SHARES MUST BE REGISTERED IN A STOCK EXCHANGE TO BE THE OBJECT OF A TAKEOVER

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On October 11, 2001, the Corte Primera de lo Contencioso Administrativo (the "Court"), a tribunal that deals with administrative matters, rendered a decision regarding the sphere of competence of the Comisión Nacional de Valores ("CNV"), the Venezuelan securities regulator. The case regards the authorization given by the CNV to BBO Operador del Mercado Monetario, C.A. ("BBO") to takeover Consolidated Industrial Investment L.T.D. ("Consolidated"). The main issue of the case is that the shares of Consolidated were not registered in the Bolsa de Valores de Caracas (Caracas Stock Exchange) ("BVC").

The dispute began when Siderúrgica Venezolana Sivensa, C.A. ("**Sivensa**"), a major steel industry which is Consolidated's sole shareholder, decided to make a capital increase which had a very singular feature: It gave every shareholder the right to acquire a Consolidated share for every Sivensa share acquired. Yet, this situation generated great controversy both in the national and international level, the climax of which was BBO's takeover bid which was authorized by the CNV. The reason for the bid, and for the reaction from Sivensa and Consolidated, is based on the following facts: Although Consolidated was solely owned by Sivensa, the former was also a shareholder of the latter, (24% of Sivensa was owned by Consolidated). Accordingly, if BBO acquired control over Consolidated, it would come very near to acquiring control over Sivensa. At this stage, Sivensa took two different measures to counter-attack the takeover bid. First, its Shareholders' Meeting decided to revoke its previous decision regarding the public offering of its Consolidated shares. Second, it appealed the CNV's decision to authorize the takeover before the Court.

On October 24, 2000, Consolidated and Sivensa appealed the CNV's decision by arguing that such authorization should have never been granted, basically, because Consolidated's shares were not registered in any stock exchange. Even though Sivensa had previously been authorized to make a public offer of its Consolidated shares and, accordingly, Consolidated had been registered in the *Registro Nacional de Valores* (National Securities Registry) kept by the CNV, the Consolidated shares were not registered in the BVC, which is a necessary requirement in order for a company to be a potential takeover object, according to articles 109 and 110 of the *Ley de Mercado de Capitales* (Securities Market Law) ("**LMC**").

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They argued that even though the public offer of its Consolidated Shares by Sivensa had been authorized by the CNV, since such public offer to sell had not occurred, the CNV had authorized a takeover bid over shares which were neither public nor registered with any stock exchange at that time. Consequently, the authorization to BBO breached the rules established in the LMC. On the other hand, the CNV argued as a preliminary issue that, since Sivensa had decided against selling its Consolidated shares, the authorization granted to BBO has been tacitly derogated because its was subjected to a condition which had not been fulfilled. It argued, in consequence, that any decision regarding the appeal initiated by Consolidated and Sivensa would be ineffective.

With respect to merits, the CNV submitted that its power to regulate takeover bids has the purpose of protecting the company's shareholders; therefore such power should not depend upon the inscription of the shares in a stock exchange. In fact, it stated that there is a period of time between the moment in which a company offers its shares and the moment in which such securities are effectively registered in a stock exchange, and that, if the CNV is deemed incompetent to regulate during that period, the purpose of the regulation itself (*i.e.* the shareholders' protection) would be violated.

Several considerations were taken into account by the Court in order to reach a decision:

First, the Court established that the securities market is of a public nature, since the State has broad and pronounced supervision, direction, control and sanction powers over individuals' economic rights. However, it also established that such fundamental individual rights should not be violated. In the judges' opinion the right of property and the freedom of economic activities, recognized by the Venezuelan Constitution, under articles 115 and 112 respectively, can be lawfully restricted by the community's needs, values and interests (public or social utility), and by reasons of social interest (such as human development, security, health issues and environmental protection).

Second, the Court analyzed the interpretation of the pertinent LCM's articles (*i.e.* 109, 110 and 111), establishing that takeover bids had two dimensions: a procedural and substantive, the latter deriving from the civil and commercial branches of the law.

Third, the Court determined that takeover bids proceedings have two clearly differentiated periods. Firstly, a preparatory or preliminary stage, in which the CNV intervenes in order to protect public interests, and which culminates with the granting of an authorization. Second, the takeover process as such, which is the stage that begins with the publication of the offer's conditions. The right of property and the freedom of economic activities are limited by the requirement of obtaining an authorization from the CNV for the proposed takeover bid, since the efficacy of the right to buy or sell publicly traded shares is suspended until such authorization

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is granted. The Court further established that the preparatory stage has the purpose of balancing the individuals' economic and patrimonial interests involved in the operation against the public interest which the CNV has the obligation to protect. All of the above, explains the public order character of the rules which regulate takeover bids.

Fourth, the Court concluded that even though the LMC establishes that the CNV has the power to regulate certain technical aspects of the process, it also restricts such power. Accordingly, as stated *supra,* the LMC established that the shares subjected to control by the CNV in takeover processes are only those which are registered in a stock exchange. It was also pointed out that comparative law studies show that this exigency is recognized by other States, and not only by Venezuela (*e.g.* the United States of America, Spain and France). Indeed, the fact that only shares registered in a stock exchange may be the object of takeover bids, is based in the public essence of the rules which regulate the capital market.

Fifth, the law does not establish the CNV's control over shares not registered in a stock exchange; therefore, such control constitutes a restriction to the right of property and the freedom of economic activities and thus, as a restriction of constitutional rights, it must be *expressly* made by law, and not by an extensive interpretation of a rule which *does not expressly* stipulate so. Indeed, the Court established that the negotiation of shares not registered in the stock exchange have a private nature, therefore escaping the CNV's controlling powers. Finally, the Court stated that registration in the BVC must be done before the takeover bid, that is, that the condition applies *ex ante* instead of *ex post* to the initiation of the administrative procedure in order to obtain the authorization from the CNV.

Consequently, the decision stated that the authorization granted by the CNV was illegal, due to the fact that the CNV is incompetent to regulate takeover bids over shares not registered in the stock exchange before the administrative proceeding for obtaining the authorization begins. It further determined that the consequence of the illegality was that the authorization was null and void, according to the special law which regulates administrative matters (*Ley Orgánica de Procedimientos Administrativos*). Yet, the Court also took into account the CNV's allegation that the act was subjected to a condition which had not been fulfilled and that, accordingly, the authorization was already ineffective. Hence, no right with respect to BBO had been created by the CNV's authorization and so it was declared.

In conclusion, the Court established that the CNV's authorization for the takeover was an act issued outside its sphere of competence, since shares not registered in a stock exchange do not fall within the scope of regulation of the CNV.

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