people pill* is another defence, under which the entire board of the target company threatens to quit in the event of a successful takeover[38].

2. Some defensive measures that can work as mechanisms for the protection of creditors

The threat of a takeover to be launched over the company induces corporate directors and controlling shareholders to act in concert[39] and create strategies (*defensive measures*) which aim at preventing a potential takeover attempt or at frustrating an existing one. Indirectly, such measures provide creditors who are not interested in the change of control over the company some protection.

There are two possible motivations for the adoption of defensive measures: either the directors are only interested in keeping their jobs– *management entrenchment hypothesis*[40]- or they truly believe the price offered is not fair and that shareholders should get a higher price in return of their shares – *shareholder interest hypothesis* –. In the first case, the board will adopt strategies that affect the efficiency of the market for corporate control and might lead to a decrease in the company's share value[41]. In some cases, the controlling shareholder are also interested in keeping their position of control, which is why they will support the adoption of such measures (by approving them in a general meeting)[42], and thus putting the interests of minority shareholders and other constituencies at stake. In the second case, the management will try to increase the share value of the firm (*premium effect*[43]) – either by seeking alternative offers (*white knight defence*), or by forcing the hostile bidder to offer a higher price through the adoption of

[38] Some authors, namely LEITÃO (2007, 64), argue that in most cases the potential acquirer will want to replace the management of the company, and thus will not be discouraged from completing the takeover if the board adopts this defence.
[39] *See* Art. 2º, n.º1, *d)* of the Takeover Bids Directive for a definition of "persons acting in concert".
[40] VAZ (2013, 157). *See* also LEITÃO (2007, 64).
[41] According to Recommendation I.6.1 of *Código de Governo das Sociedades da CMVM* (2010, 2), "*In cases such as change of control or changes to the composition of the Board of Directors, defensive measures shall not be adopted that instigate an immediate and serious asset erosion in the company, and further disturb the free transmission of shares and voluntary performance assessment by the shareholders of the members of the Board of Directors*." (Translation used by the *Sonae Capital* Corporate Governance Report of 31.12.12).
[42] Art. 182º, 3, *b)* of CVM.
[43] The expression "premium" in the context of a takeover refers to the difference between the estimated market value of a target company's shares and the actual price paid by the bidder in order to obtain the control over the company. VAZ (2013, 160).

post-bid defences (such as the *poison pill*). Other options are available, as point 3 of this chapter will demonstrate[44].

One can distinguish between two types of defensive measures[45]: *preventive* – adopted when there is no offer pending with the purpose of preventing future takeovers from happening (also referred to as *pre-bid defences* or *shark repellents*[46]) - and *reactive* defences (also named *post-bid defences*) – adopted after a takeover bid has been announced with the purpose of frustrating that specific takeover[47]. In the EU, most jurisdictions have adopted the board neutrality rule[48], thus restricting the circumstances in which the board might adopt *post-bid* measures[49]. Such options clearly reflect the idea that although defensive measures might be considered a mechanism to negotiate the bid price, they may also operate to allow entrenchment of underperforming boards[50].

The adoption of *post-bid* defences is also restricted in Portugal, while *pre-bid* defences are generally allowed[51]. Special disclosure requirements apply to *pre-bid* defensive measures under art. 245º CVM[52]. Such disclosure requirements benefit stakeholders, such as future investors and corporate creditors[53], as they allow them to evaluate if the company has build appropriate defences or, if, on the contrary, is likely to have a change of control[54].

In this chapter some examples of defensive measures which can work as mechanisms of protection for creditors shall be provided. These may lead in the frustration of the takeover, thus benefiting creditors who are likely to be affected by the control transaction. *Strong* creditors will be able to approve some defensive measures

[44] *See* pp. 20 and ff.
[45] Terminology used by CORDEIRO (1994, 772 and ff) and VAZ (2013, 141 and ff.). For other defensive tactics classifications, *see* GUINÉ (2009, 23-27).
[46] LEITÃO (2007, 61).
[47] In the framework established by the Takeover Bids Directive, the board neutrality rule (art. 9º) refers to the adoption of reactive tactics, while the *break-through rule* (art. 11º) is applicable to two specific types of preventive measures - the restrictions on the transfer of securities and on voting rights.
[48] *See* footnote 22.
[49] Such option contrasts with the one adopted by the U.S., where the board is granted a significant role in the takeover process.
[50] *See* DAVIES and HOPT (2009, 265).
[51] Except when the *breakthrough rule* is applicable. See art. 11º of the Takeover Bids Directive and art. 182º-A CVM.
[52]This article implemented the obligations established for MS under art. 10º of the Takeover Bids Directive. It was modified by D.L. n.º185/2009 of 12.08.09, which added other information duties, such as a declaration on the compliance with a corporate governance code or the reasons for non compliance (*comply or explain* approach regarding *soft law*) - *See* art. 245º-A, n.º1, *n), o)* and *p).*
[53]*See OECDE Principles of Corporate Governance* (2004, 21) *Principle IV.D* – "*Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.*"
[54] VAZ (2013, 164).

by means of an agreement with the majority shareholders or of a contractual clause in their financing agreements[55].

i) Pre-bid defences[56]

Voting caps, golden parachutes and poison pills are some examples of *preventive* defensive measures shareholders can approve or introduce in the company's articles of association[57].

Restrictions on voting rights lead to disruptions on the principle of proportionality between capital and vote. Art. 384º, nº2, *b)* of the CSC states that the articles of association may establish that the votes issued by a single shareholder[58] which exceed a maximum number are not counted, regardless of the amount of its stockholding (*voting caps*). This strategy constitutes an exception to the principle of *one share-one vote*[59] and grants some shareholders more power in the general meeting.

The *golden parachutes*[60] are clauses under the employment contract between the company and its directors or managers that specify a compensation if the employment is terminated, namely as a result of a merger or takeover (in such cases these clauses are named *change-in-control benefits*[61], and they render the takeover more expensive to the bidder). Under Portuguese law the amount of the compensation must comply with the limits established by art. 403º, nº5 of CSC.

Some preventive measures imply *control over the company's shares*[62]. The typical example is the *poison pill* (also known as *shareholder rights plan*) [63], which is a

[55] This possibility shall be explained in Chapter VII.
[56] According to CORDEIRO (1994, 773 and ff.), four types of preventive defensive measures can be outlined: *organizational measures, restrictions on voting rights*, *financial schemes* and *control over shares*. This classification was also approached by LEITÃO (2007, 61 and ff.). *See* also VAZ (2013, 144 and ff).
[57] Art. 182º-A CVM.
[58] For the calculation of voting rights, s*ee* art. 20º CVM.
[59] ANTUNES (2009, 31-32). *See* the limitation of art. 386º, n.º5 CSC.
[60] Allowed under arts. 402º and 403º CSC, although art. 245º-A, n.º1, *l)* establishes the obligation for the company to disclose such agreements with the members of the board, in line with art. 10, n.º1, *k)* of the Takeover Bids Directive.
[61] These benefits generally consist on severance payments, bonuses or stock options. *See* L'ITALIEN (2012).
[62] Some preventive measures which imply such control are the *Macaroni Defence* (a company that is likely to become an acquisition target will issue a large number of bonds that must be redeemed at a higher premium in the event of a takeover) and the *Lobster Trap* (the firm's articles of association contain a provision which prevents individuals with more than 10% ownership of convertible securities, namely convertible preferred stock and warrants, from transferring these securities to voting stock). *See* LEITÃO (2007, 64) and VAZ (2013, 147).
[63] Under the French law, Article L 233-32 (II) of the French *Code de commerce*, allows the target company to adopt a *poison pill* (the "*bons Breton*"), as long a certain requirements are met. The shareholders may, in an extraordinary general meeting approve the issue and allocation to all shareholders of warrants carrying the right of subscription for shares of the company on preferential terms. This power

tactic whereby the shareholders have the right to buy the target company's shares at a discount in the event of a takeover, increasing the cost of such takeover for the potential acquirer[64].

