

Sell out: new minimum float criteria

After a public consultation phase, Consob replaced its notification of 2002 by issuing notification no. DEM/11065125 of 21 July 2011 (the "**Notification**"), which updates the general criteria to exercise the powers granted to it by Legislative Decree No. 58 of 24 February 1998 ("**TUF**") on amending the float relevant for the obligation to purchase pursuant to article 108, paragraph 2, of the TUF for shareholders holding more than 90% of the voting capital of a listed Italian company.

2002 Notification

The above paragraph 2 of article 108 of the TUF was intended to replace the then-existing legislation on residual takeovers, i.e., the law that existed prior to the transposition of Directive 2004/25/CE, the Takeover Directive. This legislation essentially aims at ensuring that listed companies maintain a level of floating stock sufficient to ensure regular trading and that requires that, in absence of such minimum float, the controlling shareholders purchase the minority shares and delist the company.

Also in force of the previous law, the TUF gave Consob the power, after consultation with the Italian Stock Exchange, to increase the percentage level of required float set out in article 108, in individual cases, for specific companies. This to protect the interests of investors who wish to continue to hold the shares and benefit from the shares being listed in those circumstances where, despite single ownership in excess of 90%, the float was sufficient to ensure regular trading.

Consob therefore issued a notification containing some general criteria to exercise these powers, with the two-fold intention to reduce its discretion as much as possible and to guarantee transparency in the market in advance.

More specifically, Consob explained that there would be grounds for an increase of the threshold only in exceptional cases, involving companies with significant market capitalization, indicating that a float value of approximately Euro 330 million, even if representing less than 10% of the ordinary share capital, was sufficient to let presume regular trading.

Because it is, however, in the market's interest to have a float with the highest value possible, this principle was modulated so as to create a sliding scale, increasing the permissible ownership threshold in line with the capitalization growth of the company. Therefore, Consob created a table with 14 brackets of increasing capitalization, corresponding to ownership percentages greater than 90%, up to a maximum of 97%, designed to guarantee an increasing value of the residual float.

Highlights

New maximum stake threshold of 94%

4 thresholds for increasing capitalization with decreasing float

Confirmed procedure for determining and maintaining thresholds

Conditions of effectiveness

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The new criteria

Even though the conditions governing the obligation to purchase have not been modified with respect to the previous law (in fact the 90% percentage threshold and the methods in which this threshold can be exceeded— prior takeover bid or selective acquisitions - have remained unchanged), Consob nevertheless highlighted the need to update the criteria set out in its 2002 notification, because of the significant changes in the Italian stock market over the past few years, which have created a structure with very different operating conditions than those existing in 2002.

Nevertheless, the criteria were updated with the objective of balancing the interests of minority shareholders and the need to protect market efficiency.

The maximum percentage

The first amendment concerns the maximum threshold, above that of 90%, that Consob can set, which is reduced to 94% from the previous 97%. The justification for this reduction is the need to prevent "interferences" between the provisions governing obligations to purchase and the sell-out and squeeze-out (set out in paragraph 1 of article 108 and article 111 of the TUF, respectively), which become applicable after the percentage threshold of 95% is exceeded.

As explained by Consob, setting the maximum threshold at 94% avoids "*altering the convenience of the choices made by involved individuals in relation to operative strategies which, even if based on different legal structures, can in substance aim to achieve the same goal, identifiable as acquiring possession of all issued shares; more specifically, if a threshold equal to or greater than 95% were established, the resulting conditions could create an operative strategy based on selective purchases, to exceed this threshold, to the detriment of the alternative, i.e., promoting a tender offer, where the squeeze out and sell-out regulations could be applied.*"

Capitalization brackets

The empirical analysis conducted by Consob confirmed the negative correlation between float capitalization and the illiquidity index, so that where the capitalization value of float increases, the liquidity of the shares also increases.

Therefore, Consob confirmed the criteria of having increasing levels of capitalization in relation to the residual float, nonetheless limiting them, because of the different structure of the stock market, to 4 brackets which correspond to four levels of ownership in excess of 90%, ranging from 91% to 94%, as set out in the table below.

Capitalization brackets	Percentage of Ownership %	Percentage of Float %
$X \leq 2.800$	90%	10%
$2.800 < X \leq 4.800$	91%	9%
$4.800 < X \leq 9.600$	92%	8%
$9.600 < X \leq 17.500$	93%	7%
$17.500 < X$	94%	6%

Consob specified that the capitalization of the companies will be calculated on the basis of the weighted market average of the trading prices in the six months prior to the presupposition at the base of the increase measure.

