ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Corporate Ownership and Control
Law Reform and the Contestability of Corporate Control *

by

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Company Law Reform in OECD Countries
A Comparative Outlook of Current Trends

Stockholm, Sweden
7-8 December 2000

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* Part II and III of this paper draw on my article "Le Difese contro le O.P.A. Ostili. Analisi Economica e Comparazione" (2000) Rivista delle Società 737.

In this paper, I consider, from an economic perspective, those aspects of corporate law and securities regulation relating to takeovers and discuss subsequent policy implications. In Part I, I analyse the impact of large shareholdings disclosure on both investor protection and the number of takeovers. Part II is dedicated to takeover barriers, with particular reference to Continental Europe and recent legislation directed to limit the use of these barriers and make corporate control contestable. Part III considers defensive strategies, with particular reference to the U.S. and to the exportability of American defences to Europe. In addition, the role of market rules is analysed as a possible substitute for takeover defences in the enhancement of shareholder value. Part IV touches upon mandatory bid rules and recent attempts in Europe to mitigate their impact and avoid hindering efficient corporate control transactions. Part V draws some conclusions which highlight the role of corporate control contestability in law reform.

I. To What Extent Should Large Shareholdings Be Disclosed?

Securities laws generally require large shareholdings in listed companies to be promptly disclosed to investors. This requirement is important for the efficiency of securities markets[1]. However, the impact of large shareholdings disclosure on the market for corporate control should also be considered. If bidders' incentives are reduced, there might be a decrease in the number of takeovers with subsequent negative effects on investor protection.

Comparative Overview

In the U.S., section 13(d) of the Securities Exchange Act imposes certain disclosure requirements on persons within ten days of the date that they acquire more than five percent of the beneficial ownership of a public company[2]. The section's purpose is "to provide information about any concentration of shareholdings", so that "even an investor making just a significant passive investment, one *really* made only for investment and not for the purpose of acquiring control, will have to deal with its requirements. Nonetheless, the disclosure obligation imposed by §13(d) has

[1] On mandatory disclosure in general, see Coffee, 'Market Failure and the Economic Case for a Mandatory Disclosure System' (1984) Virginia Law Review 717.

[2] See Macey and Netter, 'Regulation 13D and the Regulatory Process' (1987) 65 Washington University Law Quarterly 131.

particular significance for a would-be acquirer"[3]. In addition, Item 4 of Schedule 13D (promulgated by the Securities and Exchange Commission pursuant to its authority under the Securities Exchange Act) requires that five percent purchasers of a company's stock disclose their reasons for buying the shares and any plans or proposals they have with respect to the target[4].

In Europe, the "major holdings disclosure" was harmonised by the Directive 88/627 of December 12, 1998 (MHD)[5], which is grounded on the assumption that "a policy of adequate information of investors in the field of transferable securities is likely to improve investor protection, to increase investors' confidence in securities markets and thus to ensure that securities markets function correctly" (1st considerandum of the Directive's Preamble). Under Article 1(1) MHD, Member States shall make the relevant disclosure duties applicable to natural persons and legal entities who acquire or dispose of holdings in listed companies meeting the criteria laid down in Article 4(1). These criteria refer to acquisitions whereby "the proportion of voting rights held by [the acquirer or the transferor] exceeds or falls below one of the thresholds of 10 per cent, 20 per cent, 50 per cent and 2/3". When these thresholds are crossed, the acquirer or the transferor "shall notify the company and at the same time the competent authority ... within seven calendar days of the proportion of voting rights he holds following that acquisition or disposal". Under Article 10(1), "a company which has received a declaration referred to in the first sub-paragraph of Article 4(1) must in turn disclose to the public ... as soon as possible but no more than nine calendar days after the receipt of that declaration". Under Article 3, Member States may adopt requirements stricter than those stated by the Directive, provided that they apply generally.

Economic Analysis

The disclosure of large shareholdings has been examined from an economic perspective mainly by U.S. scholars who have criticised the disclosure requirements of the Williams Act (which are, to some extent, similar to those provided for in Europe by the MHD). These requirements "are controversial ... because the rules appear to force inefficient wealth transfers from shareholders of bidding firms to shareholders of target firms"[6]. As argued by Fischel, "for the market for corporate control to function effectively, outsiders must have adequate incentives to produce information. Outsiders are not generally privy to inside information about a potential target. A decision to tender

[3] Gilson and Black, *The Law and Finance of Corporate Acquisitions*, 2d ed., Westbury (N.Y.) 1995, p. 898.
[4] On the ambiguity of this provision and the ensuing dilemmas, see *ibidem*, p. 915.
[5] For a commentary, see Edwards, *EC Company Law*, Oxford 1999, p. 291 ff.
[6] See Macey and Netter, *op. cit.*, note 2, p. 131.

only occurs after an offeror determines that the target will be more profitable in its control and that a tender offer is likely to succeed. These decisions involve research costs. The incentive to produce this information is the expected gain from the appreciation of the offeror's equity investment after obtaining control. Any legal constraint that limits the ability of owners of privately produced information to realise its exchange value will discourage devoting resources to produce new information. In other words, a failure to recognise a property right in privately owned information will decrease the incentives to produce this information"[7].

In a similar vein, it was argued (with reference to projected law reforms in Italy) that there is a trade-off between the protection of minority shareholders and the mobility of corporate control[8]. If shareholdings disclosure rules provide for a low threshold, the equity market is more transparent and this reinforces the minority's protection; however, potential bidders cannot accumulate a sufficient "toehold" in the target in advance of the bid and this reduces corporate control contestability[9]. In fact, "buying a stake or toehold in a takeover target is a common and profitable strategy. The potential acquirer can gain either as a buyer who needs to pay a premium for fewer shares, or as a losing bidder who sells out at a profit. Therefore a company that owns a toehold has an incentive to bid aggressively, as every price it quotes represents not just a bid for the remaining shares but also an ask for its own holdings"[10]. However, if the bidder is forced to disclose its shareholding in the target too soon, the toehold and the ensuing profit for the bidder will be smaller and the control contestability will be consequently reduced.

Policy Implications

Therefore, a policy maker has to fix the threshold for shareholdings and the delay for disclosure by balancing the need for transparency on the one hand and that for corporate control contestability on the other. Investor protection will depend upon an appropriate level of shareholdings disclosure and this will also depend on the ownership structure of the listed companies in a given market. If ownership is concentrated and the blockholders tend to form controlling coalitions, there may be a greater interest in making corporate control contestable[11]. If

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[7] Fischel, 'Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers' (1978) Texas L. Rev. 1, at 13.
[8] See Pagano, Panunzi and Zingales, 'Osservazioni sulla Riforma della Disciplina dell'OPA, degli Obblighi di Comunicazione del Possesso Azionario e dei Limiti agli Incroci Azionari' (1998) Rivista delle Società 152, at 166.
[9] *Ibidem*, 166-167.
[10] Bulow, Huang and Klemperer, 'Toeholds and Takeovers' (1999) 107 J. Pol. Ec. 427.
[11] Pagano, Panunzi and Zingales, *op. cit.*, p. 167.

there are difficulties in providing for a relatively high threshold (e.g. 10 per cent), adjustments can be made with reference to the timing of disclosure (a maximum of 7 + 9 = 16 days under the MHD)[12].

II. Should Takeover Barriers Be Permitted?

In this part and the following I make a distinction between takeover barriers and defensive strategies. The former are often used in continental Europe and aim at immunising a company from hostile takeovers, as will be shown in this part. The latter are widely used in the U.S. and include both pre-bid and post-bid defences, as illustrated in part III. Defensive strategies can contribute to shareholder value creation, if they are directed (as is often the case) at maximising the bid's price or at frustrating bids which do not maximise wealth. If used to entrench the target's managers, defensive strategies are functionally similar to takeover barriers.

