A Legal and Economic Assessment of European Takeover Regulation

Christophe Clerc • Fabrice Demarigny

Diego Valiante • Mirzha de Manuel Aramendía

MARCCUS PARTNERS
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CENTRE FOR EUROPEAN POLICY STUDIES

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Centre for European Policy Studies
European Capital Markets Institute
Place du Congrès 1, B-1000 Brussels, Belgium
Tel.: +32 (0) 2 229 39 11 • Fax: +32 (0) 2 219 41 51
www.ceps.eu • www.eurocapitalmarkets.org

Marccus Partners – Mazars
61 rue Henri Regnault, 92075 Paris, France
Tel.: +33 (0) 1 49 97 60 00 • Fax: +33 (0) 1 49 97 60 01
www.mazars.com • www.marccuspartners.com
Pinsent Masons LLP – Paris
23 rue Balzac, 75008 Paris, France
Tel.: +33 (0) 1 53 53 02 80 • Fax: +33 (0) 1 53 53 02 81
www.pinsentmasons.com

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EXECUTIVE SUMMARY

Directive 2004/25/EC on takeover bids (the 'Takeover Bids Directive' or the 'Directive') sets out minimum rules for the conduct of takeover bids involving shares admitted to trading on a regulated market established in the European Union. It also seeks to provide an adequate level of protection for shareholders throughout the Union by establishing a framework of common principles and general requirements that member states must transpose by means of more detailed rules in accordance with their national systems and cultural contexts.[1]

Art. 20 of the Directive provides that five years after the transposition deadline, the European Commission shall examine the Directive "in the light of the experience acquired in applying it and, if necessary, propose its revision".

In the framework of this examination, the European Commission decided to appoint an external adviser to produce a study assessing the functioning of the Directive from a legal and economic perspective. The legal review was conducted by Marccus Partners under the supervision of Christophe Clerc (now managing director of the Paris office of Pinsent Masons LLP) and Fabrice Demarigny (Chairman of Marccus Partners and Head of Capital Markets at Mazars). The economic study was carried out by the European Capital Markets Institute (ECMI), within the Centre for European Policy Studies (CEPS) in Brussels, under the supervision of Diego Valiante (Coordinator and Fellow) and Mirzha de Manuel (Researcher).

This book is an abridged version with additional commentary to the original study prepared for the European Commission.[2] It is structured in two separate parts: i) a legal review and ii) an economic analysis.

The legal review considers a sample of twenty-two member states, representing 99% of the EU's total market capitalisation, while comparing the EU legal framework with those of nine major countries abroad.[3] It also builds

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[1] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142/12, 30.4.2004. The full text of the Directive can be found on the website of EUR-Lex (http://eurlex.europa.eu/en/index.htm).

[2] The (original and unabridged) study by Marccus Partners and CEPS (2012) is available on the website of the European Commission (http://ec.europa.eu/internal_market/company/takeoverbids/index_en.htm).

[3] The following EU member states are part of the sample: Austria, Belgium, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary,

on the results of a perception survey conducted within a broad sample of stakeholders, including supervisors, stock exchanges, issuers, employee representatives, associations, investors and intermediaries.[4]

The legal review finds that the Directive introduced no radical changes but improved the coherence of the regulatory framework for takeovers in Europe. The study monitors the implementation of the Directive in the sample member states, with particular attention to those provisions exhibiting an element of optionality – namely, Art. 9 on board neutrality and Art. 11 on the breakthrough rule.

The legal review discusses the position of the Directive *vis-à-vis* the two main corporate governance systems – shareholder-oriented (including the 'shareholders' primacy' system) and stakeholder-oriented (including the 'team production' system). It concludes that the Directive has taken a balanced view that aims at protecting offerors, shareholders of offeree companies, offeree companies and their employees. Thus, it has not adopted a single approach to company defences, which remain largely subject to national laws. The Directive has harmonised EU laws on a number of significant issues, however, including mandatory bids, information, squeeze-outs and sell-outs. This has been done efficiently, although there is room for clarification of some issues, such as the available exemptions to mandatory bids. According to the survey conducted within the study, most stakeholders have expressed general satisfaction with the Directive, with the exception of employee representatives.

The economic study surveys the main academic literature on takeovers bids and puts forward a theoretical framework and an empirical analysis of the information asymmetries and incentives driving the behaviour of offerors, offerees and other stakeholders.[5] From this perspective it discusses the economic rationale for takeover regulation and the economic impact of the Directive. It identifies and appraises market failures, including coordination problems (free-riding, pressures-to-tender), agency costs and incentives related

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Ireland, Italy, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden and the UK. Selected third countries are Australia, Canada, China, Hong Kong, India, Japan, Russia, Switzerland and the US.

[4] The perception study should be interpreted with some caution. As fewer takeover bids have been launched since 2008, the experience of the various players may be limited, particularly in some of the smaller EU member states. In addition, a number of stakeholders are unlikely to be aware of whether the source of any particular regulation is the Directive itself or national measures.

[5] The empirical analysis is based on a rich dataset kindly provided by Thomson Reuters SDC Platinum, available at http://thomsonreuters.com/.

to firm-specific investments. The study evaluates the Directive in its different components and finds that similar takeover rules have different effects depending on country-level and company-level characteristics – in particular ownership and control concentration. It further elaborates on the trade-offs affecting takeover regulation and the balance between individual short-term interests and the long-term interests of stakeholders.

The empirical analysis finds that the Directive had a marginal impact on the market for corporate control, in line with the legal review and given the financial crisis. The analysis also provides early evidence of a negative impact on incentives to launch a competing offer, as the Directive seems to have increased takeover costs.

The economic study also considers the effects of the Directive on growth and competitiveness and employment, based on the Global Competitiveness Index of the World Economic Forum and employment data from the European Monitoring Centre on Change, respectively. In these respects, the impacts appear to be limited but broadly consistent with the 'Europe 2020' agenda.

Following the publication of the study, the European Commission delivered a report to the European Parliament and the Council (the 'Commission Report'), notably calling for i) a clarification of the concept of 'acting in concert'; ii) a review of the numerous national derogations to the mandatory bid rule, including in particular the exemption for situations where control has been acquired following a voluntary bid for all shares of the company; and iii) further dialogue with employee` representatives with a view to exploring possible future improvements to the rights of employees in takeover situations.[6] The Commission Report does not, however, propose to make compulsory the optional articles of the Directive.

To date, no legislative procedure has been initiated to review the Directive. This study nonetheless constitutes a useful reference on takeover regulation in the European Union and in an international context, with a comprehensive assessment from a legal and economic perspective.

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[6] The Commission Report, *Application of Directive 2004/25/EC on takeover bids*, COM(2012) 347 final, Brussels (2012), is available on the Commission's website (http://ec.europa.eu/internal_market/company/takeoverbids/index_en.htm).

PART I
LEGAL ANALYSIS AND SURVEY

1. INTRODUCTION

1.1 History and adoption of the Directive

First steps. The Commission presented the first proposal for a directive regulating takeover bids to the Council in 1989. This proposal called for far-reaching harmonisation in the field, an approach that was inspired by the favourable economic climate of the time. The proposal encountered significant opposition from EU member states, in particular in relation to i) the mandatory bid rule, and ii) the limitation of defensive measures. The Commission presented a second proposal containing less detailed provisions to the Council and the European Parliament in 1996.

Initial rejection. A compromise text was negotiated in a conciliation procedure between the European Parliament and the Council, but the European Parliament finally rejected the proposal in July 2001, as an equal number of votes had been cast against and in favour of it. The vote was mainly motivated by concerns related to i) the board neutrality rule (which provides that the board should seek shareholder approval before taking defensive actions), and ii) insufficient protection of employees.

Adoption. Following the rejection of the proposal, the Commission set up a group of high-level business law experts who were tasked with resolving the issues raised by the European Parliament. A third proposal was introduced on 2 October 2002. After a compromise was reached (the so-called 'Portuguese compromise', see Box 1), the Directive was adopted on 2 April 2004 and member states were required to transpose the Directive by 20 May 2006.

Box 1. The Portuguese compromise

In the years of negotiation that preceded the adoption of the Directive, one of the most controversial proposed aspects of the Directive was whether to adopt the board neutrality rule (Art. 9 of the Directive) and the breakthrough rule (Art. 11 of the Directive). These provisions were controversial because they crystallise oppositions on the value of facilitating and frustrating takeovers. For the Directive to be enacted, the member states eventually agreed to a compromise suggested by Portugal, in late 2003. The compromise made was essentially to make Arts. 9 and 11 of the Directive optional. That is, member states could opt out of transposing the board neutrality or breakthrough rule, or both, but they could not prevent individual companies from voluntarily opting in to the rules.

> This compromise made Arts. 9 and 11 of the Directive options for which there are two levels of possible adoption: at the national level, and then at the company level. Even if the breakthrough or board neutrality rule is adopted at the national or company level, the Portuguese compromise further introduced a third option: reciprocity. If a member state allowed for reciprocity, even if one or both of the opt-in rules is adopted, a company still has the option not to apply the rule when faced with an offeror who has not adopted the same rule.

1.2 The study

Scope and definitions. The study focuses on 22 member states (the 'sample countries'), which are Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Sweden and the UK. The sample countries represent 99% of the total EU market capitalisation. Out of these sample countries, France, Germany, Italy, Spain and the UK are referred to as 'main EU jurisdictions' and Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovakia and Sweden are referred to as 'other EU jurisdictions'. The study also proceeds with a comparison of the Directive's legal framework with nine major non-EU countries (the 'major non-EU jurisdictions'), which are Australia, Canada, China, Hong Kong, India, Japan, Russia, Switzerland and the US.

Perception study. In addition, a perception study has been conducted with a sample of stakeholders (the 'sample stakeholders') including supervisors, stock exchanges, issuers, employee representatives, other stakeholder associations and investors and intermediaries. Within this last category, a distinction can be made between retail investors, financial intermediaries and institutional investors. The perception study included questionnaires and interviews.

Limits to the perception study. The perception study should be interpreted with some caution. As fewer takeover bids have been launched since 2008, the experience of the various players may be limited, in particular in some of the other EU jurisdictions. In addition, a number of stakeholders of the Directive are likely to provide only limited views on the Directive for two reasons. The first is that they may not have been involved in a significant number of takeovers subject to the Directive and are likely to have considered the takeover only from the perspective of either the offeror or the offeree. The second is that they are unlikely to be aware of whether the source of any particular regulation is the Directive itself or national measures (either to transpose the Directive or which existed before the Directive was transposed).

Review of the legal regimes. In each EU sample country and major non-EU jurisdiction, a law firm was selected to provide a review of the corresponding legal regime (Table 1). We would again like to thank all of these laws firms for their joint efforts in contributing to this study.

Table 1. Law firms selected to review legal regimes, by country

Country	Firm
EU countries	
Austria	Wolf Theiss
Belgium	Eubelius
Cyprus	Papaphilippou
Czech Republic	Wolf Theiss
Denmark	Accura
Estonia	Raidla Lejins & Norcous
Finland	Roschier
France	Marccus Partners
Germany	Marccus Partners
Greece	Karatzas & Partners
Hungary	Wolf Theiss
Ireland	Arthur Cox
Italy	Pavia e Ansaldo
Luxembourg	PH Conac
Netherlands	Houthoff Buruma
Poland	Siemiatkowski & Davies
Portugal	F Castelo Branco & Associados
Romania	Wolf Theiss
Slovakia	Wolf Theiss
Spain	Gómez-Acebo & Pombo
Sweden	Setterwalls
UK	Reynolds Porter Chamberlain LLP
Non-EU countries	
Australia	Freehills
Canada	Miller Thomson
China	HHP
Hong Kong	Cheng Wong Lam & Partners
India	JSA Associates
Japan	Nagashima Ohno & Tsunematsu
Russia	Sameta Tax & Legal Consulting
Switzerland	Homburger
US	McCarter & English

Source: Authors.

1.3 The report from the Commission

Following the publication of the study, the European Commission delivered its report (*Application of Directive 2004/25/EC on takeover bids*, European Commission (2012), hereinafter the 'Commission Report').

The Commission Report, after review of the study, calls for

- a clarification of the concept of 'acting in concert';
- a review of the numerous national derogations to the mandatory bid rule, including in particular the exemption applying to situations where control has been acquired following a voluntary bid for all shares of the company; and
- further dialogue with employee representatives with a view to exploring possible future improvements to the rights of employees in takeover situations.

The Commission Report does not propose to make compulsory the optional articles of the Directive (i.e. Art. 9 on board neutrality and Art. 11 on the breakthrough rule).

1.4 Twelve key results

1) The Directive has been transposed in all sample countries and no substantial compliance issue has emerged, except in a limited number of other EU jurisdictions or for a limited set of specific issues.
2) The transposition of the Directive has not led to major changes. Regarding the legal framework in each member state, this is due to three factors: in a number of countries, the Directive prescribed rules that had been in existence for a long time (e.g. in the UK); in other countries, changes were introduced in view of the future adoption of the Directive (e.g. in Germany); and in several cases, the most important changes were introduced in reaction to sensitive bids or the economic situation, without there being a direct link with the Directive (e.g. Italy or Hungary). Regarding the impact of the Directive on the frequency and structure of bids, the 2008 crisis has rendered meaningful comparisons almost impossible.
3) The Directive has, however, led to improvements (in view of its objectives) that should not be underestimated: coordination in relation to cross-border bids; general principles; disclosure; the mandatory bid rule; squeeze-out and sell-out rules. A mapping of changes that were

introduced after the transposition of the Directive, or in view of its adoption, show that the legal system is more 'shareholder-oriented'[7] as a result.

4) The debates that led to the optionality of Arts. 9 and 11 of the Directive have not faded away. There is no clear consensus on how to move on the optionality and reciprocity issues and generally speaking, there seems to be little appetite to change these rules. This appears to be stem from two factors: at the national level, there seems to be both fear that there is more to lose than to gain as a result of a possible change (this being true for the main EU jurisdictions, notably the UK and Germany) and a need to absorb new EU rules (for other EU jurisdictions for which the transposition has led to significant changes); at the level of issuers along with investors and intermediaries, the feelings regarding defences are balanced. First, such defences are perceived as a way to increase bid prices, but also as creating an increased risk that bids will fail. Second, there is a general feeling that there are not many possibilities for board defences and sufficient abilities to break through existing defences. Regarding other barriers to takeovers, which are not addressed by the Directive, such as pyramid structures and cross-shareholdings, there is both a general desire to remove undue obstacles to bids and also a question as to whether any measures in this respect would be efficient and not counter-productive. Regarding other barriers, such as those that may be derived from the uses of control-enhancing mechanisms, there is no evidence that the conclusions reached in the 'One Share–One Vote'[8] study commissioned by the European Commission in 2007 should be changed.

5) Legal and economic analysis shows the intrinsic contradiction between the mandatory bid rule, which acts as an anti-takeover device, and the board neutrality rule, breakthrough and squeeze-out rules, the purposes of which are to facilitate bids. From a legal standpoint, the contradictions may be reconciled if the Directive is viewed as intending to facilitate bids (through the board neutrality and breakthrough rules) while protecting the interests of minority shareholders (through the mandatory bid and the sell-out rules).

[7] Yet whether a system is more or less 'shareholder-oriented' is subject to debate.

[8] The study, by Shearman & Sterling et al. (2007), can be downloaded from the European Commission's website (http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf).

6) Economic analysis shows that there is no clear evidence that the Directive promotes economic efficiency. From a theoretical standpoint, free movement of capital is an element of overall economic efficiency, under the conditions of rational behaviour, fully informed agents and absence of transaction costs; however, these conditions are not always met (e.g. acquisitions may be made for empire-building purposes, shareholders are subject to the contradictory forces of free-riding propensity and pressure-to-tender coercion, information may be missing and transaction costs may be high for dispersed shareholders) and acquisitions come with negative externalities (e.g. they create a disincentive for firm-specific investment in human capital). As a result, from an empirical standpoint, the evidence in the literature is mixed. Takeovers can both increase or decrease shareholder value.

7) 'Corporate governance' analysis shows that the Directive is based on two different views of corporations: shareholder- or stakeholder-oriented. This contradiction is summarised in the general principle set forth in Art. 3.1(c) of the Directive, which states that "an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid".

8) Comparative analysis shows that three systems of corporate governance co-exist and affect capital markets: a management-oriented system (such as in the US), a shareholder-oriented system (such as in the UK) and a blockholder-oriented system (such as in Continental Europe). Each system should be assessed in light of its specificities regarding shareholder structures (dispersed versus concentrated), legal framework (protection of minority shareholders, employees and other stakeholders and general corporate law regarding fiduciary duties and corporate interest) and financial status (mature financial markets versus emerging markets). Only a comprehensive analysis may prevent the pitfalls of insufficiently tailored legal transplants.

9) Overall, there is a reasonable level of satisfaction among stakeholders regarding the Directive: a majority of them considers it clear; enforcement is not generally considered an issue; the allocation of competences between supervisors has not raised practical issues; the protection of minority shareholders is seen as having been enhanced by the Directive; the disclosure regime is not contested and seems to be essentially complied with; and the mandatory bid, squeeze-out and sell-out regimes are, in substance, approved.

10) One category of stakeholders, the employees, is not satisfied with the Directive. They generally view takeovers as creating high risks of lay-offs and voluntary retirements at the level of the purchased company, an

assessment that is shared by issuers and investors and intermediaries. They see risks regarding working conditions and early retirements and consider that the risks also exist at the level of the acquirer (an analysis that is generally not shared by other stakeholders). In addition, they consider that the consultation process is not organised in a satisfactory manner and regret the absence of appropriate enforcement mechanisms when offerors do not act in compliance with the intentions they stated during the bid period.

11) The mandatory bid rule is perceived as effective, although there is some debate regarding some of the (numerous) exemptions that exist, e.g. exemptions for shareholders who act in concert without acquiring shares, exemptions regarding certain corporate transactions (such as capital increases) or benefiting certain entities (such as foundations). Stakeholders do not perceive any significant issue regarding the exemption for companies in financial distress, which is frequently used. Price adjustment, although possible, seems to be rare in practice. The frustrations seem to come from three areas: the definition of acting in concert (viewed as potentially too broad by institutional investors), the use of cash-settled derivatives to build up an interest in connection with a takeover bid, and the propensity to try to obtain de facto control through an interest remaining just below the threshold that triggers a mandatory bid (e.g. a 29.9% interest). Some concern has also been raised in connection with voluntary bids launched at a low price in order to get slightly above the triggering threshold (e.g. 30%), which allows the offeror to increase its stake in a second step without triggering a mandatory bid.

12) The squeeze-out and sell-out rules are generally approved. The former is frequently used while the latter seems a rare occurrence. The 90% and 95% thresholds are generally accepted, with a preference for the former, in particular since a popular strategy with speculative investors seems to be to acquire a 5% (or 10%) interest to block the squeeze-out and attempt to negotiate a higher price with the offeror. Nevertheless, solutions exist to limit this risk (such as the German 'top-up' rule). The risk may also be avoided by facilitating alternative means of acquiring 100% control for cash (such as cash-out mergers or schemes of arrangement).

1.5 Eight key proposals[9]

Although there are some causes for satisfaction with the Directive, this does not mean that some improvements are not desirable. The question is which types of improvements? Considering the diversity of objectives of the Directive and the huge disparity in the status of capital markets and shareholding structures among member states, some choices need to be made. The potential objectives may be listed as follows (with the caveat that various combinations among these items are possible): i) increase overall harmonisation; ii) facilitate bids; iii) support integration of EU companies; iv) mandate complete neutrality; v) integrate shareholder primacy and stakeholder paradigms in a new set of rules; vi) harmonise key technical items of the Directive; vii) enhance disclosure requirements; and viii) improve employee rights.

1) The best way to improve overall harmonisation would be to give the European Securities and Markets Authority (ESMA) a coordination role in the transposition of the Directive. Considering that cross-border bids are frequent and are likely to happen more and more often, general coordination by ESMA would make sense. Yet it must be noted that this option was recently considered and rejected at the time ESMA was set up. An alternative option is to increase the powers of the group of contacts existing among supervisors.

2) If the main objective is to facilitate bids, one way would be to mandate the board neutrality rule and/or breakthrough rule (with, as an option to this rule, the possibility to set neutrality as a default option with the right for companies to opt in, as is the case in Italy). This option, however, is likely to revive the 2001 debates, the premises of which have not materially changed. Another option would be to relax the mandatory bid regime. In countries with significant blockholders, the obligation to share the control premium with all minority shareholders may have a significant price impact and thus reduce the number of value-enhancing transactions. There are a number of reforms that may be structured, some of which may have significant positive effects on the reductions of the level of undue private benefits of control. It is true that the mandatory bid rule is now well rooted in EU law; it should nonetheless be noted that this has some typical features of a debatable legal transplant and, furthermore, it does not exist in the US.

[9] This subsection is not part of the report delivered to the European Commission. Please refer to chapter 9, where the potential reforms outlined here are discussed in more depth.

3) Supporting the build-up of EU companies while keeping a level playing field with non-EU companies could be achieved through an amendment to the reciprocity exception, which could be mandated for transactions with non-EU companies and removed for intra-EU bids. Another option is to remove the reciprocity exception altogether, but this would lead to debate regarding the fairness of the systems as well as 'social control gap' issues.
4) Mandating complete neutrality during bids is another option. 'Complete neutrality' differs from the current neutrality rule, as it would remove both pro-bid and anti-bid incentives for board members.
5) As takeover bids are the centre of debates between proponents of the 'shareholder primacy' theory and 'team production' supporters, an alternative mechanism could be proposed, revolving around the choice of shareholders acting in general meetings. This would combine an individual decision of shareholders with a collective process, including a potential auction procedure, the management of counter proposals (if any) and an open debate.
6) Harmonising key technical items of the Directive could achieve better functioning without major changes. Reforms could include such items as the definition of control, some presumptions regarding acting in concert and propositions regarding exemptions to the mandatory bid rule. The reform could include enhanced protection for minority shareholders (through an extension of the equality principle) and the offeree company (through reduction of the disturbance of the company with a harmonised 'put up or shut up' rule).
7) There is strong support among investors and intermediaries for an enhanced disclosure regime. A number of proposals may be made in this respect.
8) As employees constitute the very basis on which company value is built, it seems appropriate to review the bundle of rights that they have received pursuant to the Directive. Some proposals may be made regarding the right to be consulted (instead of being informed), the costs they incur while preparing their opinion, their relationship with the offeror and the review of the commitments made in connection with the bid. In addition, appropriate sanctions should be provided, considering the high level of disregard for employee protection, and an extension to takeover bids of the provisions contained in Directive 2001/23/EC on transfers of undertakings could be contemplated.

2. STATUS AND QUALITY OF TRANSPOSITION

This chapter addresses in particular the following questions:

- What are the objectives of the Directive?
- Has the Directive reached its objectives?