Threshold determination procedure

Confirming the provisions of its 2002 notification, the new Notice provides that Italian Stock Exchange should notify Consob where it appears possible to determine a threshold greater than the one set by article 108 of the TUF for listed companies where, in connection with the launch of a tender offer over the entire share capital (*totalitaria*) or otherwise (due to purchases of shares on or off the market), one single shareholder (or group of shareholders acting in concert pursuant to article 109 of the TUF) could come, or have come, to own more than 90%. Where this occurs following a public tender offer, the new threshold would be set in advance, while in all other cases it would be set on Consob's initiative or following a request of the interested shareholder.

Moreover, the Commission may in any event take into consideration exceptional situations that, affecting the quality of the float, may prejudice "regular trading" and, therefore, prevent falling within a threshold greater than 90% if applying exclusively the criteria in the above table. While the 2002 notification considered that this could happen, for example, where the residual float was limited because shareholders other than the controlling shareholders held relevant

shareholdings, the Notification also sets out examples of circumstances where Consob might not decide to increase the threshold, such as:

- a) a shareholder exceeding 90% of the capital because of selective purchases, if Consob is aware that, other shareholders (in addition to the one exceeding the threshold) hold more than 2% of the share capital or a long position by way of derivatives (either physical or cash-settled) again in excess of 2%;
- b) potentially exceeding 90% as a result of a voluntary or mandatory takeover bid that is about to be launched, where the shareholders (other than the controlling shareholder) that hold more than 2% of the share capital have declared not to tender, or it is reasonable to expect will not tender;
- c) Consob being aware that the shareholder who holds, or could hold following an offer, more than 90% of the share capital, also holds additional long positions over the same shares by way of derivatives (either physical or cash-settled);
- d) Consob being aware that shareholders, also those who have not entered into a shareholders' agreement, and/or holders of long positions over the same shares through derivatives (either physical or cash-settled) have qualified relationships with the controlling shareholder (for example, significant related parties transactions).

Threshold adjustment

As the 2002 notification, the Notification states that after the percentage threshold is first increased, in the context of the review of whether suitable conditions exist to guarantee regular trading, Italian Stock Exchange will also monitor whether the new thresholds can be maintained.

Therefore, companies for which the threshold has been increased will be subject to the following:

1. "periodic maintenance" of the thresholds annually – instead of every six months, as provided in the earlier notification– to be performed on the basis of the capitalisation data of listed companies recorded by the Italian Stock Exchange at the end of each year;
2. "extraordinary maintenance" of the thresholds, upon the occurrence of extraordinary transactions that imply significant variations in the market capitalisation of the company's ordinary shares, such as an increase or decrease of the share capital, mergers, demergers or distribution of extraordinary dividends.

The above will also take into account extraordinary circumstances that, by affecting the quality of the float, could potentially prejudice "regular trading" and, consequently, make it necessary to set thresholds different from those set out in the table above.

In the context of ordinary maintenance, it is not envisaged that set threshold be increased. This to protect the interest of the market for floats with the highest possible value, so as to adequately ensure regular trading.

If the decision is to reduce the threshold that had previously been increased, the holder of a percentage of share capital in excess of the new threshold, will not be required to launch a residual tender offer, because the exceeding of the new limit was not the result of the shareholder's conduct. The shareholder cannot, however, increase its shareholding further, without exceeding the new allowed limit and incurring into the resulting consequences.

Conditions of effectiveness

Finally, the Notification clarifies that any decision to raise the threshold in excess of 90% for a particular company will be valid only in the context of the actual circumstances applicable when the decision was made, and therefore new threshold will be valid exclusively for the shareholder who exceeded the 90% threshold, in relation to which event the decision was made.

Therefore the new threshold will not be valid for any other shareholders if they cause circumstances that imply the further application of article 108, paragraph 2, of the TUF. For example, it will not valid if:

- i. the shareholder who originally caused the events that led to Consob's decision fails to own at least 90% of the share capital following the tender offer;
- ii. the shareholder who originally caused the events that led to Consob's decision comes to own less than 90% of the share capital after the decision; or
- iii. the shareholder who originally caused the events that led to Consob's decision continues to hold more than 90% of the share capital but less or up the percentage threshold set by Consob.

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