Types of Barriers

In Europe the distinction is frequently made between structural and technical barriers to takeovers. The former reflect existing conditions in the economic environment[13], including circumstances such as the ownership concentration in families and small groups, the influence of large banks and the relatively limited role of stock exchanges in corporate financing[14]. Technical barriers are part of the corporate governance structure, as they are erected by statutes and by the companies' memoranda and articles of association, which specify the legal rules and allocate powers between the various interested parties (shareholders, management and labour)[15]. Techniques such as pyramidal groups, cross-shareholdings and the issuance of non-voting shares, not only contribute to the separation of ownership and control, but also protect management and the controlling shareholders from the risk of unfriendly takeovers. Other tools are specifically aimed at

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[12] *Ibidem.*
[13] Gilson, 'The Political Ecology of Takeovers: Thoughts on Harmonising the European Corporate Governance Environment', in Hopt and Wymeersch, *European Takeovers*. Law and Practice, London 1992, p. 49 ff., at 65.
[14] See Jenkinson and Mayer, *Hostile Takeovers*. Defence, Attack and Corporate Governance, London 1994, p. 19, arguing that perhaps the most important difference between countries in Europe is simply the size of the quoted sector, since it is only quoted companies that can be subjected to a hostile takeover bid.
[15] See Gilson, *op. cit.*, note 13, p. 65.

discouraging takeover bids, as will be seen with respect to share transfer restrictions and voting caps.

National Rules

In this paragraph, I consider the technical barriers which have been expressly regulated by national rules also on account of their anti-takeover purpose, whereas in the paragraph that follows I shall try to assess technical barriers from a policy viewpoint [16].

(i) *Share Transfer Restrictions*. Clauses in the corporate contract which limit the transfer of shares, in general by requiring the board of directors' approval, have been traditionally used in Continental Europe as a means to control the listed companies' shareholdings and exclude unfriendly takeovers. More recently, however, similar clauses have been outlawed, also as a result of the implementation of the Listing Conditions Directive of 1979. Part II, No. 2 of the Directive's Schedule A provides that "shares must be freely negotiable" (para. 1) and that "the competent authorities may, in the case of the admission to official listing of shares which may be acquired only subject to approval, derogate from the first paragraph only if the use of the approval clause does not disturb the market" (para. 3). This provision aims to protect the functioning of the stock market, as share transfer restrictions could hinder trading and make it more onerous. The same provision does not appear to be directed at the promotion of the market for corporate control, which is enhanced only by rules either forbidding this type of clause or limiting the board of directors' discretion in granting the required approval. However, it has an impact on the functioning of the market for corporate control, to the extent that it removes a potential barrier[17].

The French Securities Commission (*COB*) has stated that clauses requiring the directors' approval of share transfers (*clauses d'agrément*) cannot be opposed to a bidder, except when they derive from a legal obligation[18], whereas Article 3.1.8. of the Paris Stock Exchange's (*SBF*) rules now require that the same clauses are not included in a company's articles. Similar rules are in force in the U.K.. Para. 3.15 of the F.S.A. Listing Rules requires that a company seeking a listing

[16] Considering that structural barriers are the effect of general economic conditions (e.g. the limited role of the public equity markets in a given economy), only technical barriers can be subjected to rules limiting their anti-takeover impact, quite apart from the merit of such rules and their practical efficacy.

[17] According to Viandier, *OPA, OPE, et Autres Offres Publiques*, Paris 1999, p. 59, absolute defences (i.e. defences inhibiting all takeover bids) are implicitly forbidden by exchange law, for listed companies are, by definition, open-ended. Moreover, trading on the exchange market would be unduly restricted by such defences.

[18] See Art. 3 (4) *Règlement C.O.B.* No. 89-03.

provides in its articles of association that its shares are freely transferable. In exceptional circumstances, a listed company may take power to disapprove the transfer of shares provided that such powers do not disturb the market. This was authorised by the Exchange with respect to the “golden shares” retained by the Government in privatised companies[19].

Italian law and practice follow similar patterns. Clauses requiring the board’s approval of share transfers (*clausole di gradimento*) are permitted under the general law. Art. 2355, al. 3, Civil Code, provides that a joint-stock company’s (*società per azioni*) articles can submit the transfer of registered shares to specific conditions (including the approval by the board of directors or third parties; but see Art. 22, Law No. 281 of 1985, forbidding clauses that remit such an approval to the unqualified discretion of the board). However, their non-inclusion in a company’s articles is a condition to listing[20]. Moreover, the third-party approval to share transfers is admitted when such an approval is contemplated by the law, as in the case of golden shares included in the articles of some privatised companies or in the case of banks, insurance companies and other financial intermediaries for which regulators’ approval is necessary.

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[19] See Stedman, *Takeovers*, London 1993, p.13.

[20] Art. 2.1.3. of the Italian Exchange (*Borsa Italiana S.p.A.*) Regulation provides that the financial instruments should be “freely transferable”. This requirement is interpreted, in practice, as excluding *inter alia* the admissibility of *clausole di gradimento*: Ferrarini, ‘Sollecitazione del Risparmio e Quotazione in Borsa’, in Colombo and Portale (Eds.), *Trattato delle Società per Azioni*, 10**, Turin 1983, p. 209.

(ii) *Voting Restrictions*. These restrictions were common in Germany "despite the protection against hostile takeovers provided by German company law and the additional protection provided by the structure of the German corporate and banking communities and the power of the banks"[21]. Before a recent reform, the adoption of voting restrictions by all companies was allowed under par. 134 (1) of the Joint-Stock Company Law (*Aktiengesetz*), providing that "the articles may limit voting rights with respect to shareholders holding more than one share by setting a maximum par value or a sliding scale"[22].

Voting restrictions were introduced to shelter management from hostile takeovers[23]. If block holders cannot vote their shares for more than 5 per cent of the company's capital (as was usually provided by the relevant articles of German listed companies) the risk of an unfriendly takeover is low[24]. Clearly, voting restrictions could be eliminated through a shareholders' resolution and a bidder could seek the support of other important shareholders in view of such a resolution being approved[25]. But the role of German banks, as shareholders and proxies for their customers, has represented a serious obstacle in the path of the bidder and an effective defence for the incumbent management[26].

Voting restrictions have been widely criticised, as they weaken the control over managers by excluding the formation of large blocks and the launch of hostile bids. Moreover, they reinforce the powers of the controlling coalitions, including banks, who supported their introduction[27]. The fact that the relevant resolutions are voted also by other investors does not prove that the same are

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[21] Maier-Reimer, 'Protection Against Hostile Takeovers in Germany: Banks and Limitations on Voting Rights', in Hopt-Wymeersch, *op. cit.*, note 13, p. 244.

[22] This rule is complemented by a requirement that voting restrictions should apply to all shareholders (*Gleichbehandlungsprinzip*). Moreover, these restrictions are not taken into consideration when counting a majority of the share capital required either by the law or by the articles; see Maier-Reimer, *op. cit.*, note 21, p. 246, explaining that in similar cases two counts of the votes must be conducted: "In the first count, the votes cast are counted; the limitations on voting rights are applied in this count. In the second count, the capital majorities are determined, and for this purpose limitations on voting rights are not applied".

[23] A frequently cited justification for voting restrictions is the desire to avoid the acquisition of German companies by foreign interests (*Überfremdung*): see Schneider, 'Gesetzliches Verbot für Stimmrechtsbeschränkungen bei der Aktiengesellschaft?' (1990) AG 56.

[24] However, voting restrictions are defined as an unreliable defensive measure by Hopt, 'Präventivmassnahmen zur Abwehr von Übernahme- und Beteiligungsversuchen', in WM-*Festgabe für Theodor Heinsius*, 1991, p. 24, arguing that they can be legitimately circumvented through voting pacts, proxies and other means.

[25] See Baums, 'Takeovers versus Institutions in Corporate Governance in Germany', in Prentice-Holland (Eds.), *Contemporary Issues in Corporate Governance*, Oxford 1993, p. 156.