ii) *Post-bid* defences

Most post-bid defences which are likely to cause relevant changes in target company's net asset situation and do not form part of the normal course of the company's *day-to-day business* must be authorised by the shareholders' meeting[65] to be engaged in by the board. Some types of defences are the *White Squire*, the *Pac-man defence* and the *Share buy-back*[66]. In the *White Squire defence*, the target company will issue new shares or securities that grant the rights to their subscription or acquisition in order for them to be purchased by a friendly investor in an amount large enough to deter a hostile takeover attempt[67]. In the *Pac-man* defence, the company threatened with a hostile takeover will attempt to acquire its would-be buyer[68]. In a *Share Buy-Back*, the target company will repurchase its own shares and consequently reduce the number of shares available in the market, with the purpose of either increasing the value of the remaining shares or of eliminating any threat of acquisition of a controlling stake in the company by a shareholder[69].

3. Influence of the board

As a consequence of the transposition of the Takeover Bids Directive, the director's role when a takeover bid has already been made is an advisory one[70]. The

can also be delegated on the board. It is generally considered that the issue of such warrants works as threat of dilution of the potential acquirer's shares and voting rights in the company and is used to force the negotiation of the bid price. Nevertheless, it cannot be applied against a foreign bidder who is subject to the board neutrality rule and the breakthrough rule in his country. *See* FARDEU (2007).

[64] The most known types of poison pills are the *flip-in provision* (a provision which gives the current shareholders of a company, other than the hostile bidder, rights to purchase additional shares in the same company at a price lower than their market value and the *flip-over rights plan* (the option of current shareholders of a firm to purchase shares from the bidder at a discount). *See* CORDEIRO (1994, 775) and LEITÃO (2007, 63).

[65] Art. 182º, n.º3, *b)* CVM.

[66] Other measures could be mentioned. For a more extensive analysis, *See* VAZ (2013, 139 and ff. and 216 and ff.), GUINÉ (2009, 29 and ff).

[67] Under normal circumstances the board would have competence to decide on an increase in the company's equity capital under art. 456º, n.º1 CSC.

[68] VAZ (2013,149-150).

[69] VAZ (2013, 153). However, one should bear in mind that art. 317º, n.º2 stipulates that a company cannot hold more than 10% of its equity capital. Also, art. 324º, n.º1, *a)* of CSC establishes that in a resolution regarding an increase of the share capital the voting rights of the shares owned by the company are suspended.

[70] Some authors criticize this option. *See* footnote 30 on p. 14.

limitation of the powers of the board during a takeover process does not prevent it, however, from exercising its influence on the shareholders' decision to accept or reject the bidder's proposal, through a report where it states the conditions of the bid and expresses its opinion on its merits and opportunity. This is the most important mechanism for the board to influence the outcome of the bid, as it can recommend the shareholders not to sell their shares.[71]. The minimum elements for such report are settled under Portuguese law in art. 181º CVM: it must contain a sustained autonomous opinion of the type and amount of the consideration offered, of the bidder's strategic plans for the company, of the impact of the bid - in the target company, generally, and on the interests of its employees, on its working conditions and on the places at which the company has business activity, in particular – and of the intentions of the members of the board who hold shares in the target company regarding the offer[72]. All the above-mentioned information should be clear, complete, up-to-date, truthful, objective and lawful[73]. The board is required to issue and send the report to the potential acquirer and the CMVM, as well as publicly disclose it[74]. Other collaboration duties are applicable to the behaviour of the members of the board during the course of a bid under art. 181º, nº 5 of CVM[75].

Besides this report, the management can also exercise its influence on the shareholders' decision by lobbying the securities and markets national authority (in Portugal, the CMVM) or the government is also available. The board might instead seek help from third parties (*Killer Bees*[76]) in order to make the change of control more expensive, namely by celebrating an agreement with the bank of the target in which

[71]As an example of such influence, s*ee* the *Report of the Board of directors of CIMPOR on the opportunity and the conditions of the offer by INTERCEMENT (Camargo Corrêa)* of April 13 2012. The Board did not recommend to shareholders to sell their shares, concluding that the price offered was low and significantly undervalued CIMPOR. Nevertheless, neither did the board recommend shareholders to maintain their investment in CIMPOR, as it did not have adequate information on the future of CIMPOR post-offer.

[72] The negative votes issued in the resolution of the board of directors that approved the report should also be mentioned. Art. 181º, n.º3 CVM.

[73] *See* arts. 7º and 181º, n.º5, *d)* CVM. The general rules of CVM concerning the disclosure of information by stock corporations are also applicable.

[74] Within eight days of the receipt of the draft public offer announcement and draft prospectus, or within five days of the disclosure of an amendment to the offer documents. Art. 181º, n.º1CVM.

[75]Such as the duty of disclosure to the CMVM of any information regarding the transmission of shares by the members of the board (held directly or in the terms of art. 20º CVM), the duty to disclose any other information required by the CMVM in its supervision, the duty to inform the employees' representatives (or in its absence the employees) of the impact the takeover bid will have on their interests and working conditions, of the contents of the offer's documents and of its report as well as, and the duty to "*act in good faith, concerning the accuracy of information and honest behaviour*"- Translation of VAZ (2011, 8).

[76] VAZ (2013, 156).

such bank promises to refuse the transaction by the potential acquirer or increase the costs of such transaction (*Bankmail*[77]). It is important to analyze the motivation underlying the adoption of such tactics in order to access whether there was a violation of their fiduciary duty of loyalty towards the company[78].

IV. CREDITOR TYPOLOGY AND BARGAINING POWER

The separate legal personality of the company has become a cornerstone of company law and entails that companies are independent legal entities distinct from the individuals who hold shares in it and manage it. As a natural consequence of this principle, only the company is accountable in the case of default, causing creditors to introduce clauses in their contractual arrangements with the company to secure their claims. However, not all creditors have the capacity to impose the introduction of such provisions.

Contractual, commercial creditors (that is, *strong* creditors), namely banks, financial institutions, big trading corporations and bondholders[79] are powerful and able to negotiate the appropriate risk compensations with the corporate debtor. The main mechanisms used to ensure that the money they lend is repaid are contractual provisions (*covenants*)[80]. The limited liability rule, also applicable to public corporations has, therefore, little impact on these creditors.