Key concepts

- The Directive has been fully transposed.
- A precise analysis of the content of the Directive leads to a balanced conclusion regarding its objectives.
- Significant progress has been achieved with respect to harmonisation, in particular on process (supervision of cross-border bids) and substance (mandatory bids, squeeze-outs and sell-outs).
- The overall effect of the Directive, although difficult to measure precisely, seems to be in line with its original intent. Still, a more detailed analysis (developed below) is necessary to assess its impact in comparison with its objectives.

2.1 Status of transposition

Transposition is complete. All sample countries have transposed the Directive. It should be noted, however, that Finland has set up a framework that is partially non-binding; although it is unclear whether such a non-binding framework is sufficient, the Finnish rules appear in practice to comply with the Directive. It should also be noted that many member states transposed the Directive gradually, through various pieces of legislation, rather than all at once. The dates of transposition refer to the year in which the Directive was substantially or fully transposed in the relative member states. Sample countries and the respective transposition dates of the Directive are listed in Table 2.

Table 2. Transposition dates for sample countries

Year	Countries
2005	Poland, Romania
2006	Austria, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Luxembourg, Portugal, Sweden, UK
2007	Belgium, Cyprus, Italy, Netherlands, Slovakia, Spain
2008	Czech Republic, Estonia

Source: Authors.

2.2 General assessment of whether the objectives have been reached

2.2.1 Description of objectives

What are the objectives of the Directive? This subsection assesses the Directive in light of the general objectives of EU law and the specific objectives of the Directive itself.

General objectives of EU law

Broad objectives. The objectives of EU law are broad and take into account a variety of concerns, including the following:

- *Economic growth and social cohesion*. With regard to general principles, the Lisbon Strategy introduced the EU objective of becoming the "most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth, with more and better jobs and greater social cohesion" (European Council, 2000). The Communication from the Commission to the Council and the European Parliament on "Common Actions for Growth and Employment: The Community Lisbon Program" confirmed that "the internal market for services must be fully operational, while preserving the European social model" (European Commission, 2005).
- *Specific concerns*. EU law shows a wide variety of concerns, including financial issues, social and environmental issues, and stakeholder protection. For instance, the 1999 Financial Services Action Plan and the 2003 EU Company Law Plan called for an integrated financial market and improved shareholder rights, while remaining sensitive to "social and environmental performance" in view of "long term sustainable growth". Specific concern for stakeholders has also been mentioned in the Commission's vision for the single market of the 21st century (February 2007).

Consistency with OECD principles. This all-inclusive approach, which takes into consideration the interest of the stakeholders, appears consistent with the OECD's Principles of Corporate Governance, which provide that "corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders" (OECD, 2004).

Specific objectives of the Directive

Description. The objectives of the Directive, as described in its recitals, are i) legal certainty on the takeover bid process and Community-wide clarity and

transparency with respect to takeover bids; ii) protection of the interests of shareholders, in particular minority shareholders, employees and other stakeholders, when a company is subject to a takeover bid for control; and iii) reinforcement of the freedom for shareholders to deal in and vote on securities of companies and prevention of management action that could frustrate a bid. Looking at the content of the Directive, its main objectives may be described as follows:

- *Integration and harmonisation*. One of the purposes of the Directive is to promote the integration of European capital markets through the creation of a level playing field. Several rules of the Directive work towards that goal, notably the board neutrality rule, the breakthrough rule and the squeeze-out rule. The board neutrality and the breakthrough rules, however, are mitigated by optional arrangements and the reciprocity exception, resulting in a more balanced approach. The harmonisation goal has an intrinsic limit – when transposed into a different legal system, a rule can achieve different results than expected. Although the EU legal framework regarding company law is far from harmonised and the ownership structure of companies also varies significantly from country to country, this 'legal transplant' issue is not specifically addressed in the Directive.
- *Protection of three main interest groups*. A variety of interests are protected by the Directive:
  - *Minority shareholders* are protected by the mandatory bid and sell-out rules.
  - *Employees* of the offeree company are protected through information rights and the right to issue an opinion. These rules allow employees and employee representatives to proceed with a proper analysis of the bid and, if need be, to express their concerns. In addition, the Directive does not affect national provisions on co-determination.
  - Protection of *offeree companies* is achieved by taking into account the interests of the offeree company 'taken as a whole', and through the rules concerning the disclosure of the offeror's intentions as to the future business of the offeree company and the likely repercussions of the takeover on the employees of the offeree company. Moreover, the opinion of the Board of the offeree company is taken into account and the bid should not disturb the normal course of business of the offeree company for an excessive duration.

2.2.2 *Assessment*

Debate on the net impact of the Directive. There is a general debate as to whether the Directive has had any significant impact and whether, when assessed in light of its objectives, any such impact has been positive or negative. As discussed below, the impact of the Directive is tangible and overall, subject to various caveats, it seems to be in line with its objectives.

Scope of changes

Creation or reinforcement of the national legal frameworks. The Directive has contributed to the establishment of a legal framework in countries (such as Cyprus, Luxembourg and Greece) where no substantial legal framework existed, as well as in others where the legal framework had been put in place while negotiations relating to the Directive were underway (e.g. in Germany). In member states with a substantial pre-existing legal framework, the Directive strengthens or further details certain provisions of the pre-existing legal framework.

Harmonisation. The Directive has led to the harmonisation of certain rules regarding takeover bids, such as the mandatory bid rule, the equitable price, employee information rights or squeeze-out and sell-out rights. It is interesting to note that the harmonisation triggered by the Directive also took place where the Directive left flexibility (e.g. factual convergence of the thresholds for 'control'). In addition, Art. 3 of the Directive lays down a series of general principles that must always be complied with (even when exemptions are applied). The optionality principle, however, has led to an absence of harmonisation regarding board neutrality. In contrast, the fact that almost no country has opted for the breakthrough rule leads to a harmonised 'freedom of contract' approach to pre-bid defences.

Facilitation of bids. As its transposition is still rather recent and because of the market turndown in 2008, it is difficult to assess the extent to which the Directive facilitates takeover bids. Nonetheless, 59% of the stakeholders consider that the transposition of the Directive produced benefits compared with the previously existing legal framework.

Direction of changes

Level of changes. Producing an overall mapping of changes introduced by the Directive is a complex exercise. The level of change (significant, not significant, in between) may not be precisely quantified and is dependent upon three factors: i) what the content of the legal framework is, ii) how it is applied by

supervisory authorities and jurisdictions, and iii) how it is applied and perceived by interested parties.

Difficult mapping. A precise description of the legal framework always shows a number of grey areas, with untested situations and potential conflicts between the spirit and the letter of the applicable laws and regulations. The enforcement of the legal framework by supervisory authorities is difficult to assess as many of them do not fully communicate on their activity and are eager to keep some discretionary power, which is typically justified by the need to fight against attempts at circumventing applicable laws and regulations. Regarding court cases, they are not that frequent in many jurisdictions and are often highly fact-intensive. Finally, in legal matters, and even more in financial matters, perception is key: the best legal framework is not worth much if interested parties are unaware of its existence or do not believe in its correct enforcement. A mapping exercise is all the more complex because it goes beyond a simple description of the current status: a mapping of changes doubles the above-described uncertainties.

Criteria. The concepts and criteria that are used may also be debated. For the purposes of this mapping, we have considered the following assumptions:

- The mandatory bid rule is in the interest of shareholders, as well as the squeeze-out and sell-out rules. The rationale behind this position is that mandatory bids permit all shareholders to benefit from the control premium, while the squeeze-out rule is attractive for potential offerors (and thus increases the number of bids) and the sell-out rule provides shareholders with an exit at a fair price.
- Defences are stakeholder-oriented, as incumbent directors and managers are more likely to take into account the interests of the parties with whom they have worked for years (including employees, creditors and local communities) without trying to maximise shareholder value. By contrast, the main objective of newly appointed directors and managers is to make sure that the offeree company quickly generates enough cash to repay the acquisition price paid by the offeror. Defences may also operate to allow entrenchment of underperforming management.

At the same time, the opposite position could also be defended:

- The mandatory bid rule may discourage potential offerors, thus depriving minority shareholders of the opportunity to receive any portion of the control premium.
- Defences may be used to negotiate higher bid prices, thus leading to higher premiums paid to minority shareholders.

Preliminary mapping of changes. Table 3 provides an analysis regarding changes in connection with the Directive.

Table 3. Changes connected with the Directive

Country	Mandatory bid	Passivity	Break-through	Squeeze-out	Sell-out	Overall view
Austria	Yes, not new	Yes, not new	No, not new	Yes, not new (but amended)	Yes, not new	No significant changes
Belgium	Yes, not new (but amended)	No, not new	No, not new	Yes, not new (slightly amended)	Yes, new	Some changes
Cyprus	Yes, new	Yes, new	No, not new	Yes, new	Yes, new	Significant changes
Czech Rep.	Yes, not new (but significantly amended) [a)]	Yes, not new (clarified)	No, not new	Yes, not new (amended)	Yes, new	Significant changes
Denmark	Yes, not new	No, not new	No, not new	Yes, not new (but improved minority shareholder protection)	Yes, not new	No significant changes
Estonia	Yes, not new (slightly amended)	Yes, not new (specified with Directive and amended)	Yes, new	Yes, not new (specified with Directive and significantly amended) [b)]	Yes, new	Significant changes
Finland	Yes, not new (but threshold amended) [c)]	Yes, not new [d)]	No, not new	Yes, not new (but amended) (redemption price)	Yes, not new but amended (redemption price presumption)	Some changes
France	Yes, not new	Yes, not new (enhanced, but reciprocity added)	No (with one new exception) not new	Yes, not new (but amended)	Yes, not new	Some changes
Germany	Yes, not new	No, not new	No, not new	Yes, new	Yes, new	[No significant changes] [e)]
Greece	Yes, not new	Yes, not new (but reciprocity added)	No, not new	Yes, new	Yes, new	Significant changes
Hungary	Yes, not new [f)]	No, not new [g)]	No, not new	Yes, not new	Yes, not new	Significant changes
Ireland	Yes, not new	Yes, not new	No, not new	Yes, not new (but new threshold)	Yes, not new (but new threshold)	Some changes

Table 3. cont'd

Country	Mandatory bid	Passivity	Break-through	Squeeze-out	Sell-out	Overall view
Italy	Yes, not new (but amended)	Yes, not new (but added reciprocity and company opt-out)	No, not new	Yes, not new (but amended)	Yes, not new (but amended)	Significant changes
Luxembourg	Yes, new	No, not new	No, not new	Yes, new	Yes, new	Significant changes
Netherlands	Yes, new	No, not new	No, not new	Yes, not new	Yes, new	Significant changes
Poland	Yes, not new (but clarified)	No, not new	No, not new	Yes, clarified	Yes, clarified	Significant changes
Portugal	Yes, not new	Yes, not new (but reciprocity added)	No, not new	Yes, not new (but more difficult to apply)	Yes, not new (but more difficult to apply)	Some changes
Romania	Yes, not new	Yes (only for voluntary bids, not for mandatory bids), not new	No, not new	Yes, not new	Yes, not new	No significant changes
Slovakia	Yes, not new	Yes, not new (clarified)	No, not new	Yes, new	Yes, new	Significant changes
Spain	Yes, not new (enhanced)	Yes, not new (clarified, but limited reciprocity added)	No, not new	Yes, new	Yes, new	Significant changes
Sweden	Yes, not new	Yes, not new	No, not new	Yes, not new	Yes, not new	No significant changes
UK	Yes, not new	Yes, not new (slightly strengthened)	No, not new	Yes, not new	Yes, not new	No significant changes

[a)] Prior trigger events: two-thirds and three-quarters of securities or voting rights. New trigger event: one-third. Price: expert price replaced by Directive criterion (highest price paid by the offeror in the previous 12 months).

[b)] Before the transposition of the Directive, only squeeze-outs outside the takeover bid situation existed (i.e. squeeze-outs under the Commercial Code). The 'Directive squeeze-out' was introduced once the Directive was transposed by way of amending the Securities Market Act. Therefore, the 'Directive squeeze-out' was completely new.

[c)] The threshold moved from two-thirds to 30% (and 50%).

[d)] The passivity rule has not been transposed as such in Finland, as the Finnish Companies Act included provisions before the transposition of the Directive that were deemed to be sufficient with respect to the passivity rule; however, the non-binding Helsinki Takeover Code provides further guidance with respect to the passivity rule.

[e)] Yet significant changes were made in view of the transposition of the Directive (mandatory bid, squeeze-out and sell-out).

[f)] Pre-transposition of the Directive.

[g)] Passivity was adopted in 2006 with the transposition of the Directive and abandoned in 2007 ('Lex Mol').

Source: Authors.

Direction of changes. Based on the foregoing analysis, Table 4 provides a summary analysis on the direction of changes that have taken place.

Table 4. Mapping the changes introduced by the Directive and their direction

	Significant changes	**Some changes**	**No significant changes**
More shareholder-oriented	Cyprus, Czech Republic, Estonia, [Germany],[a] Greece, [Hungary], Luxembourg, Netherlands, Poland, Slovakia, Spain	Belgium, Finland	[Germany], Romania
More stakeholder-oriented	[Hungary],[b] Italy	France, Ireland, Portugal	
Neutral			Austria, Denmark, Sweden, UK

Notes: This table provides a qualitative analysis, the value of which is mostly indicative. The option for companies to voluntarily opt into the breakthrough and board neutrality rules is in practice never used. As a consequence, we have considered that for the direction of changes this opt-in option has no impact and have thus disregarded this option.

[a] Introduced mandatory bid, squeeze-out and sell-out rules in view of the transposition of the Directive. There are significant changes if compared with the situation before this 'pre-transposition' and there are no significant changes since this time.

[b] In 2001 (pursuant to a pre-transposition procedure), mandatory bid and passivity rules were introduced. 'Lex Mol' (2007) removed the passivity rule. Compared with pre-2001, the overall change is shareholder-oriented. Although reciprocity was introduced, compared with pre-2007, it is stakeholder-oriented.

Source: Authors.

Impact on takeover activity

Difficult issues to assess. Because of the 2008 crisis, takeover activity overall has decreased. In addition, the recent and piecemeal transposition of the Directive has made it difficult for stakeholders to assess its overall impact on takeover activity. This is why it is logical to find that 50% of the issuers and 30% of the investors and intermediaries have no opinion on whether they considered initiating takeover bids more often after the entry into force of the Directive, and that, among those having an opinion, a majority does not consider initiating bids more often (64% for issuers and 72% for investors and intermediaries).

3. BROADER ASPECTS AND IMPLICATIONS OF TAKEOVER REGULATION

This chapter addresses the following questions in particular:

- What are the corporate governance principles underpinning the regulation of takeover bids?
- Going deeper into the analysis, what are the representations that shape the thinking on takeover bid regulations? And how have such representations evolved over time?
- How are such representations influenced by the shareholding structure?
- As takeover bids are very often cross-border transactions, what issues are raised by such transactions from a community standpoint?

Key concepts

- Traditionally, two key corporate governance issues are identified: the opposite forces of the collective action issue and the pressure-to-tender issue.
- Reflection, in this case on i) the definition of a corporation, ii) its potential identification with a political body and iii) whether it is 'owned' by anyone, has a potential impact on how regulation is structured.
- The main concepts are moving from shareholders' primacy to team production.
- The market and blockholder standpoints lead to a taxonomy of the three main models (shareholder-oriented, management-oriented and company-oriented).
- Cross-border transactions raise 'community control gap' issues.

3.1 Some theoretical bases of corporate governance

Selected issues. When reviewing takeover bid regulations, corporate governance studies typically focus on two issues: the collective action issue and the pressure-to-tender issue. Although they are more thoroughly presented in the economic part of the study, these issues are analysed here on the basis of typical conducts and applicable legal rules.

3.1.1 The collective action issue

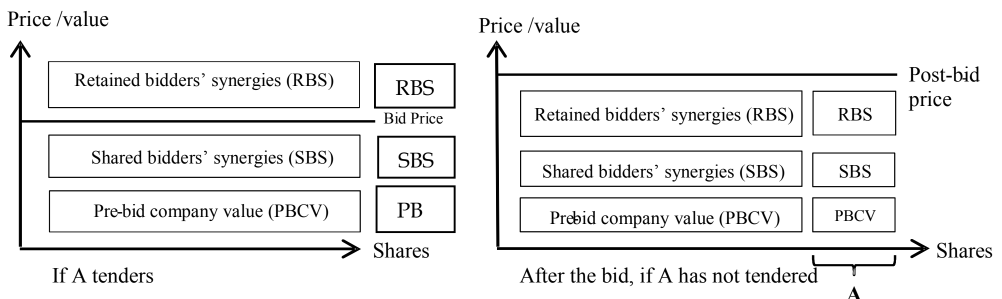
The collective action paradox

Description of the paradox. The collective action issue may typically arise during a bid when shareholders believe that the offeror is not including in its bid price the full potential of synergies that may be derived from the future entity combining the offeror and the offeree company. If there is no coordination among shareholders, a shareholder 'A' will have to make a bet:

- either A will bet on the success of the bid (even if A will not himself tender into the bid), and as a result, his interest will be not to accept the bid, as the post-bid value of his shares will be higher than the bid price (since, as mentioned above, the full value of expected synergies for the offeree company is not fully reflected in the bid price); or
- shareholder A will think that the bid may fail if he does not accept the bid, in which case it is in A's best interest to accept it.

Yet, if A is a small shareholder (i.e. one who is not likely to make any difference in the outcome of the bid), he should opt for the first solution and keep his shares in order to 'free ride' on the success of the bid. This behaviour would be all the more rational because, practically speaking, most bids succeed. This is where the paradox lies: if all the shareholders were acting rationally, bids should generally fail, as the minimum condition typically introduced in the bid (e.g. a majority or two-thirds of shares) will never be reached. This is not the case, however. How can this be explained? Figure 1 illustrates the issue.

Figure 1. Collective action paradox



If A tenders into the bid, he will receive his share of PBVC and SBS; if he does not tender, he may decide after the bid to sell his share for a price equal to his share of PBVC, SBS and RBS.

Explanation of the paradox

Several explanations. Apart from the pressure to tender issue (which is examined below), there are three main explanations to the absence (in practice) of collective action issues.

Economic inability of shareholders to cooperate. The better shareholders can cooperate, the higher the risk that they will free ride. This is best explained through an example: consider a bid with a 50% minimum condition, and a shareholding structure where 40 shareholders each hold 2%. Their interest is to cooperate so as to offer 1.25% each, so that the bid will succeed, while each keeping 0.75%, so as to benefit from post-bid synergies. Practically speaking, however, this situation is not frequent and the shareholding structure is either more concentrated (with blockholders holding much larger blocks) or more dispersed. In the former case, there will be a discussion between the offeror and the blockholder and if they agree on a price, the blockholder will offer his or her shares, which will be seen as a strong indication that the bid is likely to succeed – in this case, some free-riding is possible (unless there are other obstacles). In the latter case, cooperation is likely to be too costly and too complex to be implemented.

Legal impediment to cooperation. There is one rule that may have been ignored as an impediment to cooperation: the so-called 'defensive concert', created by Art. 5.1 of the Directive. This rule may be understood as creating a risk for cooperating shareholders to have to launch a bid. Of course, this obligation will only arise if the cooperating shareholders aggregate enough shares to reach the threshold triggering a mandatory bid (e.g. 30%) and if the offeree company is involved in the cooperation. Cooperating shareholders may take appropriate steps to avoid the realisation of this risk. Yet these steps will add to the costs and complexity of cooperation, thereby pushing small shareholders to opt for the easiest solution, i.e. tendering their shares.

Irrational behaviour. The core assumption of the free-riding issue is that shareholders behave rationally. This hypothesis is based on two premises:

- There is sufficient information to assess the post-bid value of the offeree company.
- Shareholders correctly discount the value of time.

It is likely, however, that these assumptions are not true:

- There is only little information on potential post-bid synergies (and the offeror has no incentive to disclose any meaningful information in this respect).
- Shareholders are likely to have a short-term bias when confronted with a bid (under the theory that 'it is better to have a bid in the hand than two in the bush'). Actually, the easiest solution for a shareholder, when a bid

is announced, is to sell his or her shares at a price that is close to the bid price. There is no bet, the gain is certain and there are absolutely no costs associated with this strategy. Thus, what may seem to be irrational behaviour from a theoretical standpoint may well be a very rational mode of conduct for all practical purposes.

3.1.2 The pressure-to-tender issue

Defining the issue. As discussed above, the so-called 'pressure-to-tender' issue is one of the reasons why shareholders tender into bids when they would be better off free-riding. There may be two main determinants to this issue:

- *Liquidity issue.* Shareholders may fear that post-bid liquidity is severely reduced, thus affecting their ability to sell (the pure 'liquidity' effect) and potentially reducing the listed price of their shares (the 'price' effect). The liquidity effect is most salient for small caps, where already low liquidity is further reduced. The price effect is likely to take place in all events, as investors (and in particular international institutional investors) are likely to divest from controlled companies whose float is limited.
- *Extraction of private benefits of control.* Shareholders may fear that the controlling shareholder will extract some value from the offeree company to the detriment of other shareholders, through an undue appropriation of private benefits of control.[10] The ability to proceed in such a way is obviously linked to the overall legal framework, and in particular to the way related-party transactions are structured.

Thus, minority shareholders will be pressured to tender even if the acceptance of the bid is not in their collective self-interest and the offeror may consequently be able to acquire an offeree company for a low premium constituting only a small fraction of the takeover's gain.

Solving the issue. The pressure-to-tender issue can be alleviated in a number of ways (which are more thoroughly discussed below), including

- providing for an automatic re-opening of the bid, which would allow the shareholders to know the potential outcome of the bid when they decide to tender;
- enhancing the rules regarding related-party transactions; and
- introducing more transparency for private benefits of control.

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[10] On these benefits, please refer to section 5.1 of this study.

3.2 Broader issues of corporate governance

Impact of the corporate governance premise. As it is difficult to structure a legal framework on the sole basis of traditional studies of corporate governance (the results of which are often the subject of debate), it is necessary to highlight the various theories that have helped shape modern corporate governance thinking. As we will see, the legal framework on takeover bids may vary significantly, depending on the corporate governance system that is selected.

3.2.1 Preliminary questions

Three preliminary questions. Against the background of corporate governance issues, three questions are always present, although they may not always be explicit: What is a corporation? Who 'owns' a corporation? Are corporations 'shareholder democracies'?

What is a corporation? There are two ways to view a corporation. The traditional legal analysis considers a corporation an 'incorporated' body, i.e. a legal entity of its own, with its assets, liabilities and contracts. Under a different approach, a corporation may be seen as a 'nexus of contracts' between investors, management, employees, suppliers, clients, etc.; legal personality is thus a fiction. If this latter view were to be preferred, it would entail a complex legal structure for takeover bids: as all contracts are potentially entered into with all other parties, the change of one set of contracting parties (i.e. the investors) would need to be approved (or at least pre-approved) by all other parties. This is why the traditional 'legal personality' view is generally preferred. This position is based on the argument that if it is true that legal personality is a fiction, it should not be seen as an issue – after all, all legal rules are a fiction; the most practical and useful fictions should be selected.