[26] Maier-Reimer, *op. cit.*, note 21, p. 250.

intended to maximise shareholder value. In fact, small investors are under the influence of the incumbent managers and the banks. Additionally, it may be difficult to assess a priori the impact of measures sheltering management from unfriendly takeovers, particularly if these measures are presented as a condition to pursue long term interests[28]. For all these reasons, Art. 1 (20) of the recent law on corporate control and transparency (*KonTraG*) modified para. 134 (1) of the Joint-Stock Company Law (*Aktiengesetz*) specifying that voting restrictions can only be adopted by non-listed companies. A two year gratia period was allowed to existing restrictions, which expired in June 2000.

Voting restrictions have also been introduced by several French companies since the '80s., as allowed by Art. 177 of the 1966 Law on commercial companies stating that these restrictions must refer to all shares, with the exception of non-voting shares[29]. However, the *C.O.B.* has questioned the validity of voting restrictions with respect to the 1989 Law on takeovers, arguing that they are aimed at frustrating tender offers. In order to overcome this problem, the French Securities Commission recommended to specify, in the relevant clauses, that the voting restriction is forfeited if a majority of shares is acquired through a takeover bid[30]. As a result, some listed companies' voting restrictions are automatically forfeited if either one half or two thirds of the share capital are acquired by the same party[31].

The Italian experience is not very different. Voting restrictions are in principle admitted[32]. Moreover, their adoption is expressly allowed by the 1994 law on privatisations, so that the articles of privatised listed companies generally include a voting cap to the amount of either 3 or 4 per cent of the ordinary share capital. Interestingly, the same law also provided (similarly to French practice) that the privatised companies' voting restrictions were automatically forfeited in case of a takeover leading the bidder to acquire the majority of the share capital. This provision was subsequently

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[27] Adams,'Höchststimmrechte, Mehrfachstimmrechte und Markt für Unternehmenskontrolle' (1990) AG 63, 72 ff.; Michalski, 'Abwehrmechanismen gegen unfreundliche Übernahmeangebote nach Deutschem Aktienrecht' (1997) AG 152, 159.

[28] On the collective action and strategic choice problems facing shareholders' resolutions in this area, see Gordon, 'Ties That Bond: Dual Class Common Stock and the Problem of Shareholder Choice' (1988) 76 Calif. L. Rev. 2, 42 ff.

[29] See Viandier-Cozian, *Droit des Sociétés*, 11th ed., Paris 1998, p. 103.

[30] C.O.B., *Rapport 1992*, p. 48; *Rapport 1993*, p. 50.

[31] See Oppetit-Schmidt, "Plafonnement du droit de vote et OPA" (1994) Rev. Banc. Bourse 151.

[32] See the decrees issued with respect to Credito Romagnolo by the Tribunal of Bologna on the 10th June 1985 and the Court of Appeal of Bologna on the 18th July 1985, (1986) II Giur. Comm. 481; see also Tribunal of Milan, 6 February 1992, (1992) Società 1087. Voting caps are compatible with the listing of shares, as they do not exclude the free transferability of the same: see Consob's communication No. 86/18088 of 1986 to Credito Romagnolo, reflecting the cited Bologna Court of Appeal's decree.

amended by Article 212 of the CFSA, stating that such restrictions are forfeited if a takeover bid is launched with respect to either all ordinary shares or 60 per cent of the same under Article 107 CFSA (which requires inter alia a shareholders' referendum on the acceptance of the partial bid). The new rule does not look at the outcome of the takeover bid, as did the provision previously in force, so that the acquisition of a majority of the share capital is irrelevant to the forfeiture of the voting cap[33]. Clearly, both the previous rule and that presently in force aim at overcoming the barrier created by voting restrictions against takeovers[34]. But the latter does so with greater strength, particularly considering that takeovers in Italy are not, as a general rule, conditioned to reaching a majority of the share capital.

(iii) *Voting agreements*. Voting agreements are defined by a leading treatise on takeovers as the simplest defensive measure[35]. They are entered into by two or more shareholders, each holding insufficient shares to secure effective or voting control, and provide that the parties' joint holdings are to be voted as a block and cannot be sold separately. It is usually specified that "decisions as to the sale of the shares which are subject to the agreement, or the exercise of their voting rights, are to be made unanimously (with arbitration in the event of a conflict) or perhaps by the majority of the shareholders in number or in value of the shares contributed"[36].

Agreements of this type are the *syndicat de defense* in France[37] and the *sindacati di voto* in Italy[38]. In both countries, other kinds of shareholders' agreement are also used as defensive techniques. Blocking agreements (*pactes d'inaliénabilité, sindacati di blocco*), for instance, have been executed in the field of privatisations to form *noyaux durs* of shareholders and protect the privatised companies from attacks[39].

Shareholders agreements are a valid defence against takeovers in the U.K.[40] and in France[41], but no longer in Italy after the enactment of the CFSA. Under Art. 123 (3) CFSA, shareholders are

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[33] See Enriques, 'Le o.p.a. Preventive nel Testo Unico in Materia di Intermediazione Finanziaria' (1999) I Giur. Comm. 180. This question was disputed in the course of Olivetti's bid for Telecom Italia, as the latter contested the irrelevance of the bid outcome under the new rule. However, the issue was not litigated following the bidder's successful acquisition of 52 per cent of the target capital.

[34] On the anti-takeover character of these restrictions, see Rossi, 'Privatizzazioni e Diritto Societario' (1994) Riv. Soc. 397.

[35] Weinberg and Blank, *Take-overs and Mergers*, London 1995, p. 3286.

[36] *Ibidem*; Stedman, *Takeovers*, London 1993, p. 415.

[37] See Viandier, *op. cit.*, note 17, p. 76.

[38] See, for an overview, Bonelli-Jaeger (Eds.), *Sindacati di Voto e Sindacati di Blocco,* Milan 1993.

[39] Viandier, *op. cit.*, note 17, p. 80.

[40] See the works cited at notes 35 and 36. However, voting agreements do not appear as a frequent defensive measure: see Davies, 'The Regulation of Defensive Tactics in the United Kingdom and in

entitled to back out of voting pacts, blocking agreements and similar arrangements (collectively defined as *patti parasociali*) when a takeover bid aimed at gaining at least 60 per cent of the votes is in place. The same Article provides that the withdrawal from the relevant agreement is ineffective if the share transfer to the bidder does not take place (e.g. because the bid's conditions are not satisfied). The purpose of this rule is to promote the market for corporate control in a country where control transactions have been too often hindered by shareholders' coalitions built on voting pacts and similar arrangements (including cross-shareholdings, interlocking directorates and non-voting shares).

(iv) *Cross-shareholdings*. "Companies in a cross-ownership structure are linked by horizontal cross-holdings of shares that reinforce and entrench the power of central controllers"[42]. In other words, these holdings are "a means to reduce the amount of equity that a shareholders' group has to invest in order to acquire, maintain and defend (in case of a hostile bid) the control of a corporation"[43]. In fact, cross-holdings allow each company involved to place into friendly hands a number of its own shares, thereby reducing the investment required to the controllers to keep control of the relevant company. Cross-holdings increase the agency problems between majority and minority shareholders, and give rise to "barriers to hostile takeovers which are practically inexpungible"[44].

Limits to cross-holdings are fixed by the corporate laws of several countries in Continental Europe, in consideration of the capital dilution that they are apt to cause and of their negative impact on corporate governance structures[45]. These limits are applicable to all companies, independently of whether their securities are listed on a stock exchange and, therefore, without

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the United States', in Hopt-Wymeersch, *op. cit.*, note 13, p. 195; Jenkinson-Mayer, *op. cit.*, note 14, p. 21 ff.

[41] Viandier, *op. cit.*, note 17, p. 76 ff., specifying that particular problems do not arise provided that the company's managers are not parties to a *syndicat de defense.* In fact, they would not be allowed to frustrate the offer by selecting a buyer of the syndicated shares.

[42] Bebchuk, Kraakman and Triantis, 'Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights', N.B.E.R. Working Paper 6951, February 1999, p. 8.

[43] Pagano, Panunzi and Zingales, *op. cit.*, note 8, at 168.

[44] *Ibidem.*

[45] See e.g., for France, Article 358 of the 1966 Law on commercial companies (a joint-stock company cannot hold shares of another company if the latter has a holding in the former of more than 10 per cent of its capital); on the rationale of this rule, see Viandier-Cozian, *op. cit.*, note 29, p. 605; on its limited impact from a takeover perspective, see Vatinet, 'Les défenses anti-opa' (1987) Rev. Soc. 550f., noting that the 10 per cent threshold leaves room for manoeuvre and that circular holdings are not forbidden.

regard to the impact of cross-holdings on the market for corporate control. An exception is made by Italian law, stating more restrictive rules for quoted companies[46].

Policy Assessment

On the whole, the regulation of takeover barriers has a limited impact on the contestability of corporate control. First of all, national legal restrictions concern specific barriers, so that their practical effect might simply be to re-orient defensive actions towards different techniques. For instance, the Italian rule entitling the target shareholders to back out of voting pacts, blocking agreements and similar arrangements when a takeover is in place, might create an incentive to build group structures as a defence against unwanted bids. Similarly, the prohibition of voting caps and

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[46] Under Article 121(1) CFSA, if a listed company holds two per cent or more of another listed company's voting shares, the latter may not exercise the voting rights attached to shares in the former exceeding two per cent of the voting shares and must sell such shares within twelve months. Connections among groups are also taken into account by Article 121(3); briefly, if a person or entity A holds more than 2 per cent of the shares in a listed company B, B or the person controlling it may not hold more than 2 per cent of the shares in listed companies controlled by A (see Bianchi-Bianco-Enriques, 'Pyramidal Groups and the Separation between Ownership and Control in Italy', manuscript, October 1998, p. 7). If one company is listed and the other is not, when the listed company holds ten per cent or more of the other company's share capital, the latter may not hold more than two per cent of the voting shares in the former. When the non-listed company has a two per cent holding or more in the listed company, the latter may not hold more than ten per cent of the shares in the former. Foreign listed companies have been equated to Italian non-listed companies by Consob in the case of cross-holding between an Italian listed company and a foreign counterpart: see Consob Informa No. 42 of 2 November 1999.

Under Article 121(2), the limit to cross-shareholdings between listed companies is raised to 5 per cent provided that the general meetings of the two companies give their consent to the cross-holding on the basis of an agreement between the same. This possibility was introduced in order to allow the formation of alliances based on share swaps between quoted companies. The shareholders resolution is required in light of the potential anti-takeover character of such alliances. Furthermore, Article 121(5) specifies that in case one of the two companies with reciprocal holdings gains control of the other through a takeover bid, the limits stated by the previous paragraphs do not apply. Consequently, it is the votes attached to the shares held by the acquired company which cannot be exercised See Bianchi-Bianco-Enriques, *op. cit.*, note 46, p. 7. This exception is directed to avoid the use of the limit to cross-holdings provided for by the law as a defensive measure against takeovers. Let us assume that company A plans to launch a bid on company B and the latter comes to know about it in advance. If paragraph 5 were not applicable, B could block A's takeover by acquiring a stake of slightly more than two per cent of its ordinary shares, as paragraph 1 would forbid A's purchase of more than 2 per cent of B's ordinary shares.

A restriction applicable also to non-listed companies is that provided for by Article 2359-bis, Civil Code, in compliance with Article 24a of the Second Company Law Directive (introduced by the Directive 92/101) extending the rules on the acquisition by a company of its own shares to the subscription, acquisition or holding of shares in a public company effected by another company under the public company's control.

their forfeiture in the case of a bid might increase the recourse to other techniques, such as non-voting shares. Therefore, the long-term effect of regulatory restrictions could be negligible, even when their short-term impact is noticeable (as in the cases of the Vodafone/Mannesmann and Olivetti/Telecom Italia takeovers, which were made possible by the German and Italian restrictions on voting caps).

Moreover, regulation could hardly be more pervasive and cover all takeover barriers. On the one hand, there are structures, such as corporate groups, in respect of which it is very difficult to ascertain whether they are being used mainly to shelter the target from takeovers or to enhance organisational efficiency. On the other hand, restricting the choice of "controlling shareholder structures" (CS) might not be a desirable policy approach: "...if the use of CS structures were prohibited or discouraged, this would not imply that companies would choose to go public with an NCS [non-controlling shareholder] structure. They might instead choose to remain closely held and avoid going public altogether. For if private benefits of control are large, and if the law requires an NCS structure for publicly traded companies, then going public might be discouraged even when it could provide some efficiency benefits"[47]. Therefore, if takeover barriers were entirely precluded to listed companies, the controllers might choose to keep their companies private and society as a whole would lose to the extent that new investments (with a positive net present value) would not be financed.

III. Should Defensive Strategies Be Regulated?

In this part I focus on takeover defences common in U.S. practice and ask whether and to what extent they should be admitted in Europe. I examine, firstly, pre-bid defences, which differ from the technical barriers that are predominantly used in Europe, and explore their "exportability". I subsequently consider post-bid defences and compare the different treatment applicable to them under U.S. and E.U. law and conclude with policy implications.

Pre-Bid Defences

American defensive "tactics" or "strategies" are aimed either at improving the bid terms or frustrating the offer if it is not wealth maximising, except for the case in which these tactis are used

[47] Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control', N.B.E.R. Working Paper 7203, July 1999, p. 30.

to entrench managers. Shark-repellents and poison pills are usually justified as reducing the coercion produced by takeover bids on target shareholders. The paradigm is offered by a two-tier bid creating a prisoner's dilemma for target shareholders, who fear to be frozen-out in the following merger if the tender offer is successful. But also one-tier bids can throw the offerees into a similar dilemma, if the bid price does not reflect the target's value and the shareholders accept the offer out of fear to be left with low-value minority shares, if the bidder gains control of the target[48].

In Europe, the mandatory bid rules in force at the national level (and contemplated by Article 10 of the draft directive) tend to exclude coercive two-tier bids, as they either require a bid for all the shareholdings or admit a partial bid upon the condition that it is approved by the majority of the relevant holdings[49]. However, also bids for all the shares can create a pressure to tender and the mandatory bid rules do not solve this problem, as they lead "neither to the acquisition of more shares by the bidder nor to a higher premium"[50]. A comparison with the American experience, therefore, shows that despite the non-recurrence in Europe of two-tier bids of a coercive nature[51], the target shareholders may need protection against the pressure to tender generated by all-shares offers, notwithstanding the adoption of mandatory bid rules at the Member States' level. This is what defensive tactics can provide, by allowing the target to bargain with the bidder about the terms of the offer.

However, a defensive arsenal of the American type is still unknown in Europe. Poison pills are not used and would probably violate either corporate law principles or stock exchange regulations and companies' best practices[52]. In particular, the national rules implementing the Second Company Law Directive would create barriers against the use of poison pills. For instance,

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[48] See Bebchuk, 'Toward Undistorted Choice and Equal Treatment in Corporate Takeovers' (1985) 98 Harv. L. Rev. 1693, at 1696, 1717 ff., arguing however that "allowing obstructive tactics…is a very costly and inadequate method of dealing with the problem of distorted choice"(*ib.*, 1743)

[49] This is the partial bid's treatment adopted by the City Code on Takeovers and Mergers, Rule 36 (requiring approval by the City Panel and the shareholders holding over 50 per cent of the voting rights). On the clarify pressure to tender reduction operated by this rule, see Bebchuk, *op. cit.*, note 48, at 1796 ff.

[50] Burkart, Gromb and Panunzi, 'Why Higher Takeover Premia Protect Minority Shareholders' (1998) 106 J. Pol. Ec. 172, at 187, who add: "The shortcoming of the MBR [mandatory bid rule] is its lack of coercion. It does not require the bidder to buy all shares, but merely those shares tendered. This obligation is vacuous since it remains still at the bidder's discretion how many shares will actually be tendered". On the pressure to tender in all-shares offers, see Bebchuk, *op. cit.*, note 48, at 1717 ff., 1796 ff. (with reference to the British Code on Takeovers and Mergers).

[51] It should also be noted that cash-out mergers are not allowed by European law, as harmonised under the 3rd directive (see Articles 3 (1) and 4 (1) allowing a cash payment not exceeding 10 per cent of the nominal value of the shares issued for the merger).

[52] See Davies, 'The Regulation of Defensive Tactics in the United Kingdom and the United States', in Hopt and Wymeersch (Eds.), *European Takeovers.* Law and Practice, 1992, p.195, pp. 205 ff.

the rules on capital formation would make it difficult to issue securities at a discount in order to dilute the capital of the bidder. Furthermore, the rules on shareholders' equal treatment and pre-emptive rights would forbid the bidder's discrimination as to the issuance of shares which is determined by the poison pill[53]. In addition, the rules on shares' issuance, as well as those provided for by the Third Company Law Directive on mergers of public companies, would be an obstacle to the recognition of "flip-over rights", i.e. the target shareholders' rights to subscribe the bidder's shares at a discount, so as to dilute its capital[54]. The "flip-in rights" would also be difficult to admit, as they entitle the target shareholders to resell their shares to the issuer and would therefore be subject to the limits on share repurchases foreseen by the Second Directive. In any case, the poison pill's success in the U.S. is connected with the fact that the board of directors has full discretion in the issuance of new shares. In Europe, on the other hand, a decision to increase a company's capital must ultimately rest with shareholders, so that it would be easily defeated if motivated by antitakeover purposes.

Shark repellents could be more easily accepted within the European corporate and capital market law setting, and to some extent they are already used (at least as far as super-majorities are concerned). The recourse to "fair price" provisions, for instance, could help to improve the bid terms and obtain better protection for the target shareholders[55]. However, these provisions should be analysed from the mandatory bid perspective in order to ascertain whether and to what extent the relevant rules can be either derogated or supplemented to improve investor protection in the case of a bid.

Post-Bid Defences

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[53] Also in the U.S., several decisions have invalidated planned poison pills on the grounds that state law does not permit a corporation to discriminate amongst shareholders of the same class: see Choper, Coffee and Gilson, *Cases and Materials on Corporations*, 4th ed. 1995, p. 904, at note 32.

[54] In the U.S., the question "why is the asserted right to convert target shares into bidder shares legally enforceable?" is answered as follows: "If there is a merger between the target and the bidder, the answer probably is that the surviving firm by operation of law assumes the liabilities of the merging firm, which here include the obligation to honor the conversion privilege. However, where the 'flip-over' provision is triggered by some other condition (as it usually can be in the current version of the pill), it is far from clear that the bidder is liable simply because the target provides that a 'flip-over' right exists. For example, if the 'flip-over' is triggered by a sale of some assets between the bidder and the target, the legal status of the 'flip-over' would seem uncertain. Still it possesses a deterrent threat" (*ibidem*, p. 902, at note 31).

[55] "Fair price amendments" provide an "exception to a supermajority vote requirement for a second-step transaction where the price to be paid minority shareholders exceeds a specified amount which

Takeover defences create a potential conflict of interest for managers of the target, particularly after a bid has been announced. The target's managers may favour the proposed transaction only because they have been promised personal benefits; alternatively, they may reject it to protect their position as managers[56]. In any case, takeovers are complex transactions and shareholders need the expert assistance of managers, who in turn are bound by the duty of care and protected from judicial review under the business judgement rule[57].

Under U.S. law, defensive tactics are a matter within the business discretion of the target's directors and officers[58]. As stated with reference to poison pills, they were originally intended to act as a means of allowing the board to fulfil its responsibility of maximising value for the shareholders[59]. However, "a corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available"[60]. A distinction is made between defensive tactics that benefit shareholders and those that merely protect management. In order for the business judgement rule to apply, the board must demonstrate that the takeover represented a threat to corporate policy and existence[61]. Moreover, the defensive measure must be "reasonable in relation to the threat posed[62]. This is an "intermediate standard" (with respect to the business judgement rule originally invoked by the courts) requiring a "proportionality review" in order to decide whether a defensive response is warranted[63].

In Europe, the regulation of post-bid defences has been, to some extent, *de facto* harmonised[64], whereas legal harmonisation through the adoption of a takeovers directive has encountered new difficulties, as will be shown in the next paragraph. The regulatory model prevailing in European countries appears to be that embodied by General Principle No. 7 of the City

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may be greater than the price paid in the initial tender offer": see Gilson and Black, *op. cit.*, note 3, p. 738.

[56] See Choper, Coffee and Gilson, *op. cit.*, note 53, pp. 888 f.

[57] *Ibidem.*

[58] Clark, *Corporate Law*, Boston 1986, p. 581.

[59] Macey, 'The Legality and Utility of the Shareholder Rights Bylaw' (1998) 26 Hofstra L. Rev. 835, at 837.

[60] Unocal Corp. *v.* Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), at 955.

[61] See Cheff *v.* Mathes, 41 Del. Ch. 494, 199 A.2d 548 (S. Ct. 1964), at 508.

[62] Unocal Corp. *v.* Mesa Petroleum Co., cit., at 958.

[63] See Gilson and Kraakman, 'Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 Bus. Law. 247 (1989).

[64] See Hopt, 'The Duties of the Directors of the Target Company in Hostile Takeovers – German and European Perspectives', in *Capital Markets in the Age of the Euro.* Cross-Border Transactions, Listed Companies and Regulation (forthcoming), para. I.2, stating that "in Europe in the last few years takeover laws and codes have been enacted in many countries. Most of these are patterned on the British City Code and include just like it a prohibition of frustrating action or in other terms a requirement of neutrality of the board of the target company".

Code, stating: "At no time after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits" [65]. This principle is specified by Rule 21 on "frustrating action", which includes defensive measures[66]. The following actions are mentioned by Rule 21: issuance of shares, options in respect of shares and securities carrying rights of conversion into or subscription for shares; sell, dispose or acquire assets of a material amount; making contracts otherwise than in the ordinary course of business. Similar rules have been adopted in Austria[67], Ireland[68], Italy[69], Portugal[70], Spain[71] and Switzerland[72].

In Germany, the Takeover Code of 1997 includes a rule of neutrality (Article 19) similar to the British rule on frustrating action; however, this is a voluntary Code and has been adopted only by 63 per cent of the listed companies[73]. The German draft law on takeovers[74] provides for a neutrality rule (Article 31) modelled upon the City Code, which would be applicable both to the management board and the supervisory board[75]. In France, it is only stated that the securities regulator (COB) must be notified of the target's acts other than those accomplished in the ordinary course of business; a rule which is clearly "milder" than those adopted in countries following the British model[76].

The comparative analysis of post-bid defences highlights the diversity of internal governance structures, which in turn reflects more basic differences in the allocation of powers between directors and shareholders in American and European corporations. In the U.S., boards of directors have been able to adopt the poison pill under their general authority to issue shares and to

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[65] See, for a commentary, Harvey, 'Conduct during the Offer; Timing and Revision; and Restrictions Following Offers', in Button and Bolton (Eds.), *A Practitioner's Guide to the City Code on Takeovers and Mergers*, 1998 Edition, pp. 172 ff.
[66] See e.g. Stedman, *Takeovers*, 1993, pp. 395 ff.
[67] See para. 12 of the Law on takeover bids (*Übernahmegesetz*) of 1999.
[68] See rule 21 of the Irish Takeover Rules, 1997.
[69] See Article 104 of the Consolidated Financial Services Act.
[70] See Article 1822, Investment Securities Code (*Código dos valores mobiliàrios*).
[71] See Article 14, Royal Decree 1197, 26 July 1991, on the regulation of takeover bids.
[72] See Article 29, para. 2, Federal Act on Stock Exchanges and Securities Trading of 1995. Also in Belgium there is a rule of neutrality of the target's board; however, some defensive measures are permitted: see Articles 8, 14, 15, *Arreté Royal* concerning takeover bids of 1989.
[73] Hopt, *op. cit.*, note 64, para. I.1.c.
[74] See the draft law at www. Bundesfinanzministerium.de.
[75] *Ibidem*, para. I.1.c).

decide upon the pill's redemption under their responsibility of maximising value for the shareholders. The same holds for the generality of post-bid defences. In Europe, on the contrary, a preference has emerged for an allocation of powers to the shareholders' meeting, along with the British model.

The distance between the two legal systems in the present area is shown by the academic discussion concerning recent attempts made by shareholder activists in the U.S. to limit the power of the board through the adoption of by-laws requiring the directors to redeem the pill in certain circumstances[77]. The question has been asked, in this respect, whether shareholders have such power of initiative and, in order to answer positively, the need has been felt to develop a doctrinal analysis of the allocation of powers between the board and the shareholders, asking in particular "to what extent can shareholders give the board mandatory instructions through the medium of by-law amendments"[78]. On the other hand, these actions by American shareholders may show that even there a reallocation of powers between directors and shareholders could take place in the not too distant future[79].

However, also the British approach needs critical assessment, particularly from the shareholder voting perspective. The allocation of powers to the shareholders' meeting generates well known collective action problems, such as widespread shareholders' rational apathy and free riding[80]. These problems may be reduced by the presence of institutional investors in the company's capital and also by the fact that decisions on defensive strategies are apt to increase the shares' value in a short time, by determining an improvement of the bid terms. Therefore, even assuming a sceptical attitude towards institutional shareholders' activism, an exception should be made with reference to their participation to post-bid defences, in light of the short-term profits that such conduct might generate[81].

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[76] *Ibidem,* Para. I.2; see Article 3, COB Regulation No. 89-03 of 1989.

[77] See Macey, 'The Legality and Utility of the Shareholder Rights Bylaw' (1998) 26 Hofstra L. Rev. 835, pp. 861 ff.

[78] Coffee, 'The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?' (1997) 51 U. Miami L. Rev. 605, at 606.

[79] A preference for the British system is expressed by Bebchuk and Ferrel, 'Federalism and Corporate Law: the Race to Protect Managers from Takeovers' (1999) Col. L. Rev. 1168, at 1193, arguing that it is an example of "regulation that both addresses possible defects in the takeover process and ensures that shareholders, not management, have the ultimate say on whether a takeover proceeds".

[80] See Clark, *Corporate Law*, 1986, p.

[81] See Macey, 'Institutional Investors and Corporate Monitoring: A Demand Side Perspective in a Comparative View', in Hopt et al., *op. cit.*, p. 903, at pp. 916 ff.: institutional investors do not seem to be engaging in the continuous monitoring that demands active involvement; like other investors, they appear to rely on market forces, particularly on the market for corporate control.

A different problem is created by block-holders if they own a minority stake of the share capital sufficient to participate in the control of the target. If the private benefits of control are relatively high (as happens in countries where investor protection is not yet fully developed[82]), the target block-holders might resist the takeover for reasons other than shareholder value maximisation. The outcome (if the block-holders' vote prevails, also as a consequence of the other shareholders' apathy) could be similar to that obtained in the U.S. when managers resist a takeover mainly for entrenchment purposes.

Furthermore, the comparison between the American and the European legal systems shows a substantial diversity as to the range of defensive tools available. This appears to be an effect of the different characteristics of corporate law, which is more enabling in the U.S. and less concerned with creditors' protection than in Europe[83]. The 2nd European directive, for instance, severely restricts the repurchase of the company's own shares, thus narrowing the scope of buy-backs as defensive measures. The same directive provides for pre-emptive rights in the case of an increase of the company's capital, making it difficult for the target to allot shares to a friendly party in the event of a hostile bid[84]. As argued for the U.K. (but the comment could be extended to Europe in general), "it is clear that companies have relatively few defences available in the event of a hostile bid. Target companies are typically limited to financial announcements (such as updated dividends and profit forecasts); disposals or revaluations of assets; appeals to various regulators, or finding a white knight"[85].

The Difficult Path to a European Directive

The common position adopted by the Council on 19 June 2000 with a view to the adoption of a directive on takeover bids includes a "managerial passivity" rule clearly influenced by the City Code. Article 9 (1) (a) of the directive provides that the target's board of directors "should abstain from any action which may result in the frustration of the offer" unless authorised by the shareholders' general meeting. This rule closely resembles General Principle No. 7 of the City Code. Defensive measures are typically included in the concept of frustrating action. Article 9 (1) (a) refers to one in particular, identified as the "issuing of shares which may result in a lasting

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[82] See Zingales, 'The Value of the Voting Right: a Study of the Milan Stock Exchange' (1994) 7 Review of Financial Studies, 125.
[83] See Carney, 'The Political Economy of Competition for Corporate Charters' (1997) J. Leg St. 303, at 318 ff.
[84] See Davies, *op. cit.,* note 52, p. 206.

impediment to the offeror to obtain control over the offeree company". Clearly, this specification does not limit the scope of the rule, which is general in character and focuses on the key concept of "frustration" of the offer[86].

However, Article 9 is one of the directive's provisions which have encountered the criticism of the European Parliament in its second reading[87]. The legislative resolution adopted by the Parliament on the Council's common position amends Article 9 (1) (a) by adding two specifications. The first one refers to the time from which the passivity rule is applicable to the target company. The proposed wording is similar to that used by Rule 21 of the City Code, as it makes reference not only to the official information about the bid, but also to "the time when, by whatever means, the existence of a bid becomes known". The second amendment represents a significant departure from the British model, as it specifies that not only the prior authorisation of the target's general meeting, but also that of the "supervisory board (if any)" would justify a frustrating action by the target. This would introduce a discrimination between companies depending on whether they have either a one-tier or a two-tier governance system (which would generally depend on the applicable corporate law). However, it is submitted that there are no reasons to differentiate on the basis of the internal governance structure, as is also confirmed by the German draft law extending the duty of neutrality to the supervisory board[88]. The "managerial passivity" rule implies that only the target shareholders have the right incentives to decide upon the defensive measures proposed by the management; therefore, the supervisory board could not be a proper substitute for the general meeting[89].

The Parliament's legislative resolution amends Article 9 also by adding a new paragraph 2, which would allow the target's board to take different courses of action in some cases. Firstly, the supervisory authorities could "in conformity with national law, adopt guidelines as to the permissibility of any other defensive measures" (Article 9 (2) (a)). It appears that the supervisory authorities could (if allowed by national law) make exceptions to the general rule requiring prior

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85 Jenkinson and Mayer, *Hostile Takeovers.* Defence, Attack and Corporate Governance, 1994, p. 24.

86 See Clausen and Sørensen, 'The Regulation of Takeover Bids in Europe: the Impact of the Proposed 13th Company Law Directive on the Present Regulation in EU Member States' (1999) 1 ICCLJ 169, at 207.

87 See the European Parliament legislative resolution of the 13th December 2000 on the Council common position for adopting a directive of the European Parliament and of the Council on company law concerning takeover bids (8129/1/2000 – C5-0327/2000 – 1995/0341 (COD)), Prov. Ed. 298.924.

88 See Article 31 of the draft law on takeovers.

89 See Hopt, *op. cit.*, I.4.b), arguing that "even a qualified majority of the supervisory board cannot achieve the legitimacy of a general shareholder meeting".

authorisation of the general meeting. In addition, the Member States could grant the supervisory authorities powers to authorise or forbid the adoption of defensive measures by a company (Article 9 (2) (b))[90]. All this would place the regulators in an unprecedented role with respect to defensive measures. If the European Parliament's aim were to introduce rules closer to those applicable in the U.S.[91], the rules just mentioned would go in the wrong direction by substituting the courts for regulators[92].

It is difficult to see how the Council and the Parliament's positions in respect of frustrating actions can be reconciled and a directive adopted. No doubt, benefits to the debate may derive from recent studies analysing, also in the light of American theories and empirical works, the law and economics of takeovers in general and defensive measures in particular[93]. However, the risks inherent to any compromise in this area are substantial and may easily outweigh the benefits of legal harmonisation. Furthermore, if several options were left open to Member States (as proposed by the European Parliament), no harmonisation would be effected by the takeovers directive.

Defences versus Market Rules

The relevance of the comments made above with respect to the limited exportability of American defences varies according to whether the analysis is applied to Continental Europe or the U.K. In the Continent, both structural and technical barriers make takeovers difficult, so that the question of the target defence often does not arise. In the U.K., the ownership structure of many listed companies is similar to that prevailing in the U.S. and there is an active market for corporate control, thereby raising the question why defensive strategies are rarely used. An answer could also help to predict possible developments in Continental Europe, particularly if the number of diffuse ownership companies increases.

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90 Article 9 (2) (d) specifies, however, that the defensive measures authorised by the general meeting could not be forbidden by the competent supervisory authority.

91 As argued by Mr. Klaus-Heiner Lehne, Rapporteur to the Committee on Legal Affairs and the Internal Market of the European Parliament; see the Draft Recommendation for Second Reading on the Council common position, Provisional Edition 294.900, 17/20 (Explanatory Statement), where it is argued: "the obligation of the target company to refrain from taking action, proposed in Article 9 of the common position, diminishes the position of European companies compared with American companies".

92 It is not enough to state (as done by the new Article 9 (2) (c)) that holders of securities may also have recourse to the courts with respect to defensive measures.

93 See, for opposing views, Kirchner and Painter, 'Towards a European Modified Business Judgement Rule for Takeover Law' (2000) 1 EBOR 353; Mülbert and Birke, 'In Defense of Passivity – on the Proper Role of a Target's Management in Response to a Hostile Tender Offer' (2000) 1 EBOR 445.

The limited use of takeover defences in the U.K. is due not only to technical difficulties created by company law (mainly as a reflection of the European directives), but also to the influence of institutional investors who oppose the use of excessive discretion by the managers. Moreover, the City Code on Takeovers and Mergers contains rules which can be regarded as substitutes for American defences from the viewpoint of shareholder value enhancement. Firstly, Rule 10 of the City Code provides: "It must be a condition of any offer for voting equity share capital which, if accepted in full, would result in the offeror holding shares carrying over 50% of the voting rights of the offeree company that the offer will not become or be declared unconditional as to acceptances unless the offeror has acquired or agreed to acquire (either pursuant to the offer or otherwise) shares carrying over 50% of the voting rights ...". The rationale for this rule is to exercise pressure on the bid's price, as the supply curve is upward-sloping, i.e. "the supply of shares is increasing in the bid price"[94]. As empirical evidence seems to indicate, "the number of shares supplied in a tender offer indeed increases with the bid premium"[95]. Therefore, Rule 10 qualifies the requirement for a total offer, as not only should a bid concern all the target's shares (as shown, a contrario, by Rule 36 on partial bids[96]), but the bidder should offer a price sufficient to obtain the majority of the voting rights.

Secondly, Rule 31.4 provides: "After an offer has become or is declared unconditional as to acceptances, the offer must remain open for acceptances for not less than 14 days after the date on which it would otherwise have expired ...". The rationale for this rule seems to be to avoid the pressure to tender typical of takeover bids[97]. Those who are willing to accept shall tender their shares before the bid's expiry; the others can wait, as they shall benefit from an extension of the bid's term if the same becomes unconditional as to acceptances. As argued by Bebchuk, "the requirement turns the 'first round' into the equivalent of an approval vote, because a shareholder's decision whether to tender in that round matters only in the event that his decision proves pivotal for the bid's fate. To express a preference for the bid's success, a shareholder has to tender his

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94 Burkart, Gromb and Panunzi, op. cit., note 50, at 181.
95 *Ibidem*, 182, citing Hirschleifer, "Mergers and Acquisitions: Strategic and Informational Issues", in Jarrow, Maksimovik and Ziemba (Eds.), *Handbook in Operations Research and Management Science*, 1995.
96 Rule 36.1 states: "The Panel's consent is required for any partial offer. In the case of an offer which could not result in the offeror holding shares carrying 30% or more of the voting rights of a company, consent will normally be granted".
97 See Bebchuk, *op. cit.*, note 48, at 1797.

shares in the first round; to express a preference for the bid's failure, he has to hold out in that round"[98].

Thirdly, Rule 36.5 (concerning "partial offers") states: "Any offer which could result in the offeror holding shares carrying 30% or more of the voting rights of a company must normally be conditional, not only on the specified number of acceptances being received, but also on approval of the offer, normally signified by means of a separate box on the form of acceptance, being given by shareholders holding over 50% of the voting rights not held by the offeror and persons acting in concert with it...". This rule appears to address and attempt to solve the "prisoner's dilemma" facing target shareholders, who should otherwise accept a sub-optimal price or take the risk of being left in a minority position (if the bid succeeds)[99].

Policy Implications

On the whole, the City Code aims at enhancing shareholder value through market rules which may function as substitutes for defensive measures. These rules either make an upward pressure on the bid's price or lower the target shareholders' pressure to tender and solve these shareholders' co-ordination problems. In the absence of empirical evidence, it is difficult to say whether these rules are preferable to U.S. defensive tactics from the viewpoint of target shareholders. However, considering that the structure of European corporate law hinders a wide diffusion of American style defences in E.U. Member States, the U.K. approach deserves careful consideration. In addition, this approach is supported by institutional investors, whose role in listed companies is increasing and reduces the risk of managers' entrenchment by limiting their discretion in the planning of defensive strategies. It also eliminates the collective action problems created by the required approval of takeover defences on the part of the shareholders' meeting.

To the extent that defences are admitted, the rule providing that post-bid defences should be authorised by the shareholder meeting appears to be preferable, despite the shareholders' collective action problems, to a rule leaving wide discretion to the board of directors. As argued above, the target directors are in a potential conflict of interest, whereas the target shareholders have the right incentives to decide on resistance, save for the case of blockholders who may try to protect their interests as controllers instead of maximising total shareholder value.

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[98] *Ibidem*, at 1798, who adds: "The problem is that expressing a preference for the bid's success might involve extra transaction costs in comparison to expressing a preference for the bid's failure".

IV. What Price for Mandatory Bids?

The mandatory bid rule (MBR) appears to be controversial from a law and economics perspective. Its rationale has been debated and its efficiency effects proven to be limited. As a consequence, a trend is emerging in legislation directed at improving the impact of the mandatory bid on corporate control transfers. In this part, I assess briefly these new trends in the light of the general discussion concerning the MBR.

Economic Analysis

Efforts to justify the MBR have been made on three main grounds: (i) principle of equal treatment; (ii) sharing of the control's premium amongst all shareholders; (iii) protection of minorities in case of an undesirable control transfer[100]. Each of these arguments has encountered serious objections. The shareholders' (or investors') equal treatment would not by itself justify an extension of the purchase offer to the non-controlling shareholders[101]. The sharing of the control's premium would increase the cost of acquisitions to the bidders and exclude a number of efficient transfers of control[102]. The protection of minorities could be obtained through different rules, specifically directed to reduce the controllers' "private benefits"[103].

The second objection has caused the greatest concern in the Continent of Europe. Even conceding that the MBR (as formulated in the *City Code*) is theoretically consistent with the equal treatment of investors' principle[104] and that the protection of minorities is weaker in Europe than in

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99 *Ibidem*, 1800 f., arguing however that "the problems posed by partial bids and bids for all shares are essentially the same".
100 For a critical and comparative perspective, see Skog, 'Does Sweden Need a Mandatory Bid Rule? A Critical Analysis', Corporate Governance Forum, 1995 (for an Italian translation of the paper see (1995) Rivista delle Società 967); Wymeersch, 'The Mandatory Bid: A Critical View', in Hopt and Wymeersch (Eds.), *European Takeovers.* Law and Practice, London 1992, p. 351.
101 *Ibidem*, p. 1004 ff.
102 See Bebchuk, 'Efficient and Inefficient Sales of Corporate Control' (1994) 109 Quarterly Journal of Economics 957, comparing the "market rule" (minority shareholders enjoy no rights in connection with a sale-of-control transaction) with the "equal opportunity rule" (minority shareholders are entitled to participate in the transaction on the same terms as the controlling seller) and arguing that "under the EOR, transfers that make minority shareholders worse off cannot take place, and consequently inefficient transfers will never occur. At the same time, however, the EOR is inferior to the MR in terms of facilitating efficient transfers: the former prevents a wider range of such tranfers than the latter" (at 960).
103 See Pagano, Panunzi and Zingales, *op. cit.*, note 8, p. 156.
104 See Hopt, 'European Takeover Regulation: Barriers to the Problems of Organising Takeover Law in the European Community', in Hopt and Wymeersch, *op. cit*, note 100, p. 165, at p. 179.

the U.S. so as to justify the adoption of an MBR, the concentration of corporate ownership in Continental Europe would suggest caution when importing the *City Code* model. As stated in view of recent legislative reform in Italy, the protection of investors against undesirable control transfers should cause the smallest possible damage to "control mobility"[105]. This can be done by mitigating the MBR with reference to one or more of its elements: the bid's price, the relevant threshold (30 per cent or more of the voting capital) and the quantity of shares to be purchased.

Legislative Trends

MBRs in Continental Europe are, in fact, diversified and often try to adapt the concept of the mandatory bid to local conditions and needs. The various drafts of the E.C. directive also reflect the Member States majority's concern that mandatory bids might be excessively burdensome and deter efficient transfers of control in too many cases. Whereas the 1990 draft included an MBR of the U.K. type[106], subsequent versions have mitigated this position. The 1996 proposal provided that mandatory bids shall "be launched to all shareholders for all or for a substantial part of their holdings at a price which meets the objective of protecting their interests" (Article 10 (1)). The Explanatory Memorandum commented that "there were serious objections to the imposition of the full mandatory bid on all Member States. The requirement for a full mandatory bid was criticised as a burden on business which would undermine market mechanisms and be liable to upset the financial markets". The common position on the takeovers directive excluded this possibility and reformulated the MBR by stating : "The bid shall be addressed to all holders of securities for all their holdings at an equitable price" (Article 5 (1)). The "equitable price" concept is not defined, but appears to respond to the request of a milder treatment for mandatory bids. However, the European Parliament has adopted an amendment defining this concept in adherence to the City Code, as "the highest price paid by the offeror on a regulated market ... in the twelve months preceding disclosure of the bid" (Amendment 8)[107].

In reality, the "equitable price" requirement in the common position seems to be a reflection of national rules, both outside and inside the E.U. The Swiss Stock Exchange Act of 1995, for instance, includes an MBR stating that "the price offered shall be at least as high as the stock exchange price and shall not be lower than 25 per cent of the highest price paid by the offeror for equity securities of the offeree company in the preceding 12 months" (Article 32 (4)). The practical

[105] See Pagano, Panunzi and Zingales, *op. cit.*, note 8, p. 157.
[106] See Hopt, *op. cit.*, note 104, p. 178.
[107] See the legislative resolution cited at note 87.

effect of this rule, in most cases, will be to allow the bid to be made at a discount with respect to the price paid for the acquisition of the controlling block. Similarly, the Austrian Takeover Law of 1999 provides that the bid price should be at least equal to the average stock exchange price in the six months prior to the controlling block's purchase, but lower than any price paid by the bidder for that purchase in the 12 previous months, discounted by 15 per cent (§ 26 (1))[108]. The Italian Consolidated Financial Services Act of 1998 also provides for a mandatory bid's price to be lower than the highest price paid by the bidder for the acquisition of control. Article 106 (2) of this Act states: "The offer is launched within 30 days at a price not lower than the arithmetic average between the average market price of the last 12 months and the highest price paid by the bidder in the same period of time for the purchase of voting shares".

Policy Implications

The economic studies on the MBR are of limited use if the mandatory bid's price is different under the rules just analysed. Presumably, a lower number of efficient control transfers will be deterred by these rules, but a higher number of inefficient transfers will be allowed if the bid's price is lower than that paid for the controlling block[109]. In any event, legislators will find it difficult to assess the impact of rules which mitigate the U.K. approach with respect to either the price or the threshold relevant for the mandatory bid to apply. In addition, criteria making reference to the market as a basis for the bid's price will give rise to strategic behaviour by the bidders, who will time their transactions so as to obtain the least favourable conditions for investors. Moreover, the above examined rules might present difficulties of implementation and will determine different outcomes depending on market conditions[110]. This may be perceived as unfair by the investors in cases where the bid's price is inadequate to grant them a real "exit" from the company.

V. Conclusions

In this paper, I considered, first of all, the impact of large shareholdings disclosure on the market for corporate control, showing that the bidders' incentives are reduced by mandatory shareholdings disclosure and the number of takeovers might decrease as a result. Therefore, a policy

[108] See Bydlinski and Winner, 'Das neue Übernahmegesetz . Ein Überblick über die materiell-rechtlichen Bestimmungen' (1998) ÖBA 913.

[109] This may be derived by implication from Bebchuk, *op. cit.*, note 102.

[110] See Macchiati and Siciliano, 'Gli Effetti Economici dell'Offerta Obbligatoria Successiva' (1999) Politica Economica 169, at 182-183.

maker should fix the shareholdings' threshold and the delay for disclosure by taking into account the need for both transparency and corporate control contestability. If ownership is concentrated as a result of controlling coalitions, there may be a greater incentive to make corporate control contestable.

I then examined the technical barriers which have been expressly regulated by national rules on account of their anti-takeover purpose and tried to assess the same from a policy viewpoint. I concluded that they have a limited impact on the contestability of corporate control. Firstly, their practical effect might simply be to re-orient defensive actions towards different techniques. Secondly, regulation could hardly cover all takeover barriers. For structures like corporate groups it is very difficult to ascertain whether they are being used mainly to shelter the target from takeovers or to enhance organisational efficiency. In addition, if takeover barriers were entirely prohibited to listed companies, the controllers might choose to keep their companies private and society as a whole would lose.

I subsequently considered U.S. takeover defences, asking whether and to what extent they should be admitted in Europe. I examined both pre-bid and post-bid defences and compared the different treatment applicable to them under U.S. and E.U. law. I concluded that, to the extent that defences are admitted, the rule providing that post-bid defences should be authorised by the shareholders' meeting appears to be preferable, despite the shareholders' collective action problems, to a rule leaving wide discretion to the board of directors. I also argued that market rules, such as those included in the *City Code*, may function as substitutes for defensive measures as to shareholder value enhancement. Considering that the structure of European corporate law hinders a wide diffusion of American style defences in E.U. Member States, the U.K. approach deserves careful consideration.

In the last part, I analysed the mandatory bid rule (MBR) from a law and economics perspective. This rule's rationale has been debated and its efficiency effects proven to be limited. A trend is emerging in legislation directed to mitigate the impact of mandatory bids on transfers of corporate control. I examined this trend and concluded that the economic studies on the MBR are of limited use if the mandatory bid's price is lower than that paid by the bidder for the acquisition of control. Presumably, a lower number of efficient transfers of control will be deterred by these rules, but a higher number of inefficient transfers will be allowed if the bid's price is lower than that paid for the controlling block. In addition, criteria making reference to the market as a basis for the bid's price will give rise to strategic behaviour by the bidders and determine different outcomes depending on market conditions. This may be perceived as unfair by the investors who might be deprived of a real "exit" from the company.