In contrast, involuntary creditors – namely tort victims, consumers and tax collectors – and some voluntary creditors – workers, small suppliers and small traders - lack such bargaining capacity (they are, consequently, *weak* creditors): this type of creditors is "*unable to contract around liability or to prepare adjustments to risk-shifting by negotiating some compensation in advance*"[81] and therefore more exposed to the risks caused by shareholders' opportunistic behaviours. It can be argued that the covenants negotiated by *strong* creditors in indentures or bonds[82] can benefit all

[77] *Ibdem*
[78] *See* Recommendation I.6.1 of *Código de Governo das Sociedades da CMVM* (2010, 22), referred to on footnote 40.
[79] When the company gives lenders bonds to secure its debts such creditors are referred to as "bondholders". *See* ARMOUR, HERTIG and KANDA (2009, 118). On bond issuing under Portuguese law, *see* CÂMARA (2011, *Manual* , 134 -139).
[80] DOMINGUES (2009, 288). This study will focus on certain types of covenants in its Chapter VII.
[81] ANTUNES (1994, 135).
[82] The difference between indentures and bonds is that while the former are non-secured loans, the latter are loans secured by a mortgage or a pledge. However, the expression "bond" usually refers to both types of lending agreements. DOMINGUES (2009, 568, footnote 2368).

creditors; however, if such provisions are not introduced (which is more likely to happen in continental jurisdictions, where covenants are not so frequently used)[83] unprotected creditors may stand to lose out more[84].

V. CORPORATE CREDITORS AND THE TARGET COMPANY: RISKS BORNE IN THE EVENT OF A TAKEOVER

As a result of the clear demarcation between the corporation, as a legal person, and the corporate associates, shareholders' liability is limited to the amount of their capital investment[85]. Agency problems[86] might arise between the shareholders and the company's creditors as contractual parties, as the former might attempt to manipulate the company's limited liability to undertake actions that benefit them at the expense of creditors.

One of the cases where such conflicts are particularly relevant is when bondholders face expropriation of their wealth through inappropriate investment decisions, adopted by the company after issuing their bonds. Usually such decisions only seek to enhance shareholder wealth, without considering the consequences for other constituencies and for the company itself. The adoption of riskier strategies has a *strong* potential to reduce the overall value of the firm's assets and consequently of its debt finance, thereby harming creditor interests. According to Smith and Warner, there are four major activities that the management (acting in the shareholders' interest) might engage in after the bond issue[87]: transferring assets from the corporate pool and leaving the creditors with worthless claims, namely by means of raising the dividend rate (*asset dilution*)[88]; selling assets used in low-risk business activities to pay for the acquisition of

[83] *See* p. 34.
[84] DOMINGUES (2009, 288, footnote 1100).
[85] FERRAN (2008,19).
[86]The modern version of the agency theory, as set out by ARMOUR, HERTIG and KANDA (2009, 115 and ff.), comprises three types of agency problems: between managers and shareholders, between majority and minority shareholders and between shareholder and non-shareholders (such as the company's creditors). *See* also JENSEN and MECKLING (1976, 310).
[87] SMITH and WARNER (1979, 117-118). *See* also NASH, NETTER, and POULSEN (2003, 203-204).
[88] Nevertheless, many legal systems establish restrictions to the distribution of dividends, and such legal provisions are considered to be part of the creditor protection framework offered by general company law, as it is mentioned on p. 33.

assets to be used in high-risk business activities (*asset substitution*) [89]; increasing the company's overall borrowing (*debt dilution* or *claim dilution*)[90]; unwillingness to make the investments required for growth opportunities when the gains arising from the project might also benefit bondholders (*underinvestment*) [91]. Directors and managers have additional incentives to adopt such strategies when they own significant equity stakes (through stock option plans[92]) or when they are accountable to majority shareholders.

When considering the case of a takeover that causes the company's share value to drop, there are no doubts that creditors bear the burden of such depreciation, as their claims and bonds will consequently become less valuable. Additionally, creditor's guarantees might be harmed as a result of the new owner's business decisions[93] .

The changes of control operated through *Leveraged* or *Management Buy-Out*, provide two examples where the newly-owned company may not have the sufficient asset base to meet the corporate creditors' claims. The consequences of such operations will usually be that the company is saddled with repayment obligations arising from financing the acquisition and, consequently, its existing bonds are downgraded[94]. According to John Armour and David A. Skeel Jr., "*creditors may find the face value of their claims suddenly deflated by the target's having taken on a heavy debt burden to finance the acquisition or subsequent restructuring*"[95].

[89] ARMOUR, HERTIG and KANDA (2009, 116). In the case of *asset substitution*, there will be a change in the company's risk profile. Shareholders can benefit from an increase in the riskiness of the firm's business, by receiving more dividends if the value of future cash flows increases. On the other hand, if such value decreases, shareholders will not be harmed, as they cannot lose more than the value of their shares (as a consequence of the company's limited liability). Creditors, on the other hand, have fixed claims against the company, which means that even if more profit is generated, they will not receive more than what was contractually stipulated. And, of course, the riskier the company's profile, the greater the chance it will not generate sufficient cash flow to pay them. The company needn't even to default on its obligations for the interests of creditors to be harmed: the increase of the riskiness in the debtor's business activity will imply a decrease on the value of the creditors' claims in secondary loan markets.

[90] ARMOUR, HERTIG and KANDA (2009, 117). The more creditors a company has, the lower will the expected recoveries for such creditors be should the firm default. The new borrowing will be subsidized by the existing lenders.

[91] *See* ARMOUR, HERTIG and KANDA (2009, 117, footnote 7).

[92] However, if the blocks of shares owned by directors are poorly diversified, they will be more adverse to risk-taking.

[93] The potential acquirer's intentions with regard to the future business of the target company must be disclosed in the offer document, in the terms of art. 6º, n.º3, *i)* of the Takeover Bids Directive.

[94] An example of a complex Leveraged Buyout which resulted in a downgrade of the bondholders' bonds was the case NJR Nabisco. *See* OSÓRIO (2011, 33, footnote 13).

[95]ARMOUR and. SKEEL (2007, 1739).

A *Leveraged Buyout* (LBO) occurs when the target company's assets are used as collateral to purchase the company itself[96]. The financial sponsor will partially finance the acquisition with borrowed capital (usually bank debt), secured by the company's assets or its capacity to generate future cash flows[97]. Consequently, the purchase costs will be transferred to the company itself. The ratio of the company's debt to its equity is called *leverage ratio* [98], and the higher the leverage, the higher the returns will be for the financial sponsor, thereby creating an incentive to employ as much debt as possible to finance the acquisition. As a consequence, the surviving entity will be privately held[99] and highly leveraged (a *shell corporation*[100]), and if it does not generate sufficient profit to service the debt there is a high risk of insolvency. A particular type of leveraged acquisition is the *Management Buyout* (MBO), when the incumbent management acquires all or a sizeable portion of the company's shares by means of a merger with a newly formed company created by them. The funding is provided by debt or securities, also secured by the target's assets or future cash flows (MBO are usually highly leveraged acquisitions)[101].

To protect themselves against such risks, creditors use a range of covenants when celebrating bond or loan agreements (in addition to the basic obligations to repay principal and interest). We shall examine some of these covenants further along in this study[102].

[96] OSÓRIO (2011, 79).
[97] *Ibdem*
[98] BRATTON (2006, 55).
[99] *See* the distinction made on footnote 6.
[100] BRATTON (2006, 55).
[101] Some financing instruments used are bonds (art. 348 and ff. of CSC), convertible bonds (art. 365 and ff. of the CSC), no-voting stocks (art. 341 and ff. of CSC) and secured bank loans (such as mortgage loans). Some techniques which can be adopted consist on the issue of shares and warrants, the sale leaseback and the use of equity investment funds and of employee stock option plans. *See* OSÓRIO (2011, 99-114).
[102] *See* point 3 of Chapter VII.

VI. THE INTERESTS OF CREDITORS IN THE LIGHT OF DIRECTORS' DUTIES DURING A TAKEOVER

When the board of directors advises the shareholders on a takeover bid or adopts certain strategies and defensive measures to frustrate a takeover attempt[103], their actions must be seen in the light of the general fiduciary duties ("*deveres fiduciários gerais*")[104] established under art. 64º CSC [105]. Such duties constitute a central aspect of corporate governance[106] and are equally binding for the management of public corporations. This legal provision establishes a series of obligations owed primarily by members of the board of directors to the corporation that employs them, and outlines two general fiduciary duties: a *duty of care* ("*dever de cuidado*"), on the one hand, and a *duty of loyalty* ("*dever de lealdade*"), on the other. The *duty of care* entails that a director must use ordinary care and prudence while operating the company's business. The standard of conduct used to access whether a director or manager can be held liable for violating this duty is *the business judgment rule[107]*. This United States case law-derived concept contains a legal presumption that the firm's directors and managers are properly informed, that their actions were taken with a *bona finde* regard for the interests of the corporation and that they were based on rational criteria from a corporate / economic standpoint[108]. The *duty of loyalty* encompasses that corporate directors or managers of a company must put the company's interests ahead of their own[109].

If corporate directors breach one of the general duties, they will be liable towards the company for not pursuing its interests (being that such claim can also be filed by the company's creditors- art. 78º CSC)[110]. For this reason, it is important to access whether the fiduciary duty of loyalty requires the board to take into account the

[103] Such strategies and measures are described in points 2 and 3 of Chapter III.
[104] VAZ (2013,131).
[105] Art. 64º, n.º1, *a)* refers to the duty of care and skill and art. 64º, n.º1, *b)* refers to the duty of loyalty. This is the text arising from the reform brought by Decree-Law n.º76-A/2006, of 29.03.06, in which there was a specification of the fundamental duties according to which the management of the firm should guide itself. João Calvão da Silva argues that the bifurcated concept arising from the reform is a mere *legal transplant* of the common law concept of «fiduciary duty». *See* SILVA (2006-2007, 33) and WATSON (1993, 91).
[106] *See Principle VI.A.* of the *OECDE Principles of Corporate Governance* (2004, 24).
[107] FRADA (2007, 3).
[108] *See* ABREU (2012, 19), ABREU and RAMOS (2004, 13), SILVA (1997, 515- 516) and VASCONCELOS (2009, 11-32).
[109] *See* NUNES (2001, 89). There is a breach of this duty when directors divert corporate assets, opportunities, or information for personal gain. *See* ABREU (2012, 136-139).
[110]Also, according to ESTACA (2003, 182) and ANTUNES (2009, 36-37), the violation of the company's interests by the directors can be accepted as a just cause of removal. *See* Art. 403º, n.º1 of CSC.

creditors' interests during a takeover attempt and whether such duty is breached if directors do not exercise their influence to frustrate a bid which they believe to cause a substantial damage to those interests[111].

Such questions take us to the important debate on what interests should be considered by the board while managing the company. Under Portuguese law, the debate on which interests are included in the "*interest of the company*" is centred in the text of art. 64º, nº1, *b)* of CSC[112], which states that directors and auditors must "*pursue the company's interest taking into account the long term interests of the shareholders, while considering the interests of other stakeholders, such as employees, clients and creditors*"[113] [114].

1. The Takeover Bids Directive

Looking at Article 3º, nº1, *c)* of the Takeover Bids Directive, the same debate arises, as there is an obligation for the board of a target company to "*act in the interest of the company as a whole*", but there is no pan-European consensus on the concept of "*interest of the company*"[115]. Also, the same provision seems to call for a proportionality test between the board's obligations to act in the best interest of the company taken as a whole, on the one hand, and to provide the holders of the securities the opportunity to decide on the merits of a bid, on the other hand. The balance between the *company interest* rule and the adoption of the board neutrality rule (in Art. 9º of the Directive) by the MS renders the practical effect of the former unclear, as there is no provision regarding how the conflicts between the interests of stockholders and stakeholders might be resolved. Is the practical effect of the Directive that the board is

[111]Examples of such situations were given on the previous chapter.

[112] Other provisions from the CSC refer to the company interest, such as arts. 6º, n.º3, 251º, 328º, n.º2,*c)*, 329º, 2, 400º, n.º1, *b)* and 460, n.º2. *See* ABREU (1996, 226). This study shall only analyze art. 64º, n.º1, *b)*, as it also binds the members of the board during a takeover.

[113] Art. 64º, n.º1: "*Os gerentes ou administradores da sociedade devem observar:…(b) Deveres de lealdade, no interesse da sociedade, atendendo aos interesses de longo prazo dos sócios e ponderando os interesses dos outros sujeitos relevantes para a sustentabilidade da sociedade, tais como os seus trabalhadores, clientes e credores*". In the Spanish *Ley de Sociedades Anónimas*, modified by *Ley 26/2003*, of 17.07., art 127- *bis* establishes that directors must perform their duties in the pursue of the social interest. Such interest is merely defined as the "interest of the company", which also caused Spanish authors to discuss which interests should be taken into account by corporate directors during a takeover. Daniel Ruiz de Villa argues that the interpretation of art. 3º, *c)* of the Takeover Bids Directive and of the Introduction of *Ley del Mercado de Valores*, of 24.07.88, allow for a wider conception of the interest of the company. *See* RUIZ DE VILLA (2010, 31-33).

[114] The original version only mentioned the interests of shareholders and employees. A reform was operated by D.L.n.º 76-A/2006, of 29.03.06. A similar evolution took place in the U.K. jurisdiction, with the introduction of section 172 (1) of the *2006 Companies Act*. *See* footnote 127.

[115] SJÅFJELL (2010, 8).

entitled to take into account a broader range of interests beyond the shareholders' interests when advising on a bid, but is not bound to do so?

One could argue that the term was deliberately left vague as a political compromise, allowing each MS to interpret it within its own tradition: some authors suggest that the limits of what the board is allowed to do in order to comply with art. 3º, nº1, *c)* without jeopardizing the *neutrality* principle are to be settled by national laws[116]. It is also impossible to overlook the barriers to a complete harmonisation of takeover regulation within the EU[117], as the "*flexible framework*"[118] that the Directive introduces was unsuccessful in achieving the objective of creating a level-playing field for European companies[119].

Nevertheless, an autonomous interpretation within the context of the Directive is required[120], which is why we agree with the perspective that envisions the term in a wider sense, going beyond the interests of the shareholders as a class and allowing broader stakeholder interests - such as creditors' rights – to be taken into account[121].Whatever the target company's shareholding structure is, agency problems always arise between the potential acquirer and non-shareholders, especially creditors and employees. There is a legal obligation to take into account the interests of such constituencies, which gives rise to directly enforceable rights under art. 17º of the Directive[122] - and not just the possibility of considering such interests.

In the next point, some perspectives of which interests should be included in the concept of "*interest of the company*" in the event of a takeover shall be described.

[116] *The Takeover Directive Assessment Report* (2012, 105).

[117] Though some literature announces a convergence towards the UK model – *see* GOREGEN, MATYNOVA and RENNEBOOG (2005, 29) and VENTORUZZO (2006, 33).

[118] WOUTERS, VAN HOOGHTEN and BRUYNEEL (2009, 3-76).

[119] The distinct features of corporate governance systems lead to another debate on whether Europe should aim at building an harmonised model or if there should be a neutral position from the Commission, allowing MS to choose the system that better suits their corporate governance traditions. *See* TSAGAS (2011, 173, 182).

[120] On the principle of autonomous interpretation, *see* PAIS (2012, 91-106).

[121] In 1997, the *Amended proposal for a Thirteenth European Parliament and Council Directive on company law concerning takeover bids* (COM (97) 565 final, 5), stated that "*the board must act in all the interests of the company, including those of shareholders, creditors and employees, particularly with a view 'to safeguarding employment*". *See* also *The Takeover Directive Assessment Report* (2012, 105) and SJÅFJELL (2010, 8), who argues that "*if the principle in art. 3º, n.º1, c) is to have any real meaning, it can hardly be interpreted simply as meaning that the board should take care f the interests of the shareholders as a whole*", as the board neutrality rule is already intended to ensure that the board does not hinder takeovers and allows shareholders to have the ultimate decision on the outcome of the bid.

[122] SJÅFJEL (2010, 12).

2. The *shareholder primacy view* and the *enlightened shareholder value*

Under a *contratualist* approach, the definition of company interest would be restricted to "*the interest of the shareholders as a class that the firm maximizes its value and consequently is able to distribute dividends*"[123]. This position is also referred to as the "*shareholder primacy view*"[124] and prevailed in the Anglo-American corporate law systems (or *shareholder-oriented models*), due to the more advanced state of the market for corporate control in such jurisdictions[125]. An evolution of this perspective called *enlightened shareholder value* is adopted in the UK[126]. Following the *enlightened shareholder value* approach, corporations should pursue shareholder wealth with a long-run orientation that seeks sustainable growth and profits based on "*striking a balance"* [127] between the competing interests of the different stakeholders. The board's ultimate responsibility is to the shareholders as a class but it is required to pursue that objective with regard to long-term consequences, employee interests, relations with suppliers, customers and others, impact in the community and environment and the company's ethical reputation. In the context of a takeover, however, shareholder interests seem to come to the forefront, which leads to a shorter-term focus on current share-price and to the restriction of the powers of the board[128].

The Portuguese literature traditionally adopted this position[129], only considering the interests of non-shareholder constituencies if they are aligned with the interests of the shareholders[130]. For such authors, the interests of non-shareholder constituencies, such as employees and creditors, and the personal interests of shareholders – as mentioned in art. 64º, nº1, *b)* – should be taken into account as mere limitations to the

[123] XAVIER (1991, 242 and ff).
[124] *See The Takeover Directive Assessment Report* (2012, 32) and JENSEN and MECKLING (1976, 305 and ff.).
[125] In Spain, the Spanish Supreme Court has held that art. 226 of *Ley de Capital* (that refers to the interest of the company- "*interés social*") must be interpreted in line with shareholder primacy. *See* GERNER-BEUERLE, PAECH and SCHUSTER (2013, 74).
[126] *See* section 172 (1) of the *2006 Companies Act*. The core mechanisms of UK corporate governance (such as hostile takeovers, directors' duties and board structure) are highly shareholder-oriented, which leads to the prevalence of the interests of shareholders over the interests of other stakeholders, such as employees and creditors. *See* ARMOUR, DEAKIN and KONZELMANN (2003, 3-6).
[127] *See* the U.K. Company Law Review Steering Committee (1999, 139).
[128] *See* Rule 21 of the *Takeover Code.*
[129] According to NUNES (2006, 33, footnote 45).
[130] *See,* among other authors, XAVIER (1991, 168 and ff., footnote 76; 242 and ff., footnote 116), NUNES (2001, 85 and ff.), ABREU (2007, 33), TRIUNFANTE (2004, 212 and ff., 244 and ff.). GUINÉ (2009, 80-83) and CORDEIRO, (1994, 58). In the Portuguese case-law, see case 208/99 of the Lisbon Civil Court.

directors' duty to pursue the company's interest in maximizing its value[131]. It could also be argued[132] that in order to pursue the objective of maximizing the firm's value the board will necessarily take decisions that aim at maintaining and enhancing the value of the company's assets, which is also beneficial to the corporate creditors[133]. Some authors consider this rationale also applicable in the event of a takeover attempt: when the individual interests of the shareholders and the interest of the company as a whole and of other constituencies are not aligned, the former shall prevail, as it is the owners of the company that should be protected primarily and they will have the final decision on the success of a takeover[134].

3. The *institutional view*

In contrast to the *contratualist* view, the *institutional theory* encompasses that the need for the firm to be efficient determines that its interests do not correspond to the interests of the shareholders as a class. This view considers that companies play a fundamental social role of helping the development of a community's Economy. The company is seen as a separate economic agent (theory of *Unternehmen an sich*[135]), with interests which go beyond the direct interests of the shareholders. The interests of the company represent the common interests of shareholders, employees, creditors, suppliers and customers. Some European countries adopt this company-oriented approach[136]. This position is also adopted among Portuguese literature[137].

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[131] VAZ (2013,128-131 and 2000, 33-35), considers that the interests of non-shareholder constituencies play a secondary role in the directors' decisions and can only be attended so far as they do not conflict with the interest of a sustained creation of wealth to the shareholders.

[132] ANTUNES (2002, 107 and ff.).

[133] The purpose of enhancing the firm's wealth will, consequently, justify the limitation of liability of shareholders towards creditors: for *strong, voluntary* creditors, the evaluation of the firms' capacity of generating future cash flows will allow them to access the risks they bear and, consequently, the type of provisions they will introduce in lending agreements to protect their position; for *weak* or involuntary creditors, the profit generated by the company will be used to pay compensations for the damages caused. RIBEIRO (2012, 521, footnote 8). On the effects of the company's equity assets on creditors' claims. S*ee* Chapter V.

[134] *See* VAZ (2013, 186-19)1 and GUINÉ (2009, 69). According to this last author, the company is an instrument used by its owners, which is why its management should be guided by the interests of the shareholders.

[135] RIBEIRO (2012, 510, footnote 1).

[136] In France, art. 1848 of the *Code Civil* refers to the interest of the company ("*l'interêt de la societé*") to guide the directors when managing the company. Such expression has also been discussed in this legal system. *See* GERNER-BEUERLE, PAECH and SCHUSTER (2013, 68).

[137] *See*, namely, ESTACA (2003, 93 and ff., 106 and ff.) and ALMEIDA (2003, 50 and ff.) who argues that the "interest of the company" is the interest of the firm while pursuing its commercial activity. To ASCENSÃO (2000, 446-447), the "interest of the company" corresponds to the combination of the interests of the shareholders acting as such and the interests of the employees.

4. The *stakeholder model*

Finally, there is a growing acceptance towards the idea that "*acting in the interests of the company*" requires that the interests of all affected constituencies are valid in their own right, rather than as a means of achieving shareholder value. The same logic is applicable when discussing the company's environmental responsibility[138]. The interests that should guide the management are not only the interests of the shareholders as a class, but also the interests of other constituencies, such as employees, creditors, suppliers, customers and of local communities and authorities which can be affected by the company's sustainability– the *stakeholders.* According to the European Commission[139], a *stakeholder* is "*an individual, community or organisation that affects, or is affected by, the operations of a company*". Stakeholders can be internal (e.g. employees or shareholders) or external (e.g. customers, suppliers, creditors and the local community)[140]. This *pluralistic* view is also referred to as "*stakeholder model*"[141], and is adopted in some jurisdictions in to determine the directors' general fiduciary duties[142]. In Portugal, the authors who adopt this view consider that the formulation of art. 64º, nº1, *b)* after the reform[143] requires the board to strike a balance between the different interests of the constituencies[144].

The *stakeholder view* holds that taking into account the interests of non-shareholder constituencies will benefit the shareholders on the long-run: the firm's global value is likely to increase if its contractual relationships with those individuals are maintained and if new relationships are established. This formulation does not mean, however, that directors should only pursue the interests of stakeholders, or that such interests shall prevail over the interests of shareholder on the long-run: the primary goal of the board should be, at all times, maximizing the firm's wealth. But managing

[138] According to EIJBOUTS (2011, 35, 49-50), the normative version of the stakeholder theory is based on ethical perspectives.
[139] *See* the European Commission's *Green Paper - Promoting a European framework for Corporate Social Responsibility* (2001, 25).
[140] Other types of stakeholder classification can be adopted, namely the one used by SERRA (2011, 213-214), between contractual- shareholders, employees, business partners, suppliers, customers and creditors - and collective stakeholders – the local community, organisations, national authorities or the government.
[141] NUNES (2012, 441 and ff.) and RIBEIRO (2012, 509 and ff.).
[142] *See* s. 93(1) *AktG* for Germany.The regulation of defensive measures is consequently more relaxed than in the UK. *See The Takeover Directive Assessment Report* (2012, 64). *See* GERNER-BEUERLE, PAECH and SCHUSTER (2013, 68).
[143] Operated in 2006- *See* footnote 105.
[144] *See* FRADA (2007, 217), CUNHA (2010, 41, 570 and ff.).*See* also *Livro Branco Sobre Corporate Governance em Portugal* (2006, 141-142).

the company calls for a *proportionality test*, and directors should avoid that the decisions which aim at pursuing the long-term interests of the shareholders cause an unreasonable sacrifice to other constituencies. [145].

5. Critical analysis

Bearing in mind the considerations made above, we believe the *stakeholder view* to be the correct perspective to adopt in the discussion of which interests should guide the board of directors while managing the company. In fact, if the board only seeks to maximize shareholder wealth while managing the company, it will adopt riskier investment strategies[146] without considering the consequences on other constituencies. Such actions can have negative consequences in the company's assets and consequently on its financial situation, thereby affecting creditors.

In the particular context of a takeover, this problem becomes even more relevant: as it was demonstrated in Chapter V, corporate restructuring, especially when operated through LBO or MBO, can lead to the depreciation in the target company's share value, causing creditors' claims and bonds to become less valuable. Therefore, it is important to access which interests should be considered by the directors when a bid has been announced and whether they are required to take into account the effects of the takeover in the creditors' positions.

The vague reference made in art. 3º, nº1, *c)* of the Takeover Bids Directive to the "interest of the company as whole" has compromised a harmonised understanding leading to different interpretations of the term and to similar formulations at national level (such as art. 64º, nº1, *b)* of the CSC). But as soon as one realizes that a takeover constitutes one of the most important decisions for the company's business, one concludes that interests other than the ones form the shareholders should be taken into account, such as the interests of the company's creditors.

With this guideline mind, we reach finally the thesis defended in the present study. The risks borne by corporate creditors in the event of a takeover, together with the fact that they are important financers to the company, justifies a stronger protection of their position during the course of a bid. Naturally, such protection must comply with

[145]If two decisions with the same impact on shareholders are available, the one which is most favourable to the stakeholders should be adopted. SERRA (2011, 246-250).
[146] Such as the activities analyzed on pp. 22-23.

the board neutrality rule established at EU-level[147]. In other words, although directors' powers during a takeover process are limited, they will still be bound to the core *duty of loyalty*, which requires them to act with the interest of the company in mind, which includes the interests of its creditors.

Moreover, this duty grants the board more discretion when facing a bid, allowing it to exercise its influence[148] to thwart a takeover that is considered harmful for the company's creditors - as long as the consideration of such interests does not put the company's sustainability at stake. We consider that the board must take into account the interests of stakeholders during a takeover process, when it predicts that without a decision favouring those interests they would be substantially harmed and without a corresponding benefit to the shareholders. If directors do not exercise their influence to deter a takeover which will most likely affect the company's financial situation and the position of the company' creditors, legal standing can be exercised on the basis of arts. 17º of the Takeover Bids Directive and 78º of the CSC[149].

The consideration of other interests by the management is one of the reasons for admitting the use of defensive measures by the board in the *constituency statues* adopted by some U.S. States[150]. In Europe, a reference should be made to the Belgian legal system, where it was understood that the board of directors should assess the merits of the bid in the light of the interests not only of the shareholders but of all stakeholders[151]. Nevertheless, an *enlightened shareholder* approach of the duties of corporate directors during a takeover still prevails in Portuguese and international literature, which is why the next chapter will focus on additional legal and contractual solutions that grant creditors some protection.

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[147] The protection of creditors does not justify the abolition of the board neutrality rule in order to grant directors the power to reject a takeover bid. To do so would accentuate the *management entrenchment* risks and affect the efficiency of the market for corporate control.

[148] The influence of corporate directors in the shareholders' decision concerning the offer is exercised through the mechanisms described in point 3 of Chapter III.

[149] If directors suspected that the asset base of the company will be diminished as a consequence of a takeover and do not try to stop it, they will be liable towards the company, being that such claim can also be filed by the company's creditors via sub-rogation (art. 78º, n.º2 CSC).

[150] In the US legal system the directors are not subject to an obligation of neutrality and are empowered to decide on the merits of the bid. *See* paragraph 23-2-35-1(d) of the Indiana Code, according to which "*A director may, in considering the best interests of a corporation, consider the effects of any action on shareholders, employees, suppliers, and customers of the corporation, and communities in which offices or other facilities of the corporation are located, and any other factors the director considers pertinent*". *See* GUINÉ (2009, 82, footnote 145).

[151] *See* Royal Decree of 14 November 2007 *on the obligations of issuers of financial instruments admitted to trading on a regulated market*. Nevertheless, some authors consider that a stakeholder interpretation of the interest of the company is only appropriate in crisis situations - GERNER-BEUERLE, PAECH and SCHUSTER (2013, 66).

VII. POSSIBLE SOLUTIONS TO THE PROBLEM

1. General legal provisions

The Portuguese CSC, CVM and *Code of Insolvency* of 2004[152] contain provisions regarding the protection of creditors which are applicable to all parties who contract with companies and that aim at assisting their transactions.

Some examples of rules which grant some legal protection to creditors are rules on the formation and maintenance of companies' equity capital (namely, minimum capital standards, rules on distributions of dividends and on the serious loss of the subscribed capital[153]),the provisions establishing corporate directors' civil liability towards the company or vis-à-vis the company's creditors (art. 72º, 78º and 79º CSC[154]), the duty for the directors to file for insolvency of the company when its financial situation requires them to do so, along with the criminal liability if they do not comply with this legal obligation (art. 19º and 189º CIRE)[155], and disclosure mandatory requirements[156] concerning significant direct (and indirect- art. 20º CVM) holdings of the company ("*participações qualificadas*")[157], the prospectus which precedes a takeover bid launched over the company[158], and inside information[159]. Issuers are also subject to ongoing disclosure obligations[160].

Although these solutions benefit all creditors, they not grant as much protection as contractual remedies, as we shall analyse on the next point.

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[152] Enacted by the Decree-Law n.º 53/2004, of 18.03.2004 (hereinafter quoted as "CIRE").
[153] *See* arts. 31º to 35º and 276, n.º5 CSC. These are some expressions of the *capital maintenance principle* ("*princípio da intangibilidade do capital social*"), established under art. 32º CSC. *See* DOMINGUES (2009, 50-57, 551-575; 2011, *Capital*, 193-201 234-256; 2011 *Código,* 256-261). *See* also ANTUNES (2009, 17-21).
[154] *See* CMS guide on *Duties & Responsibilities of Directors*, September 2012, 76.
[155] Arts. 18º and 19º of CIRE. *See* EPIFÂNIO (2012, 19-20). According to RIBEIRO (2012, 487-501 and 2011, 392-401), corporate creditors can hold managers liable on the terms of art. 78º, n.º1 and 2 and of art. 79º CSC in a situation where the rules on CIRE do not grant them sufficient protection.
[156] Such disclosure duties are imposed at EU level, and aim at providing for a more transparent, efficient and, consequently, creditworthy capital markets. As current investors of the company, bondholders benefit from the information disclosed by publicly held companies in order to protect actual or potential security holders. *See* FERRAN (2008, 245) and ff. and CÂMARA, (2011, 695-704)
[157] *See* art. 9º of the Transparency Directive. Apart from art. 448º of CSC, arts. 16º to 17º of the CVM contain a special regulation concerning the disclosure of significant shareholdings in stock ownership on public corporations.
[158] *See* arts. 134º and ff. CVM and art. 3º, n.º 1 of the Prospectus Directive.
[159] Art. 248º CVM, art. 449º CSC and art. 6º of the Market Abuse Directive. For a definition of "inside information", *see* art. 1º, n.º1 of the same Directive. *See* also the prohibition of *insider trading* on art. 378º CVM and art. 2º, n.º1 of the Market Abuse Directive.
[160] *See* arts. 245º and 246º CVM and art. 10º of the Prospectus Directive.

2. Reasons for creditors to rely on contracts

Traditionally, there was a difference between the protection of creditor interests in Continental and in Common Law jurisdictions: while the Common Law tradition relied more on contractual clauses, in Continental countries the main protection was offered by general company law provisions. Such differences are beginning to fade away as the preference towards contracts increases among Continental jurisdictions. The causes of such preference are the greater sensitivity of contracts to the firm's specific business model, the heterogeneity of creditor interests - which does not advise the use of standard-form terms - and the ease of renegotiation of the clauses should the circumstances change over time.

The ability of creditors to negotiate such clauses depends, however, on the number and identity of creditors[161]: it is harder for a large number of bondholders to renegotiate contractual provisions than for a few banks- which is why bond covenants are usually fewer and weaker than covenants in lending agreements[162]; also, *strong* and *weak* creditors occupy different positions in relation to the corporate debtor, and only the former are able to negotiate the clauses in their lending agreements[163].

According to the *costly contracting hypothesis*[164] , *strong* creditors – namely banks and financing institutions – anticipate the risks of default of the corporate debtor by introducing certain types of contractual clauses (*covenants*) in their indentures and bonds. The aim of such covenants is to restrict the firm's ability to divert or substitute assets, which is why they will only work as protection mechanisms if the creditor has the power to negotiate their introduction in the agreement celebrated. Such contractual provisions grant creditors a certain amount of control over the corporate debtor's activities. Covenants can increase the firm's value at the time bonds are issued or that the debt contracts are celebrated, but they also impose costs on the issuing firm, especially the loss of flexibility when deciding on its investment and financing opportunities.

Such clauses reflect the specific needs of the contracting parties[165], which is why the issuer compares the benefits and costs of each clause[166] and selects the ones that add

[161] *Ibdem*.
[162] SMITH and WARNER (1979, 5).
[163] *See* the distinction made in Chapter IV.
[164] SMITH and WARNER (1979, 117-122).
[165] NASH, NETTER and POULSEN (2003, 201).
[166] *Idem*, 202-203, 229-230.

the most value to the firm. The company's financing needs usually determine its contracting choices, and for a company to agree to such clauses the loan provided by the counterparty must be crucial for its business activity. However, such remedies are only effective to protect *strong* creditors, who might refuse to grant the loan or demand higher interest rates if the debt contracts do not include such clauses[167].

Besides contractual clauses, issuers may choose to take security interests in corporate assets (which will require the firm to obtain the consent of the creditor before the asset can be alienated free from the creditor's interest) to help control agency problems.[168]

3. Contracting around takeovers

Literature outlines two broad categories of covenants[169]: the ones that restrict dividend and financing activities (such as limits on payment of dividends and other distributions, and limits on the issuance of additional debt) and the ones that restrict restructuring or investment decisions (namely merger restrictions, change of control provisions and limits on sales). Nash, Netter and Poulsen argue that merger restrictions, change of control provisions and limits on sales are primarily driven by the issuing firm's risk of financial distress, rather than by its investment opportunities[170]. To preserve flexibility, firms closer to insolvency are thought to be less likely to include such restrictive covenants, although they will usually not be able to negotiate the conditions of their financing contracts.

We shall focus on the covenants included in bond issues and lending agreements to protect creditors against changes of control in a company's structure. Some examples are event-risk[171] covenants in bond issues - which protect creditors against risks of claim dilution resulting from a LBO or MBO[172]-, change of control provisions and merger covenants conditioning the merger to the survivor's ability to borrow under the debt contract *ex post* the closing of the merger. One should bear in mind, however, that

[167] GUINÉ (2009, 47).
[168] SMITH and WARNER (1979, 5).
[169] *Idem*, 125-139. *See* also NASH, NETTER and POULSEN (2003, 213-229).
[170] NASH, NETTER and POULSEN (2003, 201-202). *See* also BRATTON (2006, 40-41).
[171] According to BRATTON (2006, 44), "event-risk" is "*the bond market's term for leveraged restructuring and other cases where a highly rated bond issuer changes its risk profile for governance reasons unrelated to the fundamentals of its business*".
[172] NASH, NETTER and POULSEN (2003, 204).

such clauses can also work as antitakeover devices shielding the existing management[173].

3.1. Change of control provisions

Change of control provisions (or *poison puts*) are contractual provisions which give a party to the agreement the right to terminate the contract (or to demand a higher interest rate)[174] in the event of a change of control of the other party. Such clauses are included in financing contracts, employee contracts, as well as in intellectual property rights transfer agreements[175]. In financing agreements, the creditor is given enhanced protection, as it will enable him to demand the repayment of the principal amount of the loan with interest or to cancel any obligation to grant future loans in the event of a takeover. Thus, *poison puts* are seen as acceleration clauses[176], as debt becomes due and payable upon their violation.

The condition that triggers the *poison put* is the change of control, which might be determined according to a majority criteria (the acquisition or holding, directly or indirectly, by another company or by an individual , of more than fifty percent of the voting share capital of the company or the ability to appoint or dismiss all or the majority of the members of the board of directors or of other supervisory body[177]), or according to the mandatory bids requirements (the acquisition or holding of a number of voting rights that trigger the obligation to launch a mandatory takeover bid)[178]. In some contracts the events mentioned above must be accompanied by a downgrade on the company's debt for the contract to be lawfully terminated[179]. As far as formal requirements are concerned[180], art. 245º-A, nº1, *j)* CVM establishes that change of control provisions must be disclosed by the company[181]. Under Belgian law, for such

[173] FERRAN (2008, 520).
[174] GUINÉ (2009, 46).
[175]DUBOUT (2005, 325). In debt contracts there is usually an intermediary (*agent*) between the lenders (most commonly the company's banks) and the borrower.
[176] *See* ARMOUR, HERTIG and KANDA (2009, 124).
[177] In the three-tier system. *See* footnote 2.
[178] DUBOUT (2005, 335-336).
[179] NASH, NETTER and POULSEN (2003, 224).
[180] According to DUBOUT (2005, 343). There are mainly two alternative connecting factors to find the applicable law on what concerns issues of company law: either the law of the *principal seat* of the company (that is, the place where the most important decisions are taken and from where the management operates) or the law of the country where the company has been incorporated – VAN HOUTTE (2002, 18).
[181] *See* art. 10º, n.º1, *j)* of the Takeover Bids Directive and Recommendation I.6.2 of *Código de Governo das Sociedades da CMVM* (2010, 2). Art. 350º of CSC states that the emission of bonds depends on the

clauses to be lawful they will have to be approved by the general meeting, besides of being disclosed by the company[182]. Without such approval, these provisions will resemble *poison pills*: if the company has to return its loans if acquired, its amount of debt might dissuade a potential takeover bid [183].

The inclusion of such clauses in bond contracts or in a lending agreement grants the lender (usually the company's bank) a significant degree of control over the company: they protect his interest that the ownership and control of the company remain substantially unmodified and allow him to terminate the financing agreement if it doesn't. According to Dubout[184], by introducing such provision the creditor artificially introduces a personal feature in the commercial contract celebrated with the company[185], reducing the effects of the idea of separate legal personality of the company: there is an exception to the principle that obligations of the corporation do not disappear should the board be replaced.

3.2. Merger restrictions

Some covenants contain flat prohibitions on mergers, while others only specify conditions for such activities[186]. Restrictions on mergers mitigate creditor expropriation by asset substitution, as they provide obstacles to the management's attempt to undertake riskier projects after issuing their bonds.[187] A typical merger restriction covenant is the clause in a loan agreement that states that if the debtor is subject to a merger it must immediately return the principal amount. The Portuguese law refers to such clause in art. 101º-B, nº 3 CVM.

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approval of the general meeting, but the company's articles of association can also delegate such power on the board. *See* also art. 366º CSC.

[182] *See* art. 566 of the Belgian *Code des societées,* of 07.05.99, and DUBOUT (2005, 342-344).

[183] *See* DUBOUT (2005, 344-345). On the *poison pill, see* p.18 and 19.

[184] DUBOUT (2005, 330).

[185] *Idem*, 331- "*il s'agit bien de «fabriquer» contractuellement un intuitu personae qui n'existe pas naturellement dans les engagements pris par les personnes morales*".

[186] Some requirements state that the successor must assume all the obligations in the initial debt contract or that the value of creditors' claims is not reduced due to the effect of a difference in variance rates or in capital structures. *See* SMITH and WARNER (1979, 129).

[187] NASH, NETTER and POULSEN (2003, 224).

3.3. Agreements celebrated with controlling shareholders

Shareholders agreements ("*acordos parassociais*" art. 17º of CSC) [188] are agreements regarding the ownership and voting rights of the shares in the company which can be celebrated between shareholders. Some authors consider that such agreements can also be celebrated between shareholders and third parties[189]. *Strong* creditors[190] might celebrate this type of agreements with the majority shareholder or with the *controlling block* of the company they financed, thus exercising some influence in that company's defence strategy: one of the clauses which might be included is the one establishing an obligation to the company's *blockholder* to use its majority holding to approve the adoption of a *pre-bid* defence in the general meeting or to establish such measure in the company's articles of association[191]; in the case of *post-bid* defences, the majority vote must be exercised in the general meeting held for the purpose of authorising the board to adopt the defensive measure. Creditors might be able to exercise some influence in thwarting an unwanted takeover by imposing to the shareholders the approval of some defensive tactics[192] that can protect their interests[193].

VIII. CONCLUDING REMARKS

The main purpose of the present dissertation has been to analyze the possibility of considering the interests of corporate creditors when their interests are affected as a result of a takeover. After making some considerations regarding the role of takeovers and of the market for the corporate control, we analysed the legal rules which guide the management's actions during the process of a takeover and described some situations where the position of corporate creditors might be affected by a change of control. We

[188] Translation of ANTUNES (2009, 4).

[189] We agree with the position adopted by TRIGO (1998, 146-149), who considers that such agreements can be celebrated with third parties (such as creditors) - it is not, however, the traditional view adopted among Portuguese literature regarding this subject, which considers that this type of agreements can only be celebrated between shareholders. *See,* namely, VENTURA (1999, 13).

[190] Weaker creditors will not have the power to negotiate such agreements with the company's shareholders. See the distinction made in Chapter IV.

[191] Art. 182º-A CVM. *See* PINTO, Rita (2009, 632).

[192] Special disclosure requirements are also applicable to these agreements. See art. 245º CVM.

[193] Some examples are given on point 2 of Chapter III.

attempted to prove that creditors should be protected in the event of a takeover and to provide some contractual remedies which can be used.

As a consequence of the adoption of a board neutrality rule by the Portuguese legislator, the managing board has a merely advisory role during a takeover process, although it can exercise a significant influence on the shareholders' decision through the report it elaborates on the conditions, opportunity and merits of the bid and through the adoption of other tactics referred to in this study. Some authors argue that a broader discretion should be given to corporate directors in such circumstances, arguing that if the decision on whether to accept or reject the bid is allocated to the shareholders, they will most likely sell their shares if the offer is wealth-enhancing. But the change of control itself might cause the share-value to drop, and consequently the depreciation of creditors' claims and bonds. On the other hand, the fact that the price offered maximizes shareholder wealth on the short-run does not necessarily mean it constitutes the best choice for the company and for its creditors in the long-run, especially if the bidder's intentions with regard to the future business of the company includes the adoption of riskier strategies.

The Takeover Bids Directive's vague reference to the interests of non-shareholder constituencies in such cases makes it difficult to reach a consensus on whether there is a legal obligation for corporate directors to exercise its influence to frustrate the bid when they believe it to be beneficial for shareholders but prejudicial for the company's creditors. In the context of Portuguese company law, a *pluralistic* interpretation of art. 64º, nº1, *b)* CSC leads us to accept that the general fiduciary duty of loyalty towards the company that also bounds directors during a takeover implies the consideration of the effects of the takeover on the creditors' claims and rights. Nevertheless, most national and international authors adopt an *enlightened shareholder approach* of the interests of the company during the process of a takeover, which is why it is also important to identify some additional contractual remedies which creditors can use to thwart a takeover attempt.

Two examples can illustrate that covenants can grant *strong* creditors a certain degree of control over the company. Lenders might include change of control provisions in their financing agreements as conditions for celebrating such contracts. Furthermore, by means of an agreement with the majority shareholders of the company creditors are able to approve in a general meeting the adoption of defensive measures to protect the company. Bearing in mind the different positions occupied by *strong* and *weak* creditors

in relation to the corporate debtor, there are no doubts that the latter face more risks and are not able to negotiate their defences.

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