Who 'owns' a corporation? A popular view holds that shareholders are the 'owners' of a corporation. They have invested money, they can sell their shares and they have financial and political rights. This view, in connection with takeover bids, is problematic in two respects: first, if shareholders are owners, the use of squeeze-out mechanisms against minority shareholders should be deemed an expropriation in favour of a private party (the majority shareholder) and in the interest of such a party, which is a source of difficult debates; second, if shareholders own the corporation, majority shareholders own their majority rights and thus the value (control premium) of this majority, in turn leading to the controversial question of how it is possible to justify the sharing of the control premium with all shareholders when this premium is the property of the majority shareholders. This question, as well as the previous one, is best solved in the traditional framework of corporate law. From a legal standpoint, companies are not 'owned': shareholders hold

transferable contractual rights, just as other finance providers; they have no rights to the company assets and incur no liability in connection therewith, and regarding the notion of control, it has also been held that this would be considered a corporate asset. This analysis appears especially relevant in the context of listed companies, where the relationship between a company and its shareholders is often weak.

Are corporations a 'shareholder democracy'? Companies are often described as a 'shareholder democracy'. Shareholders are compared to the people in a democracy; they are accordingly deemed to hold the ultimate power. Directors, as elected representatives, are considered the 'executive branch'. Under this theory, in a takeover bid, directors should have no autonomy – they should defer to the shareholders for all decisions that may frustrate the bid. The shareholders' democracy theory has been criticised from two standpoints. First, a company has nothing to do with a political system, and the comparison appears to have no scientific value. Second, if the comparison were to be made, then corporations should apply the 'one *man*–one vote' principle that is typical of democracies; the 'one share–one vote' concept, which provides more voting rights to wealthier shareholders owning several shares, is more akin to a plutocratic regime.

How the various positions that may be taken on corporate governance may impact takeover regulation is summarised in Tables 5-7.

Table 5. What is a corporation?

View one (Jensen & Meckling)	View two (legal analysis)	Impact on takeovers
• A 'nexus of contracts' (investors, management, employees, suppliers, clients, etc.). • Corporations are a fiction.	• Corporations are legal entities. • All legal rules are fictions. The most practical fictions should be selected.	• How could a nexus of contracts be transferred? Consent of all parties is needed.

Source: Authors, partially based on Jensen and Meckling (1976).

Table 6. Who owns a corporation?

View one (popular view)	View two (legal analysis)	Impact on takeovers
• Shareholders own the corporations.	• Corporations (as legal entities or contracts) are not 'owned'. • Shareholders hold transferable contractual rights.	• Conflict between the 'ownership' view and i) squeeze-out (expropriation) and ii) the obligation to share the control premium.

Source: Authors.

Table 7. Are corporations based on a 'shareholders' democracy'?

View one (popular view)	View two (legal analysis)	Impact on takeovers
• Shareholders represent the people, management and the government.	• Democracy applies, 'one man, one vote' rule; corporations do not. • Political systems and economic institutions are completely different.	• Who should have a final say on the merits of a bid?

Source: Authors.

3.2.2 *Basic corporate governance views and their impact on takeover regulation*

Main systems. Corporate governance is an open concept. In theory, it is possible to design an almost unlimited number of systems. We can nonetheless focus on three, which basically represent three successive states of corporate governance thinking: the traditional view, the shareholder primacy view and the team production view.

Traditional view. In the 19th century, when large corporations started to develop on a significant scale, there was little debate about corporate governance. Most companies were family-controlled and the legal framework, in particular regarding securities regulation, corporate law and labour law, was not as complete and sophisticated as it is today. Corporate governance issues had been identified by various philosophers and economists, including Adam Smith and Karl Marx, but no precise set of rules had been proposed. The relationship between shareholders and employees, described as 'capitalists' and 'workforce', was analysed from a philosophical, political and economic standpoint. The time of takeover regulation had not yet arrived.

Shareholder primacy view. The 'agency' issue in the relationship between management and shareholders became a dominant theme of corporate governance in the 20th century, with the emergence of a growing number of large, listed companies with dispersed shareholders. The main question became shareholder control over management, in order to prevent the latter, through laziness or theft, from squandering shareholder wealth. The shareholder primacy view thus emerged: drawing on the old master/servant legal concept, it applied a 'principal/agent' theory to the relationship between shareholders and management. Its premise is a complete reversal of the traditional view: where shareholders, as capitalists, used to be seen as the 'strong' party in a corporation, they suddenly were viewed as the 'weak' party, with only residual income rights, while other parties (such as creditors, employees or management) were viewed as 'strong' parties protected by their fixed-income revenues. Shareholders therefore had to be protected. Two key

concepts were introduced to this effect: first, the 'alignment of interest' theory, which aimed at aligning the financial incentives of management with those of shareholders; the massive development of stock options was one result of that idea. Second, the 'disciplinary effect' theory, which provided that takeover bids should be facilitated, as the fear of being taken over would continuously push managers to increase their company's performance (or at least to take steps to boost the share price of their company). As a result, under this theory, pre-bid defences should be removed and post-bid defences should be subject to shareholders' approval within the framework of a 'no frustration' rule.

Team production view. The shareholder primacy view has been criticised since the end of the 20th century. At least three criticisms have been formulated: i) the finance view leads to short-termism,[11] ii) shareholders are not in a weak position, especially if compared with employees (see Table 8), and iii) neglecting other stakeholders creates negative externalities. As a result, alternative models have been designed, among which the team production theory has emerged for its overall consistency (Blair, 1999). Under this theory, a company is characterised by several features, including the following: i) when production takes place in a team (which is the case in all large corporations), it is difficult to allocate precisely the merits of success or failure to specific team members; ii) most contracts entered into between a company and its stakeholders (in particular employees) are 'incomplete' – they do not specify everything that may happen, as it would be too complex; and iii) employees are encouraged to make 'firm-specific investments', which have a value for the company but are lost for the employee if he or she moves to another company. In the context of 'incomplete contracts', the encouragement mainly comes from implicit promises that firm-specific investments will be rewarded in the future, through increasing wages and internal promotions. One of the main issues to be solved is therefore how to make sure that no stakeholders unduly obtain a portion of the profit that should be shared among all stakeholders. This 'hold-up' problem may appear in the event of a takeover: new controlling shareholders may be tempted to disregard all implicit promises made by the previous management in order to reap the benefit of all past investment for themselves,[12] thus breaching the 'incomplete contracts'. In

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[11] In particular, the 'disciplinary effect' has some negative consequences.

[12] According to Davies et al. (2010, p. 19), "[a] shareholder-focused system can discourage employees from investing in firm-specific skills, as no credible promises of long-term employment are available. A lack of highly specialised workforce may well yield higher efficiency costs than prevented control shifts resulting from an entrenched management for certain firms or even sectors of the economy."

this setting, the board is called to act as a 'mediating hierarch', with a view to keeping a fair balance among the interests of all stakeholders involved. This role is facilitated by the fact that managers are the only parties to have some proximity with all stakeholders.[13] It is thus important to empower the management in its relationship with shareholders. A 'no frustration' rule is not appropriate in this respect, if it leads to a complete shift of power in the hands of the shareholders.

Shareholders and employees: A risk analysis. The shareholder primacy view is now based on the idea that shareholders incur more risk than other stakeholders. Is this correct? An analysis of the respective risks of shareholders and employees in listed companies shows that shareholders, although they are residual claimants, may not bear as much risk as employees, with their 'fixed-income revenues'. The comparison is summarised in Table 8. Figure 2 depicts the views that have been developed above.

Table 8. Shareholders as 'residual claimants' and employees as beneficiaries of fixed-income revenues: Who bears the most risk?

Period	Shareholders	Employees
Beginning of the relationship	At the time of investment, the shareholders of a listed company: • may choose among thousands of companies; • benefit from extensive normalised information prepared by management (who may be liable if the information is false or misleading), reviewed by auditors and controlled by supervisors; • may diversify their risks as precisely as they wish.	At the time of hiring, a prospective employee of a listed company: • may choose among a few companies; • has little access to information, which is not normalised and essentially not controlled; • cannot diversify his or her risk.

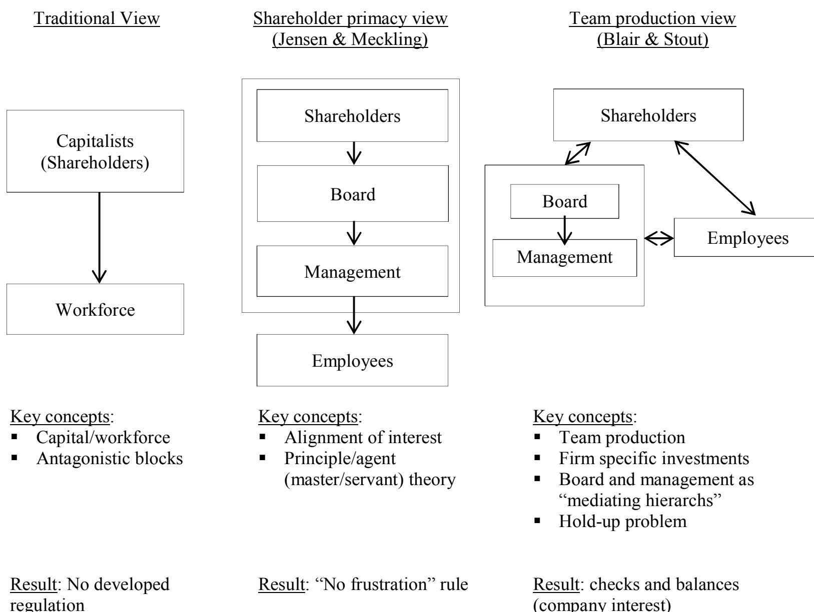
[13] This is also why the role attributed to the board by the team production theory is often seen as providing a better description of what boards actually do than the shareholder primacy view.

Table 8. cont'd

During the relationship	Shareholders who have made a one-off money investment: • decide the level of control they want to have over the affairs of the company (no control, vote at shareholders' meetings, active engagement); • receive a residual payment (dividends), partly resulting from the control that has been exercised; • may benefit from a high reward in the event of a takeover bid with a large premium.	Employees, who are making a continuous time investment: • have limited or no control over the affairs of the company; • receive a fixed-income payment (wages); • incur the risk of a 'hold-up' in the event of a takeover bid.
When the relationship terminates	Upon exit, shareholders: • receive a benefit or suffer a loss, depending on the share price; • may apply their exit strategy within seconds or minutes (a sale order transmitted by phone or the Internet).	When leaving, employees: • are in a neutral position vis-à-vis the share price; • are faced with long delays to apply their exit strategy (a notice period upon resignation, time to find a new job).

Source: Authors.

Figure 2. Traditional, shareholder primacy and team production views



Sources: Authors, partially based on Jensen and Meckling (1976) and Blair and Stout (2005).

3.2.3 *The different standpoints*

The dual view. The 'market view' of corporate governance, which is often considered the 'finance' standpoint, is frequently opposed to the 'industrial' standpoint. It is worth recalling the main terms of the debate, as it has a direct impact on takeover regulations. The main arguments for both sides are summarised in Table 9.

Table 9. Different standpoints

	Market standpoint	**Industrial standpoint**
Bases	• Unfettered markets are the best places to monitor companies.	• Blockholders are best placed to control companies. (Issues of transaction costs)
	• The fear of takeovers pushes management to act diligently (a 'disciplinary effect' against 'management entrenchment').	• If the markets discipline managers, who disciplines the markets? (Issues of market rationality and short-termism)
	• Focus: shares as a class of assets. Method: "Forecasting the psychology of the market" (John Maynard Keynes).	• Focus: productive assets. Method: "Forecasting the prospective yield of assets over their whole life" (John Maynard Keynes).
Results	• Shareholders should have the ultimate power, as they bear the ultimate risks (shareholder primacy). The 'no frustration' rule should prevail.	• A system of checks and balances is preferable (consensus formation). Company interest must prevail.
	• Blockholders may misuse their powers.	• Transparency rules and appropriate protective laws should address this risk.

Source: Authors' compilation.

The triangle model. The dual model may be complemented by the 'triangle' model, which distinguishes among three typical regimes that may be best illustrated as forming the three tips of an equilateral triangle. The main (and archetypical) features of these three models are in Table 10.

Table 10. Main features of the three models

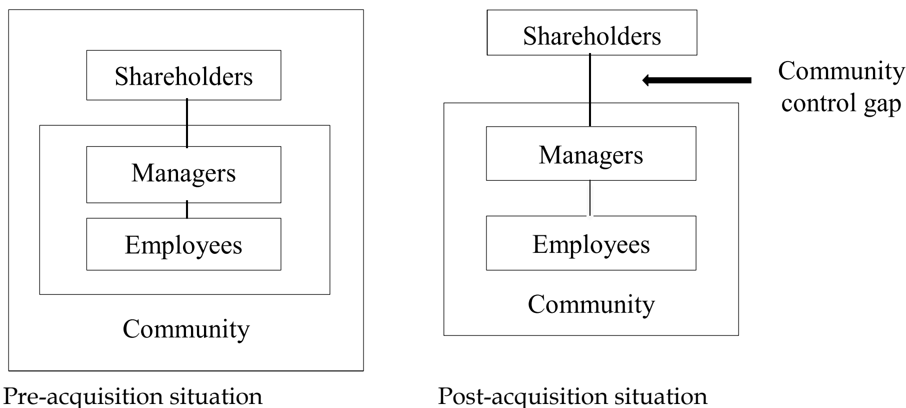
Shareholder-oriented model (UK)	**Company-oriented model (Continental Europe)**	**Management-oriented model (US)**
• Dispersed shareholders	• Blockholders	• Dispersed shareholders
• No takeover defences	• Mild takeover defences	• Strong takeover defences
• Fiduciary duties	• Corporate interest	• Fiduciary duties
• *Ex ante* controls on takeover bids (Takeover Panel)	• Mixed control (*ex ante/ex post*) on bids	• *Ex post* judicial control on takeover bids

Source: Authors.

3.2.4 *The 'community control gap'*

Community fears. Legal control is not the only way to influence an institution's conduct. Community control, through cultural habits and the proximity network, may play a role. A typical fear associated with cross-border acquisitions is the loss of this community control, which may typically lead to a loss of the ability to keep headquarters in the country of origin, develop high added-value products along with research and development in the same country, and protect employment and the environment at home. These issues, in economic terms, may be considered an increased risk of negative externalities imposed by foreign shareholders to a local company. The extent to which these assumptions hold true is beyond the scope of this study (it may be the case, for instance, that an international group acquiring a small local offeree company applies enhanced social or environmental rules as part of its general corporate policy). Still, these concerns exist and are exacerbated in the context of acquisitions of large companies (often listed companies) and of highly publicised takeover bids, and more specifically, unsolicited takeover bids. This issue, which may be referred to as the 'community control gap', should thus be borne in mind when designing potential legislation affecting takeover bids. The issue may be visualised in Figure 3.

Figure 3. Community control gap



Potential solution. There are two main ways to address the issue. The first one is to make a convincing case that such fears are ill founded or that they exist but are counterbalanced by positive effects (e.g. improved overall economic efficiency, lower consumer prices or gains obtained from the freedom for each national company to acquire foreign offeree companies). The

second way is to address the issue through regulatory action. If restricting the free market for corporate control is not an option, then the main alternatives are the following:

- Enhance community protection through
  - increased regulation of company activities, and
  - increased accountability of shareholders.
- Incentivise proper management conduct through the enforcement of a rule whereby managers must act in the interest of the company taken as a whole.

Impact on takeover regulations. If the issue of a community control gap is to be addressed through takeover regulation, the simplest way to proceed seems to be to insert a 'company interest' rule. This rule already exists in the Directive, but as it is balanced with the 'no frustration' rule, its overall effect is unclear (please refer to Art. 3.1(c) of the Directive).

4. NATIONAL LEGAL FRAMEWORK AND OPERATION OF THE DIRECTIVE

This chapter addresses the following questions in particular:

- How has the Directive generally been transposed? And what has been the impact of other takeover bid legislation adopted during the same period as, but independently of, the transposition process?
- How do the general principles of the Directive protect shareholders, employees and other stakeholders?
- Has the general possibility to provide for exemptions significantly weakened the Directive?
- How is the Directive generally perceived?

Key concepts

- The Directive is generally considered clear and without significant loopholes (if we leave aside the optionality issue, which is further described below).
- In certain countries, some events (generally linked to highly publicised and country-sensitive takeover bids) have induced some amendments to takeover regulations that were not connected to the transposition process and not in the original spirit of the Directive.
- General principles of the Directive, when read in conjunction with associated rules, protect shareholders well, even if there is room for harmonised improvement. The protection of employees is less satisfactory, as their protection mechanism is much more limited and the enforcement of their rights far less efficient. Recent reforms in the UK are interesting in this respect.
- Major non-EU jurisdictions tend to have similar general principles, focusing essentially on protecting minority shareholders.
- The perception study confirms the overall satisfaction of shareholders and dissatisfaction of employees.

4.1 Transpositions, loopholes and gold-plating

Clarity and transposition. There is an overall perception that the Directive is sufficiently clear (58%), with national transposition being the main source of lack of clarity. There are no major transposition issues.

Loopholes. As the Directive provides for broad concepts and allows for both gold-plating and exemptions, it is difficult to identify meaningful loopholes. Nevertheless, the following issues are noteworthy:

- *Negative competence conflict*. The Directive's mandatory takeover bid and squeeze-out rules are not applicable to companies whose securities are admitted to trading in a member state but which are not headquartered in a member state. In such a company's non-EU home country, mandatory takeover bid provisions, if any, may not be applicable either, if the non-EU home country only considers such rules to apply to companies whose securities are listed in the respective home countries. This negative competence conflict leaves shareholders of such a company unprotected; this result appears particularly unfair in cases where countries – the company's home state and the member state in which the securities are admitted to trading – provide for mandatory takeover bid rules.
- *Illustration*. As a case in point, a majority of the mandatory public takeover bid rules applicable to Swiss or French public companies are inapplicable to a company with a registered office in Switzerland and shares admitted to trading on the French regulated market. Given that such a company is headquartered in Switzerland, a country that is neither a member of the EU nor the EEA, under the general regulations of the AMF (Autorité des marchés financiers), provisions relating to mandatory public takeover bids and squeeze-outs do not apply. Swiss regulations do not apply to such a company either, as its shares are not listed on a Swiss stock exchange.

  In practice, such Swiss companies attempt to avoid the lack of shareholder protection by incorporating the Swiss mandatory takeover bid rules in their articles of association. It is questionable, however, whether these statutory provisions provide the full protection afforded by the respective AMF or Swiss mandatory takeover bid regulations, as it is unclear whether these provisions may be enforced by the company's shareholders.

Gold-plating. The Directive allows member states to introduce provisions going beyond the Directive's requirements in order to enhance the protection of those whose interests are supposed to be protected by the Directive (Art. 3.2(b)).

For those member states that had already introduced regulations regarding takeovers or other public bids before the entry into force of the Directive, it is questionable whether one should really consider such provisions that are not provided for by the Directive as gold-plating, since their adoption was not the result of a specific choice made in view of the Directive. For the sake of completeness, some examples are addressed below.

- *Threshold triggering the obligation to submit a mandatory bid*. Some member states provide for a double threshold (e.g. in Finland, exceeding 30% and 50% of the voting rights) or apply the threshold not only to voting rights but also to capital (France), whereas the Directive's 'control' definition only refers to a single threshold expressed in voting rights.
- *Criteria for equitable price for mandatory bids*
  - *Price determination*. To determine the equitable price, a significant number of member states [14] use an additional criterion, which provides for additional protection to minority shareholders. In these member states, the equitable price must be at least equal to the (weighted) average stock exchange price of the shares of the offeree company during a reference period. Other member states request that either the offeree company's independent directors mandate an independent expert to prepare a fairness opinion in relation to the evaluation of the offeree company (Belgium) or that in cases of conflicts of interest, an appraiser be appointed by the offeree company (France).
  - *Post-bid adjustments*. Adjustments of the bid price have to take place retroactively in connection with certain cases of share acquisitions made after the expiry of the bid period (e.g. Germany, Finland).
- *Content of the offer document*. Some member states (e.g. Ireland) require the offer document to contain more detailed information and indications than the items requested by the Directive.

4.2 Developments not directly linked to transposition

Developments. Certain member states have adopted additional regulations related to takeover bids that have no direct link with the Directive. This is the case, for instance, in the United Kingdom following the Kraft/Cadbury bid, in Italy with the 'Decreto Anticrisi' and the recent 'Lactalis' decree, and in

[14] An example could be Austria, Belgium, Germany, Greece, Portugal, Spain and (only under certain circumstances) Italy.

Hungary with 'Lex Mol'. As shown in the following examples, these developments may be substantial.

- *Hungary*. In Hungary, in the context of the attempted takeover of the Hungarian oil and gas champion (MOL) by its Austrian rival (OMV), the Hungarian parliament passed an additional anti-takeover act (Act CXVI of 2007, customarily referred to as 'Lex Mol'). Lex Mol aims at protecting strategic companies in the energy and utilities sector, by increasing the shareholder majority required for the removal of board members and by giving offeree companies a relatively free hand in adopting protective measures, such as share buybacks or voting right limitations. Lex Mol provided special regulations for companies in which the Hungarian State had held a preference-voting (or golden) share. The European Commission launched an investigation against Lex Mol examining whether the law constituted a barrier against the free movement of capital. As a consequence of the investigation, Lex Mol was slightly amended and has remained in force since.
- *United Kingdom*. In the UK, following the acquisition of Cadbury by Kraft Foods, there have been significant reforms implemented by the Takeover Panel with the explicit purpose of empowering the offeree company when a bid is launched (Box 2).

Box 2. Recent UK reforms following the Kraft/Cadbury bid

In the wake of the 2009–10 controversial acquisition of Cadbury by the US food company, Kraft, the UK Takeover Panel undertook to make appropriate changes to the UK Takeover Code (the legal instrument under which the Directive was transposed). The Code Committee of the Takeover Panel issued a consultation paper in June 2010 to investigate whether the existing regulatory framework of the Takeover Code (which transposed the Directive) left UK companies too vulnerable to hostile bids. Among the key issues the Takeover Panel sought to address were the following:

- whether the minimum, voting-rights acceptance threshold (50% plus one) should be raised to 66%;
- disenfranchisement of voting shares acquired in the offeree company during the bid period;
- whether there should be greater disclosure in offer documents and offer voting intentions;
- possible standardisation of various aspects of the existing 'put up or shut up' (PUSU) rule, including
  - imposing a standardised deadline;
  - automatic application of the rule upon the announcement of a possible bid;

   - whether a private PUSU rule should be allowed if the possible offeror has not been made public yet;
- rules regarding inducement fees in recommended bids or other protective measures concerning the bid; and
- whether the timetable of the Code should be shortened.

Throughout the consultation paper, the UK Takeover Panel made reference to the general principles of the Directive and how their concerns coincided with the objectives therein. The revisions to the Takeover Code came into force on 19 September 2011 and encompassed the following changes:

1) *Enhanced protection of the offeree company*

   Greater protection for offeree companies against protracted 'virtual bid' periods. A 'virtual bid' refers to a scenario in which a potential offeror announces that it is considering launching a bid but without committing itself to doing so. If the announcement of a potential bid is made by an offeree company, the name of the offeror and any other potential offeror who has been in discussion with the offeree company regarding a potential bid (that has not been rejected) must be disclosed by the offeree company in their announcement. If the potential offeror makes the announcement to launch (regardless of whether the announcement was intended or leaked), the offeree company is not required to disclose to any other potential offeror that such a launch took place. Yet, if the presence of another offeror is announced by the offeree, intentionally or through a leak, the offeree company must disclose the identity of such a potential offeror.

   Following the announcement of any potential offeror, a 28-day PUSU deadline is enforced within which such an offeror must announce a firm intention to launch a bid or not. This deadline can only be extended at the request of the offeree company to the Takeover Panel, which will 'normally consent' to such extensions.

   The intended purpose of the PUSU deadline is to minimise uncertainty arising from bid rumours and allow shareholders and other market participants the benefit of this information so that they may make informed decisions.

   The effect of the rule is to empower offeree companies with greater ability to control the pace and information disclosure of the bid.

   Prohibition of deal protection measures and inducement fees. Concerned over packaged deal-protection measures and the pressure they placed on offeree company boards and other potential offerors, the Takeover Panel has instituted a general ban on "any offer-related arrangement", such as inducement fees, with the offeror or those acting in concert with them. The rule carves out exceptions for certain "offer-related agreements", which are not prohibited, including a specific exception for inducement fees for white knights.

Bids that are structured as schemes of arrangement are subject to the same general prohibition; however, the offeree company recommending the scheme mush disclose the scheme along with a timetable for its application (which it must abide by), within 28 days of the offeror's announcement of a firm intent to launch a bid.

Ability of the offeree company's board to give an opinion on the bid. The offeree company board must obtain independent advice on the bid in giving its opinion on the bid to its shareholders. The offeree company board is not limited in the factors it may consider when giving its opinion on the bid and is specifically not restricted to considering the bid price. Art. 9 of the Directive does not include any such rule requiring independent advice on the bid; however, in view of the objectives of the Directive, there is no indication that the Directive disfavours such a practice.

2) *Enhanced disclosure regime*

Disclosure of offer-related fees and expenses. The total of offer-related expenses regarding the bid, such as fees for financial advisers, lawyers and accountants, must be estimated and disclosed by all parties to the bid. If the actual aggregate fees and expenses exceed the disclosed figure by more than 10%, the Takeover Panel may require a second disclosure regarding the actual figures.

Disclosure of bid financing and other financial information. Financial information regarding a bid and its financing relating to an offeree company or an offeror must be disclosed by publishing the relevant financial information for the last two financial years on a website providing the website address.

3) *Improved employee rights*. These rights are described in subsection 4.3.2 of this report.

Sources: The Takeover Panel, "Review of Certain Aspects of the Regulation of Takeover Bids", PS 210/22, London, 21 October 2010, and "Review of Certain Aspects of the Regulation of Takeover Bids, Response Statement by the Code Committee of the Panel Following the Consultation on PCP2011/1", RS 2011/1, London, 21 July 2011.

4.3 General principles of the Directive

Guiding principles. Art. 3.1 of the Directive contains general principles with which the member states must comply. These "general principles" are commonly viewed as being part of the overall level playing field supported by the Directive. It has nonetheless been noted that the concept of the level playing field alone does not provide definitive guidance in determining the best corresponding regulatory framework for takeovers. Indeed, these general principles should be interpreted in the light of the decision issued by the Court

of Justice of the European Communities on 15 October 2009,[15] which provides that they are "guiding principles" for the transposition of the Directive and cannot be regarded as general principles of Community law.[16]

Review of the general principles. Generally, the principles provided in Art. 3.1 of the Directive are fully transposed (sometimes with a verbatim transposition) or do not raise fundamental legal issues. The study therefore examines if i) each general principle is specific enough to protect the interests of the relevant constituents, and ii) transposition of the laws raises legal issues or is helpful for the application of these general principles. The study also provides a comparison with major non-EU jurisdictions.

4.3.1 Protection of shareholders

Equal treatment – Descriptions and general assessment

The principle. According to Art. 3.1(a) of the Directive, "all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected". The protection of the minority shareholders is therefore added to the principle of equal treatment.

Associated rules. Equal treatment and the protection of minority shareholders are more specifically addressed by the mandatory bid rule under Art. 5 of the Directive and the equitable price provision under Art. 5.4 of the Directive. The provisions regarding the publication (Art. 6 of the Directive – information concerning bids and Art. 8 of the Directive – disclosure of bids) serve *prima facie* the proper provision of information to shareholders, but also ensure their equal treatment by granting all shareholders access to the same information. The requirement for a fair price in the squeeze-out and sell-out provisions (Art. 15 of the Directive) is also intended to protect minority shareholders.

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[15] Judgment of the Court (Fourth Chamber) of 15 October 2009, Case C-101/08, European Court reports 2009, Page I-09823. The Court considered that

> it cannot be inferred from the use of the term 'general principles' in Article 3 of that directive that the Community legislature thereby intends the principles mentioned in that Article to be treated in the same way as general principles of Community law. As is clear from the words 'for the purposes of implementing this Directive', they are only guiding principles for the implementation of that directive by the Member States.

[16] These principles also set boundaries to the right granted to member states to derogate from the Directive rules (Arts. 4.5 and 5.4 of the Directive).

Issues. In nearly all member states, the sufficient specificity of the principle of equal treatment itself is not an issue. The general principles referred to in connection with the application and operation of the Directive appear rather to help interpret other rules, when such rules contain uncertainties. Yet a few specific issues may be pointed out:

- *Exclusionary bids*. In contrast with the equality principle, most member states allow bids to be structured so as to exclude some foreign shareholders (typically located in the US). Although it is questionable whether these exclusions are lawful, they seem necessary, in practice, when extending a bid abroad would impose excessive costs on the offeror in light of the number of shareholders that may be concerned.
- *The 'class struggle' issue*. According to the Directive, only shareholders of the same class must be afforded equal treatment, but the boundaries of this principle are unclear. The principle of equal treatment is at stake when a distinct price is proposed for different categories of shareholders. Although it is indeed permitted to offer different prices for different classes of shareholders, it may be difficult in practice to determine the extent to which differentiations are justified or how substantial such divergences in price may be. This issue may, however, be addressed at a national level, or in major non-EU jurisdictions, as described below.
    - *Separate treatment of each class*. This principle may, for instance, be found in Germany, where regulations provide expressly that the minimum price must be calculated for each class separately. The bid must contain an explanation of the price calculation and set forth why the price is justified.
    - *Independent expert*. This principle may be found in France, where the regulations state that the offeree shall appoint an independent appraiser if a squeeze-out pertains to different classes of financial instruments and is priced in a way that could jeopardise the principle of equal treatment. The independent expert will typically consider the price that was offered in a previous bid for each security class.

Extension to other situations. In some countries, the equal treatment principle has been further extended to provide equal rights to shareholders whose situations are different, as described below:

- *Post-bid top-up clause*. In *Belgium* and *Germany*, for instance, if within one year after the closing of the bid, the offeror acquires securities subject to the bid at a price that exceeds the bid price offered for said securities, all holders of said securities who accepted the bid are entitled to receive the price difference. In *Finland*, the automatic bid adjustment applies within

a nine-month period. Thus, shareholders who have tendered their shares benefit from the same price as shareholders who have kept their shares during the takeover bid and sold them afterwards. These top-up clauses may also prevent shareholders from blocking the application of a squeeze-out. In *Switzerland*, a major non-EU jurisdiction, a similar principle is applicable: the best-price rule applies from the pre-announcement or publication of the bid until six months after the expiry of the additional acceptance period. If, during such a period, the offeror acquires additional securities for an amount exceeding the bid price, the offeror is under an obligation to offer this higher price to all recipients of the public bid.

- *Extension to competing offerors*. Some countries, such as the UK, provide equality of information to competing offerors, thus extending the equal treatment principle from relationships among shareholders to relationships among offerors.

Other ways to address equal treatment: The US example. In the US, equal treatment is addressed through different mechanisms:

- *SEC rules.* In the US, the first part of the equal treatment principle set out in Art. 3.1(a) of the Directive ("all holders of the securities of an offeree company of the same class must be afforded equivalent treatment") is applied through the so-called 'all-holders/best-price' rule set out by the SEC in Rule 14d-10 of the Securities Exchange Act of 1934. The all-holders/best-price rule applies to takeover bids, both friendly and hostile, but does not apply to statutory mergers. The rules are outlined below.
  - *All-holders rule*. Under Rule 14d-10, no offeror is permitted to make a takeover bid unless the bid "is open to all security holders of the class of securities subject to the tender offer". It is customary that, if a bid is made for less than all the shares of a particular class, the offeror will purchase the shares tendered on a pro rata basis.
  - *Best-price rule*. Rule 14d-10 also provides that "the consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer".
- *State rules*. The state laws may typically include certain provisions, described below.
  - *Merger statutes*. Under state merger statutes, if an offeror proposes to acquire control of an offeree company by means of a merger pursuant to the laws of the state of incorporation of the offeror and

the offeree company, both the majority and minority shareholders of the offeree company must receive the same price and type of consideration in exchange for their shares.

- *Dissenter rights*. In addition, under the laws of many states, if minority shareholders believe that the price being offered by the offeror is below the fair value of the shares, but a majority of shareholders nevertheless accepts the bid and the merger occurs, the minority shareholders (often called 'dissenters') have the right to petition a court to set a 'fair value' for their shares. If a court rules in favour of the minority shareholders, the surviving company is required to purchase their shares for a cash amount equal to the fair value.
- *Protection of the offeree company*. While takeover statutes vary from state to state, most states generally prohibit offerors who acquire a controlling block of offeree company stock from engaging in certain transactions with the offeree company for a period of time, usually ranging from three to five years after the acquisition, unless the acquisition was pre-approved by the offeree company's board of directors. These statutes have the effect of making offerors obtain the approval of the offeree company's board before acquiring a controlling share in the company. This allows the offeree company's board of directors to bargain for provisions that are protective of minority shareholders.

Proper information

Principles and associated rules. According to Art. 3.1(b) of the Directive, "the holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid". The content of the required information is more specifically set out in Art. 6 of the Directive (information concerning bids) and Art. 8 of the Directive (disclosure of bids).

The general principle of "sufficient time and information" is further developed in Art. 7.1 of the Directive, which states that "the Member States shall provide that the time allowed for the acceptance of a bid may not be less than two weeks nor more than 10 weeks from the date of publication of the offer document".

No significant issue. No significant issue seems to have arisen in connection with these general principles. With respect to timing, the procedures typically provide for an adequate time frame; however, circumstances such as anti-trust procedures or litigation may, de facto or *de jure*, extend the period during which the offeree company is 'in play'.

Additional protection for the offeree company. Some of the major non-EU jurisdictions provide for a maximum time period between the announcement of the bid and its effective opening. The Directive lacks such a specific rule, but provides in Art. 3.1(f) that "an offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities". Mandating a specific maximum time period between the announcement of the bid and its opening could reduce the sometimes lengthy disruption to the offeree company's affairs that occurs in certain EU member states. Moreover, such a specific rule would be in line with the 'put-up or shut-up' rules introduced by some member states (such as France and the UK), which provide for a maximum time frame during which a declared offeror must take certain actions resulting in the launch of a bid. The situation in major non-EU jurisdictions is presented in Table 11.

Table 11. Maximum time period between the bid announcement and its opening in non-EU jurisdictions

	Maximum time period between announcement of the bid and its opening	**Acceptance period***	
		Minimum	**Maximum**
Australia	2 months	1 month	12 months
Canada	Not applicable	35 days	No maximum time period
China	Not applicable, the bid period opens upon announcement	30 days	60 days
Hong Kong	21 days (cash offer) and 35 days (exchange offer)	21 or 28 days; unless unconditional, the bid must remain open for a further 14 days	81 days
India	55 days	20 days	20 days
Japan	Not applicable	20 business days	60 business days

Table 11. cont'd

Switzerland	The bid may be pre-announced up to 6 weeks before its publication (subject to extensions). The acceptance period starts at the end of a 10-day cooling-off period beginning on the publication of the bid	20 days (but may be shortened to 10 days)	40 days
Russia	Not applicable	70 days	80 days
US	Not applicable	20 days	60 days (cash)**

* Subject to extensions, e.g. in case of competing bids, regulatory or antitrust approvals or litigation.

** An exchange offer usually adds six to eight weeks (or more) to the timetable for a cash takeover bid owing to registration requirements or the offeror's shareholder approval (or both) required in connection with certain capital increases.

Source: Authors.

Market integrity

Principles and associated rules. Under Art. 3.1(d) of the Directive, "false markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted".

In addition, Art. 3.1(e) of the Directive provides that "an offeror must announce a bid only after ensuring that he can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration". Art. 3.1(e) of the Directive confirms Art. 3.1(d) of the Directive in that an offeror who announces a bid without fulfilling his or her cash consideration discloses false information that may contribute to creating false markets.

Prevention of false markets. This principle is typically secured through the transposition of transparency requirements and market abuse prohibitions, which are outside the scope of this study.

Full financing requirements. To secure a consideration in cash, some member states either request a bank guarantee or a bank confirmation. This is also customary practice in most major non-EU jurisdictions. In one case (India), it may be required from the offeror to maintain cash or cash equivalents in an escrow account.

4.3.2 Protection of employees

Principle and associated rules. According to Art. 3.1(b) of the Directive, "where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business". General provisions regarding the information of work representatives, co-determination, etc. provided by national laws apply in parallel (Art. 14 of the Directive). The practical application of these principles is further described below.

Disclosed information. Offer documents must contain certain information, including on the future business of the offeree company, the safeguarding of its employees' jobs and strategic plans (Art. 6 of the Directive). The same applies to the opinion published by the board of the offeree company, which must include the board's view on the effects of the bid on, among other things, employment and the locations of the company (Art. 9.5 of the Directive). The documents that are published (bid documentation, amendments thereto and the position of the offeree company's board) must be disclosed to the representatives of the employees of the offeree company (or the employees themselves) (Art. 6.2 and Art. 8.2 of the Directive).

Opinion issued by employee representatives. Employee representatives may voice their concerns: for instance, when the board of the offeree company receives 'in good time' a separate opinion from them on the effects of the bid on employment, such an opinion must be appended to the opinion issued by the board of the offeree company (Art. 9.5 of the Directive).

Structure. The interests of employees are thus protected in two manners. First, the provision of information gives them the ability to voice their concerns (which may have an impact on the offeror) and to exit (although this second option is in most cases essentially theoretical). Second, their specific interests may be represented by the board of the offeree company, as employees have no decision-making authority. Yet it has been argued that this system is not efficient (Sjåfjell, 2010a, pp. 15 *et seq*.), as ultimately the final decision-making authority rests with the offeree company's board, which has little or no incentive to take into account employee protection in the process. Because of this structure, the disclosure requirements of the Directive may have very little effect on employee protection.

Major non-EU jurisdictions. For comparative purposes, it is worth noting that, under takeover bid regulations in major non-EU jurisdictions, the protection of employees in terms of information as well as their involvement in the bid appears to be weak. Still, an offeror is sometimes obliged to disclose in

the offer documents its intention regarding offeree company employees and the effect of the bid on the latter (for instance, in Australia, Canada, China and Hong Kong).

Basic and enhanced protection

Effective transposition in all member states. The formal transposition of the information requirements regarding employees does not, in principle, raise specific issues. All member states have introduced the information requirements of the Directive. The majority of member states have transposed the Directive without imposing further information requirements in the offer document or in the public statement of the offeree company's board.

Enhanced transposition in some member states. Some member states have introduced further requirements, such as the following:

- *Additional information*. Some countries have added information requirements that relate to information to be provided in the offer document. For example, in Ireland, further requirements have been introduced relating to the information provided to the employees concerning the long-term commercial justification for the bid. In other cases, such additional information must be provided by the board in its public statement. In the Netherlands, for instance, the board must explain why, if applicable, it disagrees with the opinion of the works council regarding a transaction that is to take place between the offeree company and the offeror.
- *Consultation rights*. In some member states (e.g. Belgium, Estonia, France, the Netherlands), works councils or representatives of the employees not only make a statement that must be published along with the statement of the board or management of the offeree company, but also have a consultation right.
- *General protections*. General labour law may often provide some additional protection. For instance, it may be necessary to consult the works council or employees' representatives in connection with the takeover bid or its application. General laws in this respect may be difficult to apply, however, in view of the confidentiality requirements of the pre-announcement period and the time constraints associated with the bid period.
- *Meeting rights*. Some countries have gone a step further. Taking into account the need to initiate a dialogue between employees and the offeror (as a potential new, controlling shareholder), such countries have provided for a meeting right, as in the examples below.

  - In France, the works council of the offeree may decide to hear the offeror. The authorised representative of the offeror must, in a hearing, first present the offeror's industrial and financial strategies, its strategic plans for the offeree company and the impact on the interests at stake, and subsequently receive comments and answer questions on the bid from the works council. If the offeror's representative does not attend the hearing, the offeror's shares are deprived of their voting rights until after the hearing takes place.
  - In Belgium, the works council has the right to invite the offeror for a hearing at the latest ten days after the start of the acceptance period.
- *Co-determination system*. In member states where a co-determination system is in place (such as Germany), the employees' delegates on the supervisory board directly participate in the public statement made by the offeree company's supervisory board.

Traditional limits and recent reforms

Significant enforcement issues. Employee representatives have clearly stated that there are significant issues with the enforcement of employees' rights under the Directive, indicating that there were numerous cases where employee representatives were not informed in an appropriate and timely manner and many cases where the information provided was not adequate. As a result, in some countries, such as the UK, it appears that employees' rights have almost never been used, creating a real compliance issue concerning the Directive.

Limited prior review; no post-bid enforcement. Another issue in relation to the protection of employees is that although information provided to employees may be controlled before the bid, no enforcement takes place after a successful bid. Thus, an offeror may fail to comply with what it had stated or diverge from its plans. Furthermore, even if *ex-ante* control of the information provided in the offer document takes place, it is more of a formal tick-the-box type of control and does not question the offeror's real intentions.

UK analysis of recent reforms. In the UK, following the Kraft takeover of Cadbury, the above-mentioned concerns were addressed through a revision of takeover regulations regarding employee protection.

As a starting point, the Takeover Panel noted that, during recommended bids, employee representatives had no time to express their views. If, as is usually the case in recommended bids, the firm's offer announcement and the offer document are published on the same day (with the offeree company board's circular effectively being combined with the offer document), there will not be time for the employee representatives to produce a circular

expressing their views. The offeree company board has no obligation to subsequently disclose to the market any circular that it may have received from employee representatives. In practical terms (especially where the offeree company operates through a number of divisions), it appears difficult for employee representatives to collate information on the likely effects of the bid on all divisions within the bid timetable. As such, the Takeover Panel (2010) observed a lack of protection of employees during a takeover bid, stating the following:

- The ability of the offeree company board and other interested constituencies to comply with their own obligations, and to provide meaningful information to offeree company shareholders and employees, depends on the accuracy and adequacy of the information published by the offeror in accordance with its own obligations.
- Better communication between the offeree board and the offeree employees (and employee representatives) would enable employee representatives to provide their opinion on the effects of the bid on employment more effectively and, in so doing, would facilitate a wider understanding of the implications that the bid may have for the interests of offeree company employees. The Takeover Panel has thus made the amendments described in Box 3.

Box 3. UK reforms regarding employee protection

Improving employees' information

- *Right to be informed*. Clarify that the Code does not prevent the provision of information in confidence to employee representatives acting in such a capacity during the bid period.
- *Timing of information*. Require the offeree company board to inform employee representatives at the earliest opportunity of their right to circulate an opinion on the effects of the bid on employment.
- *Publication at the offeree company's expense*. Require the offeree company board to publish employee representative circulars (which have not been received in good time) on the company's website (and make an announcement that the circular has been thus published). Clarify that it is the responsibility of the offeree company board to publish the opinion of the employee representatives at the offeree company's expense. However, the employee representatives' opinion will be excluded from the scope of the responsibility statement of the offeree company's board.
- *Reimbursement of representatives' costs*. Require the offeree company to pay the costs incurred by employee representatives in obtaining any advice needed to verify the information in the employee representatives' opinion in order to meet required information standards under the Code.

Strengthening the offeror's obligations

- *Negative statements*. Offerors should make negative statements if there are no plans regarding the offeree company's employees, locations of business and fixed assets, or if it considers that its strategic plans for the offeree company will have no repercussions on employment or the location of the offeree company's places of business.
- *A 12-month minimum validity of the statements*. Any party to a bid must adhere to any public statement it makes during the bid period relating to any course of action it intends to take (or not to take) after the end of the bid period. Where no time period for the application/non-application of the course of action is specified, the statement should be adhered to for a period of at least 12 months from the date on which the bid becomes or is declared wholly unconditional.

4.3.3 Protection of other stakeholders

Description

Principle and associated rules. According to Art. 3.1(c) of the Directive, "the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid". Furthermore, "an offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities" (Art. 3.1(f) of the Directive). One of the purposes of time frames for acceptance (Art. 7 of the Directive) is to prevent the offeree company from being hindered in the conduct of its affairs.

The core debate

Interests of the company and interests of stakeholders. It is always a difficult and controversial task to define what the interests of a company encompass. From a *prima facie* reading of Art. 3.1(c) of the Directive, it appears that the "interests of the company" are not equivalent to the interests of shareholders; otherwise the sentence would be mostly redundant and thus essentially meaningless. The reference to the company taken "as a whole" also points in favour of a broad analysis of the concept and suggests that the company is considered a representative of the interests of all of its stakeholders. There is no definition of the stakeholder concept, but the Directive suggests two directions: employees (who are the subject of several clauses of the Directive) and local communities (which are addressed in Art. 9.5 of the Directive through the reference to the "locations of the company's places of business"). Other interests of the company taken "as a whole" would typically include the interests of creditors,

contracting parties (such as sub-contractors) and public authorities. The environment may also be included, to the extent it affects both the employees and the local communities.

Striking the right balance. The Directive does not explain how conflicts between stakeholders' and shareholders' interests may be resolved. Such conflicts may for instance occur when an offeror intends to break up a company, relocate its activities, proceed with massive lay-offs or disregard its contractual commitments or legal obligations. Depending on the circumstances and the identity of the stakeholders considered, the offeror may act in a manner contrary to the interests of the company "taken as a whole". On the other hand, if a company puts up a defence, even if its objective is to negotiate a higher price, it risks acting in breach of Art. 3.1(c) of the Directive. The Directive leaves to member states the task of setting the limits of what is permitted or prohibited.

Prohibited conduct. Art. 3.1(c) of the Directive would seem to call for a *proportionality test* between the two rules with which the board has to comply during a bid – acting in the interest of the company as a whole and not denying the holders of securities the opportunity to decide on the merits of the bid. A member state applying one of the two rules in full and completely disregarding the other would probably not be compliant with the Directive. *For instance, no legal system should allow the board to adopt frustrating measures without strong grounds to do so – and the more efficient the measures, the stronger the grounds should be. On the other hand, no board should be fully prohibited from putting up defences that are necessary to defend the interests of the company – the more restricted the board's ability to defend the company's interests, the stronger the company's interest in the bid should be.*

Transposition. This article does not seem to have a strong impact on the way the Directive has been transposed. Member states that have transposed Art. 9 of the Directive tend to consider that the passivity rule should override all other concerns, although their legal systems formally acknowledge that the board should not act against the company's interests. Member states that have not transposed Art. 9 emphasise the board's duty to defend the company's interest, and pay less unilateral attention to the consequences this may have on shareholders' rights.[17] Actually, member states tend to justify their position as follows. Where Art. 9 has been transposed, it is claimed that the company's

[17] In Germany, for instance, the management board and the supervisory board must always respect the general principles set out in the Stock Corporation Act. They must serve the interests of the company, which includes the interests of shareholders and other stakeholders. In case of a voluntary takeover bid or a mandatory bid, the management board must, again, act in the interest of the company as a whole.

interests (taken as a whole) are best served by the disciplinary effect that comes with the non-frustration rule: this leads to better-managed companies and a lower cost of capital, both of which ultimately serve the interests of all stakeholders. Where Art. 9 has not been transposed, the reverse position is adopted: the overriding duty to protect the company's interests is deemed to best serve the interests of all shareholders, at least in the long run. Is either attitude compliant with the Directive? It is rather difficult to provide a clear answer.

Major non-EU jurisdictions: The US example of 'stakeholders' statutes'. Among major non-EU jurisdictions, the US provides an interesting example of stakeholder protection: approximately 30 US states have enacted so-called 'other constituency' statutes that authorise an offeree company's board to consider the interests of stakeholders other than the financial interests of shareholders. Notably this rule is not applicable in Delaware, where, if the offeree company board has decided to put the company up for sale, the board is subject to the Revlon duty to maximise shareholder value exclusively and thus cannot consider the interests of other stakeholders, including employees.

4.4 Exemptions to the Directive

The principle and its purpose. According to Art. 4.5 paragraph 2 of the Directive, member states may, in their national legal frameworks, provide certain exemptions or derogations from the rules of the Directive, or grant supervisory authorities the power to waive certain rules. Nevertheless, such derogations are still subject to the general principles in Art. 3 of the Directive. The granting of exemptions may help to improve attainment of the objectives and general principles of the Directive, in particular where they help to balance diverging, protected interests. As a result, these exemptions have generally not been seen as weakening the Directive.

General and specific exemptions. Some member states (such as the UK,[18] Finland[19] and Ireland[20]) entrust their supervisory authority with the general

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[18] *General exemption.* The Panel may derogate or waive the application of a rule to a person (provided, in the case of a transaction and rule subject to the requirements of the Directive, that the general principles are respected), either

i) under the circumstances set out in the rule; or

ii) under other circumstances where the Panel considers that the particular rule would operate unduly harshly or in an unnecessarily restrictive or burdensome or otherwise inappropriate manner (in which case a reasoned decision will be provided).

power to grant exemptions without specifying the provisions for which an exemption can be granted. Such exemptions take effect in cases where the application of a rule appears to operate in an unduly harsh or burdensome manner, taking into account the general principles of the rules and the interests of the shareholders. In the UK, such exemptions can also be granted if the offeree company has very few shareholders, provided that a certain procedure and several safeguards are observed.

In the other member states, exemptions or derogations are granted specifically for certain obligations, in particular the mandatory bid rule.

4.5 Perception

Perception. Stakeholders are generally positive regarding the Directive, with the noticeable exception of employee representatives.

- *Enhanced principles of certainty and transparency*. A majority of stakeholders are of the opinion that the Directive has enhanced legal certainty and transparency (65%) and that its transposition has enhanced certainty and clarity (67%). Among the stakeholders who consider that the Directive is unclear, there is disagreement on the source of the lack of clarity. Some stakeholders consider that the vagueness is caused by the Directive itself (40%) while others believe that it stems from the national transposition of the Directive. Stakeholders nevertheless agree that the absence of clarity could be addressed through further guidance (77%).

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[19] *General exemption*. According to a provision in the Finnish Securities Markets Act (SMA), the Finnish Financial Supervision Authority (FSA) can for a special reason authorise exemptions from the provisions of Chapter 6 of the Finnish SMA. In its Takeover Standard, the Finnish FSA has stated that the exemption consideration is based on an overall assessment of all circumstances at hand, taking into account the effect of the exemption on the position of the minority shareholders as well as the question of whether the minority shareholders were aware of the arrangement beforehand and had an opportunity to affect its contents (e.g. in a general meeting of shareholders). The Takeover Standard sets out examples of circumstances that can constitute a special reason to diverge from the mandatory bid obligation.

[20] *General exemption*. The Panel, as the Irish supervisory authority for the purposes of takeover bids under the Takeover Regulations, has the power under Irish statute "to grant derogations from, or waive, any rules under [Section 8 of the 1997 Act (i.e. the Takeover Rules)] in relation to a particular matter where, in the opinion of the Panel, having regard to the exceptional circumstances of the matter but taking into consideration the schedule principles, it is appropriate to do so".

- *Divergent opinions on the protection of employees*. While stakeholders in general believe that the obligations set out in the Directive regarding the protection of employee rights are sufficient and enforced appropriately (73%), employee representatives strongly disagree with this view (100%).
- *Negative effects of takeovers*. Stakeholders at large recognise the negative effects of takeover bids on employment, admitting that takeovers sometimes or frequently result in lay-offs (76%) and early retirements at the offeree company's level (63%).

5. MANDATORY BID RULE

Under the mandatory bid rule (Art. 5 of the Directive), if an entity acquires control over a company, it is obliged to make a takeover bid for all the remaining voting securities of such a company at an equitable price. This rule protects minority shareholders by granting them both a right to sell their shares in the event of a change of control, and the benefit of the premium paid for the controlling stake. The percentage of voting rights conferring control and the method of calculation of this percentage must be determined by the member state in which the registered office of the company is located. The supervisory authorities may be authorised by member states to adjust the equitable price under certain circumstances and in accordance with criteria that are clearly determined. Any such decision must be substantiated and made public.

This chapter addresses the following questions in particular:

- Is the mandatory bid a takeover-hostile provision?
- How are the key concepts of control and 'acting in concert' defined and used?
- What are the main exemptions to mandatory bids and how can they be categorised?
- What rules are applicable outside the EU?

Key concepts

- The mandatory bid rule protects minority shareholders through the prohibition of two-tier bids and the sharing of the control premium, while potentially reducing the number of bids, thus functionally acting as a takeover defence. This issue is confirmed by economic analysis and the perception of stakeholders.
- Its application raises some issues, such as the lack of harmonisation in the key concepts of control and acting in concert. Still, different shareholding structures mean that a cautious approach is required regarding the harmonisation of control. 'Acting in concert' is a notion to which active shareholders who wish to coordinate pay close attention, and which has been the object of specific scrutiny in Italy (which uses 'hard' concepts) and in the UK (which uses 'soft' concepts). A majority of stakeholders also consider that the definition of acting in concert may be easily circumvented.

- The variety of exemptions to the mandatory bid rule (more than 35) is justified by the diversity of situations and interests that are covered; however, it seriously reduces the predictability of the Directive in this area.

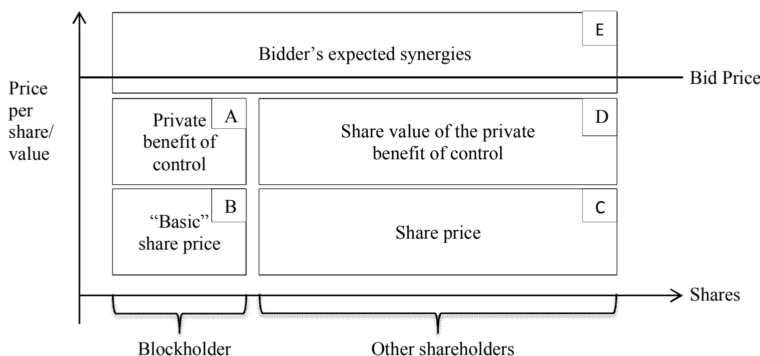
US laws on 'control share cash-out'. There is no direct counterpart to the Directive's mandatory bid rule under US federal law or, with only a few exceptions, under the laws of most US states (including Delaware). The only exception is that three states (Maine, Pennsylvania and South Dakota, none of which have a significant number of public companies incorporated under their laws) have 'control share cash-out' laws, which provide that if an offeror gains voting control over a specified percentage of the outstanding shares of a company (ranging between 20% and 50%), the other shareholders of the latter can require the offeror to purchase their shares at a 'fair price'.

5.1 The mandatory bid – A takeover-hostile provision?

A takeover-hostile provision. The mandatory bid rule may be seen as a 'takeover-hostile' provision in that it prevents the offeror from using coercive bid structures, such as partial bids and two-tier bids (Enriques, 2009, p. 11). In addition, the mandatory bid rule may increase the cost of acquisitions, both friendly and hostile, to a level that acts as a deterrent to takeover bids altogether.

As an illustration, consider a potential offeror who may only wish to purchase, for instance, 35% of the shares in a company. With the mandatory bid, he or she will have to be prepared to purchase 100%. This substantially increases the prospective cost of a takeover for the offeror and may deter the offeror from launching a bid at all. This issue is even worse when there are private benefits of control, as shown in Figure 4.

Figure 4. The mandatory bid and private benefits of control



As Figure 4 shows, the offeror's expected synergies (E) need to be sufficient to pay for both the private benefit of control[21] of the blockholders (A) and the extra amount resulting from the application of the mandatory bid rule (D); otherwise there will be no bid (unless the blockholder is ready to give away a portion of its private benefits of control, which would not be rational). In addition, even in the absence of the private benefit of control, a blockholder may be in a position to negotiate a higher bid price than dispersed shareholders would.

Private benefits of control. The amount of the private benefits of control is thus a significant component of the analysis, as it has a direct impact on the anti-takeover effect of the mandatory bid rule. It has been the subject of a certain number of studies. Although the precise figures may be subject to debate, they give a broad indication as to the possible levels of private benefits of control in different countries. For instance, the figures in Table 12 have been computed (Zingales and Dyck, 2004).

Table 12. Value of private benefits of control

Country	**Value (%)**
US	1
Germany	1
UK	2
France	2
Spain	4
Finland	7
Sweden	7
Denmark	8
Portugal	20
Italy	37
Austria	38
Czech Republic	58
Brazil	65

Source: Authors; Zingales and Dyck (2004).

In several countries, the value of private benefits of control may thus be significant enough to make the mandatory rule a powerful anti-takeover device.

[21] The private benefit of control refers to the power of a controlling shareholder to use corporate resources for its private advantage.

5.2 Transposition

Dynamics of transposition. The mandatory bid rule existed in many member states before adoption of the Directive. In 4 out of 22 member states (Cyprus, Greece, Luxembourg and the Netherlands), no mandatory bid rule existed prior to the transposition of the Directive, and in 5 other member states the rule has been amended in connection with the transposition of the Directive. Generally the Directive has helped to improve protection of minority shareholders by lowering the threshold, specifying the triggering events, requiring control over the price and setting out time periods within the bid processes.

5.2.1 Definition of control

Flexibility. The Directive has granted member states a large degree of flexibility in the definition of 'control'. As a criterion for defining control, member states use either the crossing of a specified threshold, the acquisition of de facto control, or a combination of both criteria.

Crossing a specified threshold

Success of the 'threshold' approach. With the exception of Estonia, all member states provide for a specific threshold of voting rights or shares carrying voting rights that must be met or exceeded. This is generally considered the simplest method of defining control, although, to be meaningful, it must come with a number of exemptions (such as the 'larger shareholder' exemption, which provides that a shareholder crossing the specified threshold does not need to launch a mandatory bid if there is a shareholder with a larger holding).

Concentration on 30% and 33% and the issue of de facto control. Although the Directive grants flexibility to the member states in the determination of this threshold, in most member states the threshold is either 30% or 33%. This convergence is interesting, as there is no 'magic' in these numbers. Whereas the 33% threshold may, in some cases, correspond to the blocking minority for decisions subject to super-majority vote, the 30% level has no specific justification. Compared with the 'hard' control level of 50%, it is low. Yet, if it is meant to prevent acquisition of de facto control, it is often too high, since companies with a widespread shareholding and an average turnout ratio at general meetings of 50% or less may be controlled with 25% of the voting shares. One manner of addressing the de facto control issue is the 'Hungarian method', which is described in Box 4.

Box 4. The Hungarian method

In Hungary, two thresholds have been introduced and the holdings of the other shareholders are taken into account. A person must launch a mandatory bid if he or she

- acquires (directly or indirectly) more than 33% of the voting shares or voting rights (regardless of the shareholdings of others); or
- acquires (directly or indirectly) more than 25% of the voting shares or voting rights in an offeree company in which no shareholder other than the offeror holds more than 10% of the voting rights.

The 'creep-up' issue. A shareholding between 30% and 50% does not give its holder the certainty that it will retain control of the company forever. Such shareholders are thus left with uncertainty, as a result of which they may be tempted to 'creep up', i.e. to move from 30% to 50% without triggering a bid. There are two approaches to address this issue:

- *The restricted increase approach*. Some countries provide that any acquisition of shares – or of a certain quantity of shares over a certain time period – above the 30% (or 33%) threshold will give rise to a mandatory bid. Examples of such additional percentages and relevant time periods include
  - France – 2% of shares or voting rights within 12 months;
  - Greece and Italy – 3% of voting rights within 12 months;
  - Ireland – 0.05% of voting rights within 12 months; and
  - the UK – one share (which means that any acquisition triggers a mandatory bid).

  Yet these rules have different functions, for instance,
  - in France and Greece, which have a large number of blockholders, the rules allow blockholders to slowly increase holdings. Large blockholders thus retain some freedom to increase their participation and the market has ample time to be informed; and
  - in the UK and Ireland, where shareholding is more widespread, no leeway is granted.
- *The 50% threshold approach*. If the 'magic' figure is 50%, the easiest way to address the issue is to set a second threshold at the 50% level. This has been done by Portugal and Finland. Poland has followed a similar approach, but with a second threshold set at 66%.

Acquisition of actual control

Compliance with the Directive. The Directive requires a threshold to be considered when determining whether control has been taken. However, this may leave the door open to use of the notion of actual control coupled with a presumption of control set at a certain threshold, as well as the use of a threshold combined with other criteria.

Reference to actual control. Only Estonia refers to the notion of actual control. Two member states, Denmark and Spain, combine two alternative criteria: either crossing a specified threshold or holding actual control.

Summary view

The definition of control used in the various member states is shown in Tables 13 and 14. A synthesised map is presented in Figure 5.

Table 13. Definition of 'control'

Threshold			**Actual control**	**Mixed (both threshold and actual control are provided)**
30%	**33% or 1/3**	**Second threshold**		
Austria Belgium Cyprus Czech Republic Finland France Germany Ireland Italy Netherlands Sweden UK	Greece Hungary Luxembourg Poland Portugal Romania Slovakia	Finland (50%) Poland (66%) Portugal (50%)	*Estonia:* There is a presumption of dominant influence if i) a person holds a majority of the votes represented by the shares (i.e. 50% +1); or ii) a person, being a shareholder of the company, has the right to appoint or remove a majority of the members of the management or supervisory board; or iii) a person, being a shareholder of the company, has sole control over a majority of the votes pursuant to an agreement entered into with other shareholders; or iv) a person has dominant influence or control over the company or the possibility of exercising it.	*Denmark:* The acquirer controls 50% of the voting rights through a holding or pursuant to an agreement and thereby holds a controlling influence, controls the financial and operational aspects of the company pursuant to the articles of association or an agreement, controls the majority of the members of the board of directors, or owns more than 1/3 of the voting rights and exercises a controlling influence over the company. *Spain*: The acquirer obtains 30% of the voting rights or appoints more than half of the board members within 24 months.

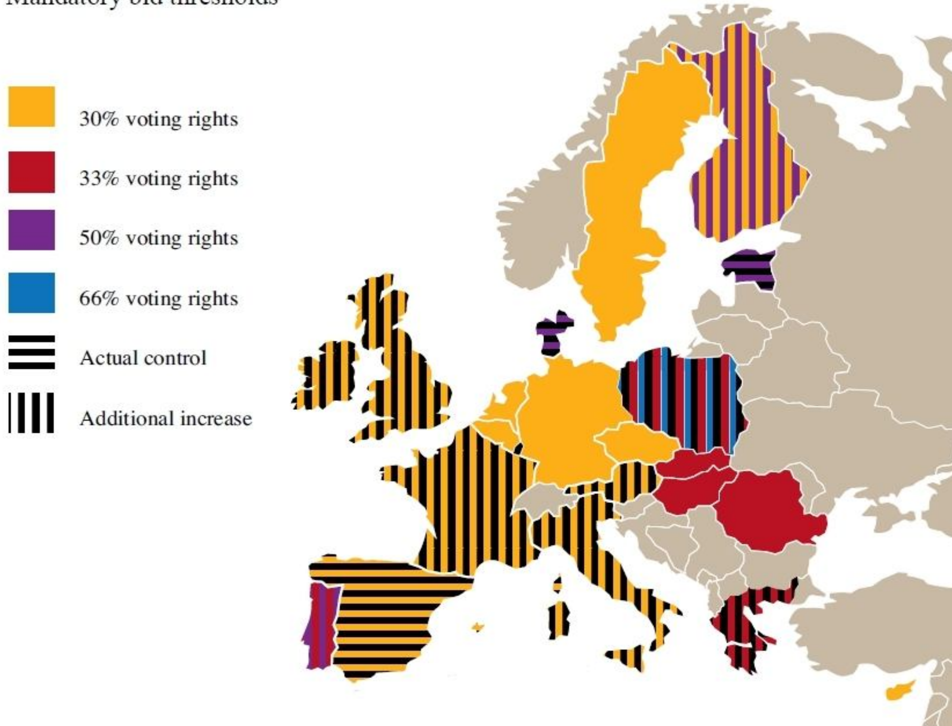
Source: Authors.

Table 14. Additional criteria

No increase	Slow increase	Large shareholder
Ireland (0.05% increase above 30% within 12 months provided that a single shareholder who holds more than 50% of the voting rights may acquire additional securities) *UK* (any increase between 30% and 50%)	*France* (increase by 2% in capital or voting rights between 30% and 50% within 12 months) *Austria* (increase by 2% between 30% and 50% within 12 months) *Greece* (increase by 3% between 33% and 50% within 6 months) *Italy* (increase by 5% between 30% and 50% within 12 months) *Poland* (increase by 10% by a shareholder holding less than 33% within 60 days or 5% increase by a shareholder holding more than 33% within 12 months) *Spain* (increase by 5% between 30% and 50% within 12 months)	*Hungary* (25% threshold if no other shareholder holds at least a 10% participating interest in the offeree company)

Source: Authors.

Figure 5. Synthesised map of bid thresholds



Note: In Hungary the threshold is 33% voting rights with an additional criterion – a 25% increase if no other shareholder holds more than a 10% participating interest in the offeree company.

5.2.2 Definition of acting in concert

A significant issue. The issue of acting in concert is relevant for calculating the control threshold. In a significant number of member states, the definition of 'acting in concert' and the question as to whether persons were acting in concert, and were thus committed to a mandatory takeover bid, has frequently been discussed and has led to various law suits and enforcement decisions by supervisory authorities.

The main definitions. Art. 2.1(d) of the Directive defines "acting in concert" as follows: "'persons acting in concert' shall mean natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid".

According to Art. 10(a) of the Transparency Directive (2004/109/EC),[22] acting in concert involves "a third party with whom that person or entity has concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the issuer in question".

The concept of acting in concert is also included in the Acquisitions Directive (2007/44/EC), although the very broad definition provided in level 3 guidance of the Acquisitions Directive is not used by member states in connection with mandatory takeover bids. This may reflect a willingness of member states to use a narrow definition for the purpose of greater clarity and foreseeability.

Two possible approaches. Member states take two different approaches with respect to the definition of acting in concert: they either retain a definition that is very close to the one in the Takeover Directive or add to this definition the concept of concert as defined in the Transparency Directive.

The Transparency Directive definition does not specifically refer to acquisition situations, but envisages concerts relating to the (long-term) strategy of the offeree company. In this context, the concert would be the exercise of voting rights with a view to applying a certain policy and influencing the management and strategy of the offeree company.

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[22] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390/38, 31.12.2004.

Consequently, a concert within this meaning can also occur independently of an acquisition, if shareholders already holding shares agree on the strategy. Conversely, in member states (such as the UK or Italy) that have opted for the definition provided by the Takeover Directive, such concerted parties must also acquire additional shares in order to trigger a mandatory bid. Investors acting in concert are thus more likely to find themselves in a situation where they need to launch a mandatory bid in member states that combine the two definitions, such as France, Germany or Spain.

Shareholder engagement or activism. Some concern has been raised that excessively broad definitions of acting in concert may lead to undue restrictions on shareholder engagement or activism or other forms of collective shareholder action. This issue has been addressed recently in both the UK and Italy. The positions these countries have taken serve a similar goal (easing the way for collective shareholder action), but the measures chosen are different.

In the UK, the Takeover Panel has issued a broad statement revolving around the key concepts outlined below.

- Only 'board control-seeking' resolutions should be addressed.
- A resolution is not normally board control-seeking if the directors to be appointed are either independent directors or non-executive directors appointed to improve the company's corporate governance.
- No mandatory bid will be imposed if the parties acting in concert have taken steps not to acquire shares, or if they have acquired shares, they undertake to dispose of them within an appropriate time period.
- The following factors would not of themselves lead the Takeover Panel to conclude that a concert party had come together: i) discussions among shareholders about possible issues that might be raised with a company's board; ii) joint representations by shareholders to the board and the agreement by shareholders to vote in the same way on a particular resolution at a general meeting.

In Italy, new Consob regulations exclude a certain number of cases of cooperation from the scope of actions in concert. Such cases include coordination regarding the appointment of less than half of the board members.

The UK system is thus based on a soft concept (independence of directors) whereas the Italian one has chosen a hard notion, which leaves no room for interpretation (the proportion of appointees to the board).

Sales between concert parties. Another difficult issue is the question of how to address sales between concert parties. To determine whether this sale should trigger a mandatory bid, a fact-intensive analysis is typically undertaken, including such issues as whether the member with the largest

individual shareholding has changed and whether the balance among the holdings in the group has changed significantly.

5.2.3 Exemptions from the mandatory bid rule

A high number of exceptions. There are a large number of exemptions to the mandatory bid rule that differ significantly among the member states. The purpose of these exemptions is to find a balance among diverging interests. Some exemptions are discretionary: they may be granted by supervisory authorities (acting either pursuant to specific regulations or following a self-asserted extension of power) or by shareholders pursuant to a whitewash procedure. Other exemptions are precisely defined by the applicable laws and regulations and they fall within four categories: technical exemptions, protection of the interests of the offeror or the controlling shareholder, protection of creditors, and protection of other stakeholders. Table 15 summarises the main applicable cases and provides examples of their use.

Rationale. Each exemption category has its rationale and its debatable cases. For instance, some exemptions, meant to protect the acquirer in connection with a real change of control, are debatable, in particular those applicable to free transfers within a family or indirect transfers of holdings. Mechanisms providing for the protection of creditors may also lead to potential circumventions of the mandatory bid rule. Where exemptions relating to companies in financially distressed situations are obviously necessary, those relating to certain types of corporate transactions require a closer review, as their rationale is ultimately linked to the corporate interest of the underlying transaction, which is always difficult to assess *ex ante*. How the interests of shareholders are taken care of in these cases should be closely reviewed (whitewash procedure, *ex ante* approval by a supervisory authority or by competent courts, etc.). Finally, exemptions that are part of a strong defensive mechanism or linked to the protection of a member state's interest should be assessed in light of the pros and cons of the principle of the free contestability of control and the specificities (or lack thereof) applicable to public entities.

A specific issue: The voluntary bid exemption. Art. 5.2 of the Directive states that the mandatory bid rule is not applicable where control has been acquired following a voluntary bid made in accordance with the Directive to all holders of securities. The conditions under which member states apply this exemption vary.

In certain member states, any voluntary bid for all the shares of the offeree company may qualify (e.g. Belgium, Finland, Ireland, the Netherlands, Portugal, Czech Republic and Slovakia).

In other member states, only a voluntary bid complying with certain requirements may qualify for the exemption, for instance,

- in Italy, the provisions regarding mandatory takeover bids do not apply if the shareholding is acquired as a result of a cash or exchange takeover bid on at least 60% of the securities in each category and certain conditions are met,[23] including a whitewash procedure;
- in Germany, Greece and Romania, the voluntary bid must be launched in accordance with the equitable price rules; and
- in Spain, an equitable price has to be offered or the bid has to be accepted by shareholders (other than the offeror) representing at least 50% of the voting rights targeted by the bid.

It is noteworthy that the differences among these requirements are partly caused by diverging conditions and requirements for voluntary bids among member states.

Finally, the issue created by the combination of the voluntary bid exception and the absence of 'creep-up' thresholds between 30% and 50% creates a risk of circumvention: an offeror may launch an offer at a low price, obtain between 30% and 50% of the offeree shares and then buy additional shares up to 51% (or more). The offeror is thus able to acquire the control of the offeree without triggering a mandatory bid and at a low price. The Hochtief case has illustrated this risk in Germany. This risk may be avoided if applicable regulations provide for a compulsory, minimum acceptance condition stipulating that, if the offeror does not hold more than 50% of the shares after the offer, the offer is deemed unsuccessful.

[23] In Italy, the conditions are as follows:

i) the offeror and persons acting in concert with the offeror have not acquired shareholdings exceeding 1% (including shares acquired under forward contracts maturing at a later date) either in the 12 months preceding the notice to Consob disclosing the takeover bid or during the bid period; and

ii) the bid has been approved by a number of shareholders who jointly own the majority of the relevant securities excluding securities held by the offeror, by the majority (or relative majority) shareholder if that shareholding exceeds 10%, and by persons acting in concert.

Exemptions applicable to foundations. In Belgium, exemptions apply to foundations acquiring shares for free[24] or the acquisition of certificates. In this respect, Belgian law provides that if a person acquiring more than 30% of the securities carrying voting rights of a company is i) a legal person (e.g. *stichting-administratiekantoor*), who is ii) issuing in exchange, with the cooperation of the listed company, certificates that entitle the former owner of the securities to all future revenues arising therefrom, such legal person does not have to launch a bid to the extent that such certificates, within three years of their issuance, can at all times and under all circumstances be re-exchanged against the initial securities (Art. 52 § 1, 12° Decree). If such free exchange is no longer possible within the three-year period, the legal person must launch a bid immediately at the conditions (price and so forth) prevailing at that time (Art. 52 § 4 Decree).

In the Netherlands, the mandatory bid requirement does not apply to i) an independent foundation that acquires control after the announcement of a hostile bid as a protective measure for a maximum period of two years, or ii) an independent trust office (*administratiekantoor*) that has issued depositary receipts. Although no voting rights are attached to depositary receipts, the holders of such receipts may ask the independent trust office (*stichting administratiekantoor*) to give a proxy to vote. The independent trust office may refuse to grant a proxy if a public bid has been announced or is made in respect of a share in the capital of the company. In the event that an independent trust office gives a proxy to vote and (consequently) a holder of depositary receipts is able to use at least 30% of the voting rights, it becomes obligatory to launch a mandatory bid. The independent trust office itself is exempted from the obligation to launch a public bid.

Main use of exemptions. It is difficult to assess precisely the use of exemptions that have been granted, as the information is not always public. Based on declarations by supervisors and stakeholder perception, it seems that the most commonly used exceptions are voluntary bids, specific transactions (such as capital increases or mergers), acting in concert without acquisition, absence of real change of control and financially distressed companies. It should be noted that acting in concert without acquisition may be considered either an exemption to the mandatory bid rule or not being addressed by the mandatory bid rule, depending how this rule is interpreted.

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[24] If the person acquiring more than 30% is a public utility foundation (*stichting van openbaar nut/fondation d'utilité publique*) subject to the Law of 27 June 1921 and is acquiring such securities for free (Art. 52 § 1, 10° Decree).

Table 15. Exemptions

	Discretionary exemptions
1	Exemptions are decided by the supervisory authority. (The change of control was linked to exceptional circumstances or it would be inappropriate or unduly burdensome to apply the mandatory bid rule under the circumstances.) [a]
2	Exemptions are decided by shareholders (whitewash procedure). [b]
	Defined exemptions
	Technical exemptions
3	• Certain offeree companies are exempt (e.g. open-ended collective investment scheme)
4	• Exclusion procedures [c]
5	• Controlling agreements [d]
	Protection of the offeror or the controlling shareholder
6	• There is no real change of control
7	– The change of control is only temporary
8	– The change of control was the result of a mistake and/or there was no intention to take control
9	– Existence of a larger shareholder
10	– Intra-group transaction (no change of the ultimate controller)
11	– The transaction takes place within the same acting-in-concert group
12	– The acquisition is small [e]
13	– Financial derivatives [f]
	• There is a real change of control
14	– The change of control did not result from a voluntary act
15	*Disposal of shares by another investor*
16	*Changes in the total number of shares or voting rights not caused by the offeror*
17	– The change of control is the result of a voluntary takeover bid
18	*Any voluntary bid for all the shares of the offeree company may qualify*
19	*The voluntary bid must comply with certain requirements (for instance regarding its price)*
20	– The acquisition is indirect and a 'substance test' is applied
	– The change of control results from a personal event
21	*Inheritance, donation, marriage, divorce*
22	*The transaction takes place within the same family group*
23	– A concert is formed but no shares are acquired
	Protection of creditors. (The acquisition is made upon exercising a financial security, such as a pledge.)
24	• Without any other conditions
25	• The acquirer needs to sell the acquired shares within a certain time period
	Protection of other stakeholders
26	• The offeree company is in a financially distressed situation [g]
	• Control was acquired pursuant to specific types of corporate transactions

Table 15 cont'd

27	– Capital increases (with or without preferential subscription rights) or capital reductions
28	– Mergers
29	– Divisions
30	– Reorganisations
31	– Contributions in kind
32	– Distributions of company assets to shareholders
33	– Schemes of arrangement [h)]
34	• The rule is not applicable to certain entities that have acquired control (e.g. foundations or issuers of sponsored depositary certificates) [i)]
	• Protection of state interest and public order
35	– Privatisation exemption or other state interest [j)]
36	– Need to meet statutory obligations [k)]

[a)] For instance, these exemptions may be found in the UK or in Poland.

[b)] Some countries take the view that shareholders should be authorised to waive the mandatory bid rule, since the rule seeks to protect shareholders. Yet, since controlling shareholders may overrule minority shareholders, a whitewash only protects majority shareholders, unless majority or interested shareholders are excluded from the vote. A whitewash procedure exists in the UK, subject to approval by the Takeover Panel.

[c)] Such an exemption applies when the acquirer has acquired enough shares to be allowed to proceed with the squeeze-out of minority shareholders, provided that the latter are sufficiently protected by the relevant exclusionary rules.

[d)] This exemption applies to acquisitions by a person who entered into a controlling agreement or a profit transfer agreement with the company, provided that such person effects a buyout of the minority shareholders (Germany, Czech Republic).

[e)] For instance, the acquisition concerns less than 1% of the voting rights (Cyprus).

[f)] In Italy, for instance, if the thresholds are crossed as a consequence of a purchase of financial derivative instruments, the purchaser may be exempted if it undertakes i) to transfer the derivatives or the securities in excess to non-related parties within six months, and ii) not to exercise, during the same period, the voting rights in excess of the crossed threshold.

[g)] This category includes all kinds of financial distress. Accordingly, any capital increase, merger, reorganisation or contribution in kind (etc.) applied in connection with a financially distressed situation may fall within this 'financially distressed' category.

[h)] In the UK and Ireland, a scheme of arrangement is a compromise or arrangement between a company and its members and is therefore generally only used in recommended bids where there is no reasonable likelihood of a competing bid. Court-sanctioned schemes of arrangement bind all the shareholders within a class and have stamp duty and tax advantages over a public bid. Schemes require approval by a majority in number representing at least 75% in value of the shareholders voting at the relevant meeting.

[i)] This exemption may be found in Belgium and in the Netherlands.

[j)] An example of such an exemption exists in Greece, where a person investing in the privatisation of a state-owned company may be exempted. This exemption enables the Greek State to benefit from the full control premium without sharing it with minority shareholders.

[k)] When a transaction is completed in order to meet specific statutory obligations, the acquirer may be exempted from the requirement to launch a mandatory bid (Czech Republic).

Source: Authors.

5.2.4 Price determination

Principles set forth in the Directive. The mandatory bid must be launched at an equitable price as defined in Art. 5.4 of the Directive. The following principles apply to the equitable price:

- *Minimum price.* As set out by Art. 5.4 of the Directive, this price must correspond to

  > [t]he highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by member states, of not less than six months and not more than 12 before the bid referred to in paragraph 1 shall be regarded as the equitable price. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired.

- *Potential adjustments.* According to Art. 5.4 of the Directive, member states may authorise their supervisory authorities to adjust the price referred to in the first paragraph of Art. 5.4 in certain circumstances and in accordance with criteria that are clearly determined.
- *Type of consideration.* The offeror may offer consideration in cash, securities or a combination of both. Where the consideration offered by the offeror does not consist of liquid securities admitted to trading on a regulated market, it shall include a cash alternative. The obligation to provide a cash alternative also applies where the offeror has, during a reference period of not less than 6 and not more than 12 months, purchased cash securities carrying 5% or more of the voting rights in the offeree company.
- *General transposition.* Art. 5.4 of the Directive (equitable price criteria) has been transposed in all the member states. Differences exist, however, in connection with the price determination. Such differences relate to the reference made to previous acquisitions and to additional criteria used to determine the equitable price.

Reference period. The criterion used by the Directive is the highest price paid for previous acquisitions by the offeror or other concerted persons during a reference period that may not exceed 12 months. Certain member states (for example the UK, Italy, Belgium, Ireland, Spain, France, Romania and Austria) refer to a 12-month period, whereas a minority of member states (Finland, Germany, Greece and Portugal) refers to a 6-month period.

Weighted averages. Several member states[25] use an additional criterion for the determination of the equitable price, which is the (weighted) average stock exchange price of the shares of the offeree company during a reference period varying from 30 days (Belgium) to 12 months (Romania). The weighted, average stock exchange price takes into account the volumes of securities traded.

Indirect acquisition. There is no obvious method to determine the equitable price when the mandatory bid is triggered by an indirect acquisition. If the acquired holding company has no assets other than the listed shares, the price may be calculated on an implicit and transparent basis, i.e. by dividing i) the total price paid by the offeror for the securities of the acquired holding company by ii) the number of securities of the offeree company held by the acquired holding company.

Multi-criteria approach. Where there has been no previous acquisition by the offeror, a multi-criteria approach makes sense, as used for instance by Spain. Yet such a method may also be used for all mandatory bids, in which case it is a means to secure a higher price for minority shareholders.

Adjustment of the price by supervisory authorities. Art. 5.4 of the Directive provides that member states may authorise their supervisory authorities to adjust the mandatory bid price in accordance with criteria that are clearly determined. To this end, they may determine a list of circumstances in which the highest price may be adjusted either upwards or downwards. Art. 5.4 of the Directive provides for four examples:

- where the highest price was set by agreement between the purchaser and a seller;
- where the market prices of the securities in question have been manipulated;
- where market prices in general or certain market prices in particular have been affected by exceptional occurrences; and
- to enable a firm in difficulty to be rescued.

Most countries have not transposed all cases, but only some of them. Still, this does not appear to have raised specific issues.

Post-bid adjustments. Some member states, such as Germany, extend the automatic bid adjustment to a post-bid period. This rule may disadvantage certain shareholders (for instance, hedge funds) who take a position just above

[25] For example, Austria, Belgium, Germany, Greece, Portugal, Romania, Spain and Italy (only under certain circumstances).

the squeeze-out threshold to prevent its success in an attempt to negotiate with the offeror, post-bid, a higher price for the purchase of their shares. This rule makes such a post-bid purchase so costly for the offeror that any strategy based on such a purchase becomes highly uncertain.

5.3 Comparison with major non-EU jurisdictions

Overview. There is no mandatory bid rule in the US. Major non-EU jurisdictions that have adopted mandatory or equivalent takeover bid rules have selected a variety of thresholds. In some cases, a single threshold is applicable (20% for Australia and Canada, 30% for China and Hong Kong, one-third for Japan and Switzerland); other countries may apply several thresholds, such as India (15%, 55% and 75%) and Russia (30%, 50% and 75%). A minority of major non-EU jurisdictions have, in addition, applied anti-creeper provisions that allow a person to increase his or her holdings by a limited percentage within a specified time frame: 2% (Hong Kong), 3% (Australia) and 5% (Canada, India and Japan, subject to specific conditions). Some major non-EU jurisdictions provide for additional triggers, such as the acquisition of control (India) and specific exemptions (such as block transactions in Canada, when the price paid does not exceed 115% of the market price).

Whitewash procedure. A majority of the major non-EU jurisdictions that have adopted mandatory takeover bid rules provide for so-called 'whitewash procedures' permitting shareholders' meetings to waive the obligation to launch a mandatory takeover bid. Such waivers are permitted in certain limited circumstances, such as capital issuances (China, Hong Kong), financial difficulties (China) or the acquisition of control (India).

Price. Seven out of eight major non-EU jurisdictions (the US does not have mandatory takeover bid rules) set the minimum mandatory takeover bid price by reference to the highest price paid by the offeror over a specific pre-bid time period, ranging from 3 to 12 months (interestingly, Switzerland only requires the bid price to be at least equal to 75% of the highest price paid). In Japan, there is no requirement to set a minimum price.

India, Russia and Switzerland in addition refer to some sort of weighted average price of the securities over a 60-day to 6-month pre-bid time period. Without referring to such a weighted average in the first instance, China provides that if the bid price (determined based on the highest price rule) is less than the average of the daily weighted average price over the 30 trading days preceding the bid announcement, the offeror's financial adviser must justify the offered price.

Schemes of arrangement. In major non-EU jurisdictions that have been exposed to the UK legal system (India, Australia, Canada and Hong Kong), so-

called 'schemes of arrangement' represent an effective alternative to recommended voluntary and mandatory takeover bids in order to obtain control of a listed public company. They can be described as follows:

- *Description*. A scheme of arrangement is a court-approved agreement between a company and its shareholders (or creditors, such as lenders or debenture holders). Depending on the relevant major non-EU jurisdiction, a scheme of arrangement may provide for almost any type of transaction or combination of transactions, such as share purchases, amalgamations, share redemptions, transfers of assets or share issuances. In Hong Kong, for instance, the statutory procedure in practice usually involves either the cancellation of all the existing offeree company shares and the subsequent issue of new offeree company shares to the offeror (a cancellation scheme) or the transfer of all the existing offeree company shares to the offeror (a transfer scheme), in return for the issue of either cash or offeror shares to the former shareholders of the offeree company.
- *Voting requirements*. Schemes require the offeree company to put in place a proposal to its shareholders and it must be passed,
  - in India, by a majority in number representing at least 75% in value of the shareholders;
  - in Australia, by a majority in number representing at least 75% of the votes cast;
  - in Hong Kong, by a majority in number representing at least 75% of the votes cast by disinterested shareholders; and
  - in Canada, by a 66% to 75% majority of the votes cast.

  Once approved by the court, the scheme is binding on all shareholders. Such court approval usually involves a hearing on the fairness and reasonableness of the transaction. Interestingly, in Hong Kong, a scheme of arrangement only becomes binding when the number of votes cast against the scheme at the court hearing does not account for more than 10% of the votes attaching to all the disinterested shares.

  The Indian takeover regulations grant an exemption for any transfer or acquisition of shares or control over the offeree company that takes place pursuant to a scheme of arrangement or reconstruction, including amalgamation or merger or demerger under any law or regulation, Indian or foreign.
- *Advantages*. There are a number of advantages of using a scheme instead of a (recommended) takeover bid, particularly
  - the flexibility in structuring a takeover;

  - the certainty of obtaining 100% of shares on a specified date, provided the requisite majority and the court approve the scheme;
  - the threshold for a successful scheme is lower than that for a takeover bid (which usually requires between 90% and 95% acceptance in the relevant major non-EU jurisdictions before the offeror can compulsorily acquire the remaining offeree company shares); and
  - a court approves the scheme, which may repel challenges to the transaction.
- *Downsides*. There are also certain downsides of using a scheme:
  - the duration of the process (lengthy due diligence and negotiation phases, mandatory shareholder disclosure, convening of a shareholders' meeting and the application to court); and
  - unlike a formal bid, a scheme does not allow the offeror to adjust the terms of the bid quickly.

US procedures. In the US, several procedures are noteworthy:

- *One-step mergers*. A one-step or statutory merger is one in which the offeror and offeree company enter into a merger agreement subject to the approval of the owners of a majority (or super-majority if required by state law or the offeree company's incorporation documents) of the outstanding shares of the offeree company. Rule 14d-10[26] does not apply to one-step mergers. Yet, to the extent that minority shareholders believe that the price being offered by the offeror is below the fair value of the shares, but the majority of shareholders nevertheless accepts the bid and the merger takes place, state merger statutes give minority shareholders (often called 'dissenters') the right to petition a court to set a 'fair value' for their shares. The price set by the court, however, does not necessarily need to be the highest price paid by majority shareholders.
- *Two-tier takeover bids*. In a two-tier takeover bid, the offeror will make a takeover bid to obtain voting control of the offeree company. In a second stage or tier, the offeror votes its controlling interest to obtain merger approval at a shareholders' meeting. Typically, the offeree company's shareholders would receive higher compensation for their shares in the

[26] Rule 14d-10 of the Securities and Exchange Act of 1934 provides that the consideration paid to any shareholder for securities must be the highest consideration paid to any shareholder for securities tendered in such a bid, and all shareholders must have an equal right to elect the type of consideration from among those offered (all-holders/best-price rule).

first tier (takeover bid) than in the second tier (merger). This is the exact scenario that is prevented by the mandatory bid rule under Art. 5 of the Directive. The corporate statutes of Delaware and most states permit majority shareholders to engage in a squeeze-out merger without the approval of the minority shareholders. The triggering event for a second-step squeeze-out merger is that the offeror holds at least 90% of the offeree company's voting shares following a takeover bid or other share acquisition programme.

There are nonetheless some anti-takeover measures that a company can use to counter the threat of a two-tier takeover bid. For example, a company may add fair price and super-majority amendments to its corporate charter. A fair price amendment stipulates that an acquiring company must pay a fair price for all of the offeree company's shares that it purchases (although this does not necessarily mean the highest price the acquiring company has paid). A super-majority amendment increases the necessary majority to approve an acquisition or merger from one-half to two-thirds.

- *Appraisal rights*. Depending on state law, the offeree company's shareholders who do not tender their shares in a cash takeover bid and who do not vote in favour of the merger may have appraisal rights. Appraisal rights entitle such shareholders to a cash payment from the offeror equal to the value of its shares as determined by a court. It should be noted that a court may determine a price lower than the price received in the original takeover bid; therefore, even with appraisal rights, minority shareholders are not guaranteed a price equal to that received during the initial takeover bid. Appraisal rights are rarely exercised in the US.
- *Sell-out*. In most cases, if an offeror acquires a significant interest in an offeree company and has no intention of acquiring the remaining interests held by minority shareholders, it is not obliged to do so. A few states, however, including Maine, Pennsylvania and South Dakota, have 'control share cash-out' provisions stipulating that if an offeror acquires voting shares above a specified threshold, the other shareholders can demand that the offeror purchase their shares for cash at a fair price. The triggering event for the sell-out procedure is that the offeror has acquired at least the following threshold amounts of the offeree company's voting shares: 20% in Pennsylvania, 25% in Maine and 50% plus one voting share in South Dakota.

5.4 Perception

Acting in concert (clarity of definition). Stakeholders have diverging opinions regarding the clarity of the 'acting in concert' definition. Two-thirds believe there is enough clarity and one-third is of the opposite view. Disagreement also persists on the means to improve the definition. Among the stakeholders interviewed, 64% consider that the definition could be improved by redrafting the definition contained in the Directive. Most supervisors, however, are of the opinion that more guidance should be provided at the EU (86%) level.

Agreement to create new presumptions of acting in concert. A substantial majority of stakeholders suggests that agreements triggering an acquisition of control always constitute acting in concert (63%). Also, a majority of stakeholders (51%) considers that agreements granting one person a definite right to acquire control of an issuer in future should in principle be considered acting in concert. There is no agreement among stakeholders as to whether agreements granting persons a contingent right to acquire control of an issuer in future should constitute acting in concert. In fact, 37% of stakeholders in principle favour such a change, whereas 39% are in principle against it. A majority of stakeholders believes that three situations should in principle be recognised as constituting acting in concert:

- within the same transaction, if person A and person B act in concert, and person B and person C act in concert, all three should be considered to be acting in concert (71%);
- agreements having the effect of replacing board members (57%); and
- agreements among shareholders that aim at replacing existing board members by persons who have a significant relationship with such shareholders (70%).

Easy circumvention of the definition of acting in concert. Although a majority of stakeholders considers that the acting in concert rule 'often' attains its objective (50%), the definition is easily circumvented. A majority of stakeholders is of the opinion that the rule is too vague to be enforced (60%). This opinion is shared by a majority of supervisors (67%), whereas certain issuers state that the rule is too broad and includes situations that should not be covered (33%). Finally, investors and intermediaries are generally of the opinion that other reasons explain the rule's failure to reach its objectives.

Enhanced protection of minority shareholders through the mandatory bid rule. A majority of stakeholders agree that the mandatory bid rule protects minority shareholders appropriately (56%) and 48% perceived a significant increase in the protection of minority shareholders since its transposition.

Similarly, stakeholders agree that the discretionary exemptions did not weaken the mandatory bid rule and also that the equitable price rule protects the minority shareholder interests adequately (59%). The legal remedies that are available to enforce the mandatory bid rule are perceived as sufficient by a majority of stakeholders (71%).

Obstacles to acquisitions. Still, 77% of the stakeholders consider that the mandatory bid rule constitutes always, frequently or sometimes a real obstacle to takeover bids.

6. TAKEOVER DEFENCES, CONTROL STRUCTURES AND BARRIERS NOT COVERED BY THE DIRECTIVE

This chapter addresses the following questions in particular:

- Are all defences similar or should they be categorised?
- How have the board neutrality and breakthrough rules been implemented? And how should the change in shareholders' structure affect our understanding of such rules?
- What types of defences and barriers not covered by the Directive may prevent the success of bids?
- What are the major rules applicable in non-EU jurisdictions?

Key concepts

- Defences may be used by managers in a self-serving manner; they may also be considered a method to negotiate the bid price.
- The board neutrality rule is an attempt to prevent such self-serving conduct. It is a relative success (15 sample countries out of 22). Reciprocity has also been largely adopted. The extension of widely dispersed shareholding, the new role of hedge funds and the impact of stock options on management call for a fresh view on the relevance of the neutrality rule. The breakthrough rule is a failure.
- Outside the EU, some major markets allow defences to a certain degree: mostly the US, but also countries like Canada, Japan and Australia. All three of these make use of 'poison pills', a defence aimed at avoiding value destruction for the company and its shareholders if the bid fails (in contrast with such defences as the sale of assets at a discount). If most non-EU jurisdictions claim to implement some kind of board neutrality rule, the precise meaning of such rule may significantly differ from its Directive counterpart.
- Stakeholders do not consider that the Directive is an obstacle to bids with regard to defences.

  In keeping with the findings of the study, *Proportionality Between Ownership and Control in EU Listed Companies: Report on the Proportionality Principle in the European Union*, referred to as the 'One Share–One Vote' study by Shearman & Sterling et al. (2007), pyramids remain a popular

mechanism, while cross-shareholdings stay at a low ebb. Both mechanisms are perceived as defences not frequently used.

Other barriers, such as anti-trust or sectoral regulations, remain potential obstacles to bids. The situation does not seem to have changed as a consequence of the Directive, and non-EU countries have essentially kept the same regulations.

6.1 Objectives and background

6.1.1 Diversity of objectives

Various considerations. Reasons to regulate defences include i) their impact on the ability to negotiate a higher price; ii) their potentially abusive use by managers to protect their own interest without appropriately considering shareholders' interests; iii) their inherent quality (value-destructive or not); iv) the role they play in the ability of the board to defend the interests of other stakeholders and to prevent team production hold-ups; and v) their potential impact on the 'social control gap' issue.

6.1.2 Categorising defences

Types of defences. One of the key issues in the context of takeover bids is the application of takeover defences by offeree companies. These defences may prevent a change of control, make takeovers more difficult or costly, or allow offeree companies to negotiate higher prices. Takeover defences can be classified as 'pre-bid defences' and 'post-bid defences' as explained below.

- Pre-bid defences may constitute barriers to the acquisition of shares in the company (e.g. share transfer restrictions contained in the company's articles of association) or barriers to the exercise of control at the general meeting (e.g. voting restrictions, shares with multiple voting rights).
- Post-bid defences are put in place once the company has become subject to a takeover bid.

Alternative classification of defences. Another way to classify takeover defences is to look, once the bid has failed, at the value of the defence from the perspective of the offeree company and its remaining shareholders. Analysing the value of takeover defences is relevant in order to assess their impact and evaluate how regulation or facilitation of such defences correlate to the objectives of the Directive. The categories are identified in Table 16.

Table 16. Categories of takeover defences

Category	Examples
• Value-enhancing	• Capital increase, warrants (poison pills)
• Value-destructive	• Crown jewel, [a] share buyback
• Value-neutral (no possible *ex-ante* classification)	• Seeking a white knight, white squire, dividend payout,[b] sale of treasury shares, Pac-Man defence, [c] acquisition of assets, bid launched on another company, merger

[a] The crown jewel defence could also be value-neutral depending on the proceeds from the sale of the relevant assets.

[b] Assuming that the dividend is substantial enough to discourage the offeror, this defence could be value-enhancing for the shareholders and value-destructive for the company, resulting in an equilibrium.

[c] So long as the offeror was rational in its decision to launch the initial bid, the Pac-Man defence would also be rational. This could potentially result in a value-enhancing merger.

Source: Authors.

Value-enhancing defences. A capital increase used as a takeover defence is observably value-enhancing for the offeree company and its shareholders, as it brings in new cash to the company that may either be used in the company's projects or as distributions to post-bid shareholders. Likewise, insofar as issuing warrants (poison pills) gives existing offeree company shareholders the right to subscribe to new shares at a discount while also infusing capital into the company, such defences are similarly value-enhancing. In addition, poison pills are never value-destructive, as their highly deterrent effect results in the fact that such warrants are never exercised – their exercise is only *threatened*.

Value-destructive defences. Conversely, such defences as share buybacks, if they are exercised solely for the purpose of defending against a bid, will likely result in a value reduction for the offeree company and its shareholders and are thus value-destructive. A crown jewel defence is generally value-destructive to the extent that the disposed assets were strategic or sold at a discount.

Value-neutral defences. The value of other defences cannot be categorised in advance; it depends on an analysis of fact-specific considerations, including the economic rationality of the decisions that are made.

Variables that affect value. Clearly, it is difficult to accurately categorise any defence as absolutely value-enhancing or value-destructive because such valuations ultimately depend on the outcome of a particular defence for the company. In many cases, the overall value of a successful defence may be affected by such variables as the rationality of the board, market conditions and incentives unrelated to normal business practice.

6.1.3 Provisions of the Directive

Provisions relating to takeover defences. Since member states have traditionally had fundamentally differing approaches to takeover defences, the way to treat such defences constituted a key issue in reaching a compromise necessary to adopt the Directive. The final compromise provides for a board neutrality rule (Art. 9 of the Directive) and a breakthrough rule (Art. 11 of the Directive) that member states are allowed to apply or not (Art. 12 of the Directive). Even if a member state decides not to make these rules mandatory, it cannot prevent companies from applying them on a voluntary basis. In this case, the decision to voluntarily apply the rules must be adopted in turn by the shareholders' meeting and can be reversed in the same manner. Furthermore, the reciprocity exception (Art. 12.3 of the Directive) allows member states to authorise companies applying the board neutrality rule and the breakthrough rule to cease applying them against an offeror who is not subject to the same rules in his or her country, and thus to 'retaliate' against such an offeror.

6.2 Transposition

6.2.1 Board neutrality rule

Description. The board neutrality rule (Art. 9 of the Directive) relates to post-bid defences. It provides that during the bid period, the offeree company's board must obtain the authorisation of the shareholders' meeting before taking any action that may result in the frustration of the bid. This rule may facilitate takeover activity by limiting the board's power to raise obstacles to hostile takeovers.

Implementation. A large majority of sample countries (15 out of 22) have transposed the obligation for companies to apply the board neutrality rule. Most of these sample countries already provided for a board neutrality rule prior to transposition of the Directive. A majority of the sample countries (12 out of 22) have also adopted the reciprocity rule. The details of the transposition are as follows:

- *Transposition by member states.* Among the sample countries, 15 out of 22 (Austria, Cyprus, Czech Republic, Estonia, Finland,[27] France, Greece, Ireland, Italy, Portugal, Romania,[28] Slovakia, Spain, Sweden and the UK) impose the board neutrality rule.

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[27] The board neutrality rule is transposed in a non-binding legal framework.

[28] The board neutrality rule is only transposed for voluntary bids, not for mandatory bids.

- *Pre-existing board neutrality*. In 12 cases, the board neutrality rule pre-existed the transposition of the Directive (Austria, Czech Republic, Estonia, France, Ireland, Italy, Portugal, Romania, Slovakia, Spain, Sweden and the UK). The board neutrality concept was new in three countries (Cyprus, Finland and Greece). A few sample countries transposing the board neutrality rule (France, Italy, Spain[29] and Portugal) introduced the reciprocity rule.
- *Reciprocity opt-in*. The majority of sample countries (12 out of 22), including Belgium, Denmark, France, Germany, Greece, Hungary, Italy, Luxembourg, the Netherlands, Poland, Portugal and Spain, provide for reciprocity. Each allows the offeree company not to apply the board neutrality rule where the offeror is not subject to these rules.
- *Passivity opt-out with reciprocity opt-in*. Seven sample countries do not apply the board neutrality rule but provide for reciprocity (Belgium, Denmark, Germany, Hungary, Luxembourg, Netherlands and Poland). In these member states, the reciprocity rule is rarely used, as only companies that have opted-in (a rare occurrence) are subject to the reciprocity rule.

Default neutrality rule with opt-out (Italy). Italy has adopted a specific system that is worth mentioning: the default neutrality rule with an opt-out option at the company level. Pursuant to Art. 104 of Italy's Consolidated Financial Law, the passivity rule is mandatory for Italian companies except in case of express derogation in the articles of association. Apparently, the companies in Table 17 have so far used the opt-out option. Most of them are controlled by blockholders.

Table 17. Italian companies that have opted out of the board neutrality rule

Company name	Market value (in € million)
Fiat S.p.A	8,232
Banca Carige S.p.A	2,660
YOOX S.p.A.	510
Marcolin S.p.A.	273
Tamburi Investment Partners S.p.A.	202
AcegasAps S.p.A	190
EL.EN. S.p.A.	53
Mondo Home Entertainment S.p.A	11
Meridie S.p.A.	7
Nine companies, total market capitalisation	**12,137**

Source: Authors.

[29] Reciprocity is only enforceable against non-Spanish companies.

Rationale for the board neutrality rule. The rationale for the board neutrality rule is stronger in situations in which the share capital is dispersed among several shareholders, as it is more difficult to acquire control of companies in which a blockholder holds a substantial proportion of the share capital, at least where such a blockholder is not favourable to the bid. A significant increase in the number of widely held companies was observed in Continental Europe between 1996 and 2006. The UK, historically, has had dispersed shareholdings in 90% of its companies. In Germany this figure has increased from 26% to 48%, in France from 21% to 37% and in Italy from 3% to 22%. In the light of these developments, the rationale for reinforcing the board neutrality rule may be regarded as stronger today than before.

The new role of pro-offeror hedge funds. Since the board neutrality rule was first proposed as part of the draft Directive, the way in which it was meant to be implemented has changed, due to the role hedge funds now play during bids. In companies with a dispersed shareholding, the balance of power has thus been further shifted in favour of the offeror over the company, which might not be in a position to defend itself against the bid. Indeed, "hedge funds acting as arbitrageurs will favour the bidder and seek to secure the success of the bid, by accepting it and voting against defensive measures, if asked to do so" (Davies et al., 2010, p. 2).

As a result of this unforeseen situation, the price received by the offeree company shareholder may not be optimal, and more generally, bids having negative economic consequences may succeed more easily.

This can be remedied through the suspension, in general meetings where there is a vote on defences, of voting rights of shareholders who acquired their shares after the bid was announced, thus excluding hedge funds that invest in companies once a bid has been launched.

'Toothless' defences. It should also be noted that defences requiring support by the general meeting of shareholders after the bid has been launched significantly weaken the ability of boards to resist a bid. The effect of such a requirement is that the success of a bid becomes staked on the question of whether shareholders of the offeree company believe that their incumbent board can improve on the bid, either by negotiating a higher price or by making profitable improvements to the company (which in practice cannot be evidenced within the bid period). This effectively renders the defence toothless as a mechanism for an offeree company board to resist a hostile bid.

The impact of compensation. An academic study in the US drafted by Professors Kahan and Rock (2002) has examined the impact of management compensation packages on bids. It states that "both greater use of stock options and greater restrictions on takeover defences make it more likely that an

unsolicited bid will be consummated, but managers are likely to favour the former over the latter”. When stock options vest upon change of control, the management is likely to promote the success of a bid. Such contractual arrangements thus create an inherent pro-bid bias. The situation regarding neutrality can be summarised as in Table 18.

Table 18. Neutrality

		Neutrality	
		Yes	**No**
Reciprocity	**Yes**	France, Greece, Italy, [a] Portugal, Spain [b]	Belgium, Denmark, Germany, [c] Hungary, Luxembourg, the Netherlands, Poland
	No	Austria, Cyprus, Czech Republic, Estonia, Finland, [d] Ireland, Romania, [e] Slovakia, Sweden, UK	

[a] Subject to the opt-out in the bylaws.

[b] Neutrality applicable to non-Spanish companies not subject to the passivity rule in their country of origin.

[c] Modified neutrality rule.

[d] The neutrality rule has not been transposed as such in Finland, as the Finnish Companies Act included provisions before the transposition of the Directive that were deemed to be sufficient with respect to the passivity rule. Nevertheless, the non-binding Helsinki Takeover Code provides further guidance with respect to the passivity rule.

[e] For voluntary bids only, not for mandatory bids.

Source: Authors.

6.2.2 Breakthrough

Description. The breakthrough rule (Art. 11 of the Directive) neutralises pre-bid defences during a takeover. This rule reiterates certain restrictions (e.g. share transfer or voting restrictions) during the takeover period and allows a successful offeror to easily remove the incumbent board of the offeree company and to modify its articles of association. Based on the principle of proportionality between capital and control, this rule overrides multiple voting rights at the general meeting authorising post-bid defensive measures as well as at the first general meeting following a successful takeover bid.

Breakthrough rule. Only one member state in the sample countries transposed the breakthrough rule (Estonia), but there is no reported case that the rule has been used so far. France and Italy have transposed the breakthrough rule partially. In France, the limitation of voting rights provided

in the articles of association of a company subject to a takeover bid are suspended for the first general meeting following the closing of the bid if the offeror, either alone or in concert, holds capital or voting rights in excess of two-thirds of the offeree company. In Italy, limitations to voting rights applicable to previously state-owned companies are, in certain cases, suspended following a bid, and shareholder agreements are restricted. In Estonia, the provision transposing Art. 11.5 of the Directive requires the offer document to set out the compensation to be offered if the offeror has, at the closing of the bid, acquired at least 75% of the share capital carrying voting rights.

Compensation in the event of breakthrough. In some countries, applicable provisions require the price paid to the shareholders to be reasonable or equitable (such as in Austria, the Czech Republic or Slovakia for example). In other countries, such as Hungary, the minimum amount of compensation has to be defined in the articles of association of the offeree company. Also, in certain EU jurisdictions, the relevant supervisory authority is competent to review challenges to the fairness of the price offered in exchange for the removed rights or to determine the amount of the equitable compensation (for instance in the Czech Republic, Germany, Ireland or the Netherlands).

Criticism. It could be argued that the breakthrough rule may violate the principle of shareholder decision-making, which is used to validate the principle of board neutrality. Furthermore, even if the breakthrough rule were to be applied by a company in practice, its authority could be inconsistent in that some divergences from the one share–one vote rule are covered, whereas others – such as preferred shares, double voting rights, golden shares or restricted shares – are not (Geens and Clottens, 2010, p. 21). It has also been suggested that if the breakthrough rule were made mandatory, companies wishing to keep the same voting structures could simply reorganise their corporate structure into a pyramid structure. This is supported by the example of Belgium, where following the introduction of the one share–one vote rule in 1934 there was an increased emergence of pyramids (Geens and Clottens, 2010, p. 17).

6.2.3 Other defences

Continuing debate on defences. The complexity of takeover defence regulation is increased by the continuing debate around defensive mechanisms, which remain popular both within and outside the EU as evidenced by the flux of new defences being created. Some examples of these new defences are listed below.

- *Defensive measures of formerly state-owned companies.* For instance, Italian laws authorise state-owned companies to use defensive measures including the following:
  - national interest and state participations are protected[30] mainly by means of i) 'golden share' rights and ii) limitations of shareholdings held by private entities; and[31]
  - poison pill-type defences for companies in which the state has a qualifying participation.[32] In particular, such companies are allowed to issue, in favour of one or more shareholders, shares and financial instruments granting the right to request the attribution of new shares or financial instruments with voting rights.[33]

  Art. 3 of the Italian *Legge sulle Privatizzazioni*, however, as amended by the Implementation Decree,[34] provides that articles of association of formerly state-owned companies (operating in strategic fields) that limit holdings are not operative if the relevant limits are crossed following a takeover bid that results in the offeror holding more than 75% of the voting share capital (thus working on a 'mini-breakthrough').
- *Tender offer warrants*. Under French law, the issuances of tender offer warrants are allowed to create a threat of dilution of the offeror's equity holding and voting interest in the offeree company. The vote of the offeree's general meeting of shareholders deciding the potential issue of tender offer warrants may be held prior to the bid. The authority granted to the board of directors to issue tender offer warrants is valid for a maximum period of 18 months, but may not be applied against an offeror who is subject to the board neutrality rule and the breakthrough rules in his or her country. The vote may also take place during the bid period, however, in which case the authority may be used against any offeror, irrespective of whether the reciprocity exception applies or not. This mechanism, which is always subject to shareholders' approval, has

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[30] *Legge sulle Privatizzazioni* [Privatisation Law], Law Decree No. 332 of 31 May 1994 (converted into Law No. 474 of 30 July 1994), as amended.

[31] Such limits have been included, in particular, in the articles of association of companies in which the state, also through the Cassa Depositi e Prestiti, owns a controlling shareholding.

[32] *Finanziaria 2006*, Law No. 266 of 23 December 2005.

[33] Such a provision de facto grants an offeree company in which the Italian State holds a share the right to realise a capital increase through which the public entity shareholder can increase its participation.

[34] Legislative Decree No. 229 of 19 November 2007.

been designed to empower offeree company boards to negotiate a higher bid price.

- *Poison-pills redemption clause*. In Finland, a so-called 'poison-pills redemption clause' may be introduced in the articles of association of an offeree company. The articles of association of several listed companies contain provisions imposing an obligation to redeem other shareholders' shares when one party has acquired a certain amount of shares, the threshold usually being one-third or 50% of the outstanding shares. Such a redemption is usually made according to pricing rules that differ from those set out for takeover bids. As the threshold triggering the mandatory bid has been reduced to 30%, it is typically set as a condition for completion in voluntary bids that the poison pill provision (if any) be removed from the articles of association before the bid is completed in order to prevent conflicting pricing rules from becoming applicable.

Preference shares approved by shareholders. The European Court of Justice's case law has suggested that certain preference shares may be valid defensive mechanisms if these mechanisms are provided for in the company's articles of association. In the *Volkswagen* case,[35] the court in Luxembourg decided on 23 October 2007 that preference shares allotted to the German government contravened the EC Treaty because they had been granted to the government under the Volkswagen law (the Volkswagen law provided for the capping of voting rights at 20%, the fixing of the blocking minority at 20% and the right for the Federal State and the *Land* of Lower Saxony each to appoint two representatives to the supervisory board). The European Court of Justice nonetheless specified that these provisions would not have been contrary to the EC Treaty had they been provided for in the company's articles of association. This specific clarification by the European Court of Justice indicates that even where such preference shares may act to frustrate a bid, they are permitted provided that they have been approved (by a vote required to amend the articles of association) or acquiesced to by shareholders (through the purchase of shares in a company with a pre-existing preference share provision in its articles of association).

6.3 Control structures and barriers not covered by the Directive

Cross-shareholdings. Cross-shareholdings refer to the situation that occurs when company X holds a stake in company Y, which in turn holds a stake in

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[35] Case C-112/05, *Commission of the European Communities v. Federal Republic of Germany* [2007], ECR I-8995.

company X. This may create specific links between companies that may, in certain cases, serve as a basis for defence strategies. Cross-shareholdings are efficient in this respect if they are for an amount that is sufficiently significant (at least 5%) and if they are part of a larger, strategic alliance. Otherwise, cross-participations may be unwound if the price offered in the bid is high enough. Generally speaking, under most legal systems, refusing to offer shares held as cross-shareholdings in a takeover bid offering a reasonable premium added to the market price may be deemed contrary to the company interest or the fiduciary duties of directors. This is why, where cross-shareholdings may have been used in the past, especially in France and Germany, they have become much less frequent.

Pyramid structures. A pyramid structure refers to the situation that occurs when an entity (a family) controls a corporation that, in turn, holds a controlling stake in another corporation. This process can be repeated a number of times. A stake will be deemed to be a 'controlling stake' when it reaches or exceeds 20% of the voting rights. A pyramid structure may be of interest if, through the use of several holdings, the ultimate holder controls the final issuer with less capital than it would have required in the case of direct control by the issuer. It is a means to keep control with less capital.

Use. Table 19 shows the percentage of pyramid structures and cross-shareholdings in the sample countries. It is consistent with the findings of the One Share–One Vote study (Shearman & Sterling et al., 2007), which found, on average within the EU, that 18% of all sample companies had pyramid structures and 2% had cross-shareholding structures. It confirms that on an EU-wide basis, cross-shareholdings are not an issue, whereas pyramids remain a popular structure. This is consistent with the fact that Continental shareholding structures remain to a large extent based on blockholding.

Table 19. Share of pyramids and cross-shareholding in sample countries (%)

	Overall	Recently listed	Total
Pyramids	18.1	27.5	20.5
Cross-shareholding	3.5	0	2.6

Source: Authors.

Other barriers. Other barriers that have been identified typically include anti-trust regulations, sectoral regulations, public funds, co-determination and employee ownership. Yet, none of these barriers seems to create strong or unjustified obstacles. First, anti-trust regulations deal with competition law and the barriers to a bid associated with them are thus justifiable to further anti-trust policies and are unrelated to takeover regulation. Furthermore, there is no evidence that such anti-trust regulations have been used as a takeover

defence. Second, although sectoral regulations – such as those relating to the banking sector, insurance companies, credit institutions and airline companies – can place barriers to a bid, evidence that such regulations have been used for this purpose is merely anecdotal. Next, sovereign funds rarely create strong obstacles to a bid because the amount of the funds that may be used by sovereign funds in this respect is generally too small to significantly affect a bid. Finally, instances of employee ownership do not pose a strong obstacle to a bid because the level of employee ownership is generally too small to have a significant impact. The co-determination model applied, for instance, in Germany, Denmark, Finland or Sweden, might eventually also be considered a barrier to takeovers. Offerors might indeed fear not being able to control the company once it has been taken over and thus be more reluctant to launch takeovers on companies organised under a co-determination model. Still, this fear is not founded, as in the standard co-determination model, shareholders retain the ultimate right to decide. In addition, several studies have found co-determination to have a positive impact on productivity, which is in the overall interest of shareholders.

Barriers in major non-EU jurisdictions. Many major non-EU jurisdictions have adopted specific legislation restricting foreign investments in sectors that are considered sensitive, particularly in connection with national security. Although major non-EU jurisdictions are tending to loosen restrictions applicable to foreign investment, substantial barriers remain in certain industry sectors. These sectors include the insurance and banking sector, certain commodities, aviation and transportation as well as telecommunications, broadcasting and media sectors. In some cases, foreign share ownerships exceeding specific thresholds are made subject to prior authorisation by a government agency.

6.4 Comparison with major non-EU jurisdictions

Defences in major non-EU jurisdictions. The main takeover defences used in the major non-EU jurisdictions do not differ significantly from those in the member states. In general, most of the major non-EU jurisdictions have some form of shareholder rights plan (poison pill) defence to takeovers. In the US, the use of traditional defensive measures has declined in the last five years because, upon pressure from institutional investors and other activist shareholders, a number of US public companies have revoked or purposefully let (or both) existing defensive measures expire. Nevertheless, it should be noted that such defences, even when revoked, may be re-instituted on very short notice, at any time, by the board.

The board neutrality and breakthrough rules in major non-EU jurisdictions. All major non-EU jurisdictions (other than the US) purport to have an equivalent rule on board neutrality to some extent, although the meaning and scope of the neutrality requirement varies among major non-EU jurisdictions (in Japan, for instance, a board may take defensive measures if the offeror is abusive) and the neutrality concept differs from the one of the Directive. Some major non-EU jurisdictions set out a catalogue of measures that a board may not take, whereas others set out such a list in respect of actions that need to be approved by shareholders.

There is no equivalent to the breakthrough rule in any of the major non-EU jurisdictions.

6.5 Perception

Openness of the EU market. Stakeholders largely acknowledge that the restrictions imposed by the Directive on takeover defences have contributed to the openness of the EU market for corporate control (89%). Takeover defences are perceived as having a dual effect. While they at least sometimes prevent the occurrence of hostile takeover bids (70% of the stakeholders interviewed), they simultaneously, at least sometimes, lead to higher bid prices (77%).

No evidence of impact. The existing legislation in member states is not seen as a significant obstacle to bids by stakeholders: although a high number of pre-bid defences are perceived to be used, only a few post-bid defences are perceived to be used (among which seeking white knights is predominant). Defences existing prior to the Directive generally continue to be available. This includes Finnish-style poison-pill redemption clauses. New defences (such as tender offer warrants in France) are also available.

Frequency of takeover bids. A majority of shareholders did not perceive any material increase or decrease in the use of defences since the adoption of the Directive. This may be linked to the fact that stakeholders perceived the Directive as not having a significant effect on the number of bids (40%).

7. SQUEEZE-OUT AND SELL-OUT RULES

This chapter addresses the following questions in particular:

- What variations exist in the transposition of the squeeze-out and sell-out rules?
- What are the alternative procedures?
- What is the perception by the stakeholders?

Key concepts

- The Directive provides for squeeze-out and sell-out rules pursuant to which member states must ensure that following a successful bid made to all of the holders of the offeree's securities, all remaining securities can be purchased by the offeror or sold by the remaining shareholders. The right to squeeze out minority shareholders (Art. 15 of the Directive) allows an offeror that has acquired a very large portion of the share capital to acquire the outstanding shares. The sell-out right (Art. 16 of the Directive) provides minority shareholders with a counterpart to the squeeze-out right: it allows them to force the majority shareholder to purchase their shares at a fair price.
- A limited number of major non-EU jurisdictions does not provide for post-bid squeeze-out or sell-out mechanisms. Major non-EU jurisdictions that have squeeze-outs or sell-outs (or both) usually refer to a 90% threshold in connection with an ownership or acceptance test (or both).
- Although the Directive apparently provides for a narrow set of choices, there is in fact some diversity in the transposition of the rules due to i) the choice of a uniform or dissociated 90% or 95% threshold; ii) the choice of the acceptance or ownership test, or a combination thereof; iii) the practical application of the fair price rule; iv) the potential extension of the three-month period; and v) the application of additional protections (such as independent experts).
- The EU rules apply in addition to procedures that existed in member states prior to the Directive. Some of these procedures were close to the EU squeeze-out, whereas others – such as the British-type scheme of arrangement – provided for much broader possibilities. Another way to promote a 100% ownership is the 'cash-out' merger; however, it does not exist in any member state in its pure 'exclusionary' form. Finally, the German-type 'enterprise agreement' is an alternative means to provide

full control to a majority shareholder while protecting the interests of minority shareholders.

- Stakeholders appear generally satisfied with the squeeze-out and sell-out rules, although the latter (in contrast to the former) are very infrequently used. The variety of rules among member states is often perceived as problematic.

7.1 Objectives

Squeeze-out as a bid-enhancement mechanism. The squeeze-out rule is intended to facilitate and increase takeover activity, since forcing minority shareholders to exit the offeree company allows the offeror to avoid costs and risks caused by such shareholders. As this rule may only be applied following a bid made to all of the holders of the offeree company's securities for all their securities and at a fair price, it does not harm minority shareholders. Still, it should be noted that the squeeze-out procedure may lead to value-decreasing takeovers, for instance when a 100% post-squeeze-out holding allows the offeror to replace equity by tax-deductible debt and thus to obtain a public subsidy for a private transaction.

The sell-out as a minority protection. The sell-out rule is the counterpart to the squeeze-out rule, as it protects minority shareholders from possible abuses by the majority shareholder of the latter's dominant position. Furthermore, the obligation to provide fair compensation may enable minority shareholders to obtain a better price for their shares than the one set by a potentially illiquid market. This rule alleviates the pressure to tender, as minority shareholders will not be likely, if they do not tender, to become 'trapped' in a situation where they have low liquidity and a high risk of extraction of private benefits of control. This generally promotes investment.

7.2 Transposition

Dual system. An overall review of the transposition of these rules shows that many member states, prior to the transposition of the Directive, applied squeeze-out and sell-out procedures similar to those applicable in takeover bid situations. In these countries, the triggering threshold may differ from the one provided for by the Directive and the price determination may be specified in more detail. In countries that provided few specific rules relating to takeover bids prior to the transposition of the Directive, the squeeze-out and sell-out rules are, by contrast, innovative. The merit of the Directive has been to harmonise applicable rules among member states.

Alternative procedures. In practice, such alternative procedures as mergers or schemes of arrangement may be preferred by the majority shareholders seeking to acquire shares held by a minority of shareholders.

7.2.1 Squeeze-out and sell-out following a bid

New rules. In connection with the transposition of the Directive, seven member states introduced a takeover-related squeeze-out procedure for the first time (Cyprus, Estonia, Germany, Greece, Luxembourg, Slovakia and Spain) and ten member states introduced a sell-out procedure for the first time (Belgium, Cyprus, the Czech Republic, Estonia, Germany, Greece, Luxembourg, the Netherlands, Slovakia and Spain). Some of the member states that already applied squeeze-out or sell-out rights had to amend the pre-existing thresholds. As an example, under Irish law, the threshold was increased from 80% to 90%. Ireland chose to adopt this increased threshold in respect of takeover bids alone; accordingly, the reduced threshold of 80% still applies with respect to takeovers (not takeover bids) that are not subject to the Takeover Regulations. In Italy, the squeeze-out threshold was slightly decreased (from 98% to 95%).

Ownership and acceptance. According to the Directive, member states must ensure that an offeror is able to require all the holders of the remaining securities to sell those securities in the following circumstances:

- where the offeror holds securities representing not less than 90% of the capital carrying voting rights and 90% of the voting rights in the offeree company (hypothesis A); or
- where, following acceptance of the bid, the offeror has acquired or has firmly contracted to acquire securities representing not less than 90% of the offeree company's capital carrying voting rights and 90% of the voting rights comprised in the bid (hypothesis B).

Hypothesis A refers to the **ownership test**, which is based on the shares held by the initiator at the end of the bid (whether held prior to the bid or acquired during or pursuant to the bid). Hypothesis B refers to the **acceptance test**, which is based on the shares acquired (or acquisition of which is firmly contracted) in the bid.

Under hypothesis A (and not hypothesis B), member states may set a higher threshold of up to 95% of the capital carrying voting rights and 95% of the voting rights. The same threshold applies, *mutatis mutandis*, to sell-out procedures.

Can the thresholds for sell-outs and squeeze-outs differ? The Directive does not specify whether the thresholds for the sell-out and squeeze-out rights have

to be identical. The wording of Art. 16 of the Directive is ambiguous and states that i) holders of remaining securities after a bid shall be able to require the offeror to buy those securities "under the same circumstances as provided for in Article 15.2" of the Directive, and ii) that Arts. 15.3 to 15.5 of the Directive "shall apply *mutatis mutandis*". Art. 16 of the Directive could be read to mean that the threshold set by the member states for the squeeze-out must be identical to the threshold set under Art. 15.2 of the Directive, or on the contrary, to mean that the threshold to be set for the sell-out right must be fixed within the same thresholds as laid down in Art. 15 of the Directive, but does not have to be identical. As such, it is unclear whether the Directive allows member states, for instance, to set the squeeze-out threshold at 90% and the sell-out threshold at 95%. As a result, only three member states have decided to set different thresholds for sell-outs and squeeze-outs. Table 20 shows the thresholds that member states have decided to apply.

Table 20. Squeeze-out and sell-out rules

	Squeeze-out 90%	**Squeeze-out 95%**	**Different threshold for sell-out**
Ownership	Austria, Cyprus, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Poland, Sweden	Belgium, France, Germany, Italy, Luxembourg, Netherlands, Slovakia	Romania (95%), Luxembourg (90%), Italy (90% if low liquidity)
Acceptance	[Romania],* Spain, UK	[Romania]	

* Romania provides for a squeeze-out threshold of 95% of the voting rights or 90% of the share capital and a sell-out threshold of 95% of the voting rights.

Source: Authors.

Enhanced protection when there is low liquidity. Italian law provides an additional protection for minority shareholders: it allows a sell-out right if the offeror holds 90% of the share capital (instead of 95%) in the context of low liquidity (unless a float sufficient to ensure regular trading performance is restored within 90 days).

Fair price. The transfer of the minority holdings must take place at a fair price (Arts. 15.2 and 15.4 of the Directive). The price shall take the same form as the consideration offered in the bid or shall be in cash. Member states may provide that cash shall be offered at least as an alternative. Following a voluntary bid, in both situations mentioned in Art. 15, the consideration offered in the bid shall be presumed to be fair where, through acceptance of the bid, the offeror has acquired securities representing not less than 90% of the

capital carrying voting rights comprised in the bid. The legal presumptions provided by Art. 15.5 of the Directive have been transposed by most member states without deviation. In addition, some member states request that either the independent directors mandate an independent expert to prepare a fairness opinion in relation to the evaluation of the offeree company (Belgium) or that in case of a conflict of interest an appraiser be appointed by the offeree company (France).

Enforcement. No specific issues appear to arise in connection with the enforcement of the squeeze-out or sell-out rights, other than the evaluation of the price and the attempt to extract higher value.

- *Litigation*. When the consideration offered in the bid is in cash and the squeeze-out or sell-out price is consequently paid in cash, for the same amount, within three months of the end of the bid, there is little room for litigation. In other cases, however, there is room for discussion and, considering the amounts at stake, a high incentive to litigate. This is all the more true given that it is not possible to attribute a single price to a company – only a price range makes sense. In this respect, under French law, the offeror provides the French regulatory authority with an independent expert valuation, except if the squeeze-out is made following a standard cash takeover bid. The requirements for the expert to be deemed independent are high and the work to be performed is extensive.
- *Attempts to extract higher value*. In certain circumstances, speculative investors may acquire a holding just above the 5% or 10% threshold (corresponding to the 95% or 90% squeeze-out threshold) to prevent a squeeze-out unless they are purchased at a higher price. In such cases, the German-type top-up clause for this may provide a solution.

7.2.2 Alternative procedures

General squeeze-out and sell-out rules. About half of the member states dispose of a general set of rules regarding squeeze-out procedures. In most cases, this legal framework existed before the transposition of the Directive. These squeeze-out rules provide for a threshold that is often similar to the threshold chosen in connection with the transposition of the Directive. Yet, in some countries, there may be differences in terms of the characteristics of the shares (share capital or voting rights), the level of the threshold (for instance, in Ireland, 80% ownership or if the initial holding exceeds 20%, then 75% of the outstanding shares) and the procedure. Sell-out rights independent of takeover bids also exist in some member states. In Hungary, for instance, a general sell-

out rule is applicable when an investor acquires 75% or more of the entity rights of a company.

Alternative procedures. In most countries, procedures existed prior to the transposition of the Directive, the effects of which were similar to the squeeze-out or sell-out rule (or both). These include general squeeze-out and sell-out rules that are not linked to acquisition of control, along with schemes of arrangement, cash-out mergers and (to some extent) enterprise agreements.

- *Schemes of arrangement*. A scheme of arrangement is a court-approved agreement between a company and its members that can be used to effect, among other things, a recommended takeover. This scheme of arrangement is available in the UK and Ireland. In both countries, it requires court approval and approval by at least a majority in number, representing 75% in value, of the members of each class present and voting in person or by proxy at the meeting(s) convened to approve the scheme.
- *Cash-out mergers*. Traditionally, mergers were viewed as a stock-for-stock transaction subject to shareholder vote. In effect, they were essentially a combination of three transactions: the dissolution of the absorbed company, the contribution in kind of its assets by the former shareholders of the dissolved company to the absorbing company and the issue of shares by the absorbing company to such shareholders as consideration for their contribution. This traditional view long ago disappeared in the US, where today mergers are seen as shareholder-approved transactions that may be almost freely structured (leading to 'triangular mergers' and 'reverse triangular mergers'). In the EU, the rules have not evolved in the same way and only a few member states provide for 'cash mergers'. Still, in principle, such mergers may not lead to a full payment in cash to the shareholders of the dissolved company without their consent.
- *Enterprise agreements (Germany)*. Under German law, a parent company is permitted to enter into an enterprise agreement with its subsidiary, pursuant to which the parent company i) issues certain instructions to the subsidiary's management, including instructions that are detrimental to the subsidiary, provided such instructions are in the interest of the parent group (domination agreement); and/or ii) receives all or a portion of the subsidiary's profits (profit-sharing agreement). The German Stock Corporation Act provides for a detailed procedure (including an approval by the subsidiary's shareholders by a 75% majority) and various provisions to protect minority shareholders of the subsidiary. Minority shareholders of a stock corporation that is a party to an enterprise agreement have the right to offer their shares to the parent

company at a pre-determined price, for two months as of the date of the enterprise agreement. The adequacy of the exit consideration is determined on the basis of a valuation involving, among other things, a form of discounted cash-flow analysis, the subsidiary's liquidation value and its market price.

7.3 Comparison with major non-EU jurisdictions

Overview. Three out of nine major non-EU jurisdictions (China, Japan and the US) do not provide for an option to squeeze out minority shareholders following a successful takeover bid. Yet, two of such jurisdictions provide for alternative mechanisms permitting the exclusion of minority shareholders: in Japan, callable shares may be used, while in the US, second-step cash-out mergers are also available. Alternative squeeze-out mergers are also available in other jurisdictions, such as Switzerland. Major non-EU jurisdictions that contemplate squeeze-outs usually refer to a 90% threshold (although this is 95% and 98% for Russia and Switzerland, respectively) in connection with an ownership or acceptance test (or both). Five out of nine major non-EU jurisdictions (India, Canada, Japan, Switzerland and the US) do not provide for a minority shareholder right to force the majority shareholder to sell out its shares. The threshold taken into account in sell-out procedures is the same as that considered for squeeze-outs in the relevant jurisdiction. Such a threshold, however, is only taken into account under the ownership test, since the acceptance test is not used for sell-outs. In major non-EU jurisdictions, squeeze-outs and sell-outs must be performed within a relatively short time frame following the bid (usually four months).

7.4 Perception

Use of squeeze-outs and sell-outs. The Directive rules on squeeze-out and sell-out procedures appear to be clear (68%). The right to squeeze out minority shareholders is perceived to be frequently used (60%), whereas use of the sell-out right is considered less frequent (12%). The fair price rule is seen as working adequately in practice (76%). The choice of thresholds is approved (82%) with a preference for the 90% threshold (75%). The squeeze-out rule is seen as promoting bids significantly (32%) or slightly (53%), while the squeeze-out rule is not seen as having a significant impact in this respect.

8. OTHER ISSUES

8.1 Disclosure of information

This section addresses the following questions in particular:

- What issues are raised by the disclosure regime?
- Is there a call for improvements?

Key concepts

- Disclosure of information is a key component of the Directive. The Directive provides for such disclosure in three main forms:
  - pre-bid general disclosures (Art. 10 of the Directive) relating to share and control structures that are compulsory for all publicly traded companies, irrespective of whether they are presently engaged in a takeover bid;
  - bid-related disclosures (Arts. 6, 8, 9.5 and 14 of the Directive) made by the offeror or the offeree company (including the opinion of the offeree company's board on the bid) that are triggered by the launch of a takeover bid; and
  - country-specific additional disclosures (Art. 13 of the Directive) relating to additional disclosures required by a member state beyond those articulated in the Directive.
- Although some of the main disclosure issues in this respect are addressed in the Transparency Directive (currently under revision), it is worth taking note of some issues regarding i) harmonisation of disclosures (including with respect to fairness opinions issued by financial advisers to the offeree's board), ii) the call for an extension of the scope of disclosures and iii) compliance, especially in connection with issues that are not seen as critical by the markets, but which are important to employees.

8.1.1 Objectives

Aims of the disclosure requirements. The disclosure requirements aim at enabling parties affected by a takeover to make informed decisions. Most of the disclosure requirements seek to provide clarification about the ownership and control structures of both the offeree company and the potential offeror. Information on ownership may be useful for both the offeror and the offeree

company, as the offeror can discover barriers to a potential takeover that may affect its decision to launch a bid and the offeree company can decide what strategy to adopt according to the information gained from the offeror. Information on control structures can be a useful tool for the offeror in assessing barriers to the potential takeover and determining the control exercised over the offeree company.

- *Costs*. Providing information carries a monetary and time cost that can counter the possible benefits of such information to the parties involved (Enriques et al., 2011, p. 731). The nature of disclosures requires the preparation and provision of information by both the offeror and the offeree company. Such cost factors are taken into account in a company's decision as to whether to launch a takeover bid, and may deter potential takeovers if the cost is perceived as being greater than the potential benefit. Nevertheless, in most cases such costs are likely to be insignificant when compared with the total costs incurred by an offeror (i.e. mainly the bid price, but also the costs of financial, legal, strategic and public relations advisers). As such, their deterrent effect should not be overestimated (except perhaps for unsophisticated would-be offerors wishing to acquire a small company).
- *Toeholds*. This issue is addressed by the Transparency Directive, which is currently under revision, and as such is not explored here. It is worth noting, however, that this issue is addressed in the Transparency Directive study, [36] the final recommendation of which was full transparency and aggregation of total share ownership during the bid period, including hidden ownership of (cash-settled) equity derivatives.

8.1.2 Transposition

Effectiveness of disclosures. The effectiveness of disclosures is difficult to quantify. That notwithstanding, it is necessary to consider the incentives and interests involved as well as the realistic distribution and use of the information provided.

Limited number of issues. If we exclude the above-mentioned issues, disclosures in the takeover context are mostly uncontroversial from a theoretical standpoint. A number of items have nonetheless been identified:

[36] See section 3.6.3.2 of the *Transparency Directive Assessment Report* by Marccus Partners (2009), pp. 135-139.

- *Content of disclosures*. Although the bid disclosures appear significant already, there seems to be strong support from stakeholders for further disclosures.
- *Format of disclosure*. Disclosures under the Directive are far less harmonised than under other Directives, such as the Prospectus Directive (2010/73/EU). It has thus been suggested that an improved formatting exercise could be contemplated, with specifications regarding language. The use of plain wording and the presentation of key information could also be better harmonised.
- *Enforcement of disclosures*. To the extent that the information disclosed is perceived as significant by the market, enforcement appears generally appropriate, as both the offeror and the offeree company are under the scrutiny of supervisors and plaintiff shareholders. By contrast, information less sensitive for the market may be addressed with less care, for instance when such information concerns employment or the location(s) of business. 'Boilerplate' disclosures tend to become the norm, revolving around the idea that no decision has been taken. This approach, when it becomes market practice, is a circumvention.
- *Timing of disclosures*. According to employee representatives and regulators, in many cases the procedures provided by the Directive were not followed where employees were concerned. As well as to the above-mentioned issue, this is due to a tendency to provide information to employees too late for it to be useful. This timing strategy was prevalent in the UK for a long time until the recent reform of the UK City Code on Takeovers, which revised the rule in this respect.

Information processing and independent review. The Directive provides that the offeree company must disclose its opinion on the bid. Yet, no guidance is given regarding the process whereby such disclosure should take place. While in most countries it is typical for companies to require the assistance of an external financial adviser, this is not always compulsory. In this respect, it is interesting to note that almost all major non-EU jurisdictions require the offeree company's board to prepare and disclose an opinion on the bid. This opinion is usually prepared, either mandatorily or in market practice, with a financial adviser or more rarely by an independent board committee (or both).

Employee protection. The Directive provides for employee protection by requiring the disclosure of information that may affect employees. Still, this may not adequately protect the interests of employees, as the ultimate decision about the bid lies with the shareholders and the board. The interests of shareholders are not particularly aligned with employees in the context of a takeover and thus disclosure may not provide adequate protection for employees.

8.1.3 Comparison with major non-EU jurisdictions

Comparison. With certain limited exceptions, information to be provided to shareholders on an annual basis is globally similar to the information requirements existing in member states. Information to be disclosed by the offeror in the offer document is otherwise identical to the information set out by the Directive.

In all major non-EU jurisdictions except India, the offeree company's board is required to prepare a document stating its opinion about the bid. This requirement is similar to the provision in the Directive requiring the offeree company to provide its opinion on the bid. In the Directive, however, there is no guidance about the process by which the opinion is issued. In most member states, companies usually require the assistance of an external financial adviser even though it is not always compulsory. In all major non-EU jurisdictions, such an opinion is usually mandatory or based on market practice. Most often, the opinion is prepared by a financial adviser; it is rarely prepared by an independent board committee. The report prepared by the financial adviser must be disclosed to the offeree company's shareholders throughout the major non-EU jurisdictions.

8.1.4 Perception

Support for broad disclosure requirements. A majority of stakeholders is very satisfied with the disclosure requirements set out by the Directive (58%), since the disclosure requirements and their enforcement have led to better informed stakeholders. Moreover, the takeover bid procedure is generally perceived as being sufficiently clear (71%). Nevertheless, stakeholders still show support for the adoption of further disclosure requirements: a majority of issuers believes that stakeholders would be better protected with a disclosure requirement concerning environmental policy (64%) and local business partners (67%). Issuers (77%) along with investors and intermediaries (67%) support disclosure of the offeror's commitments regarding such issues as employment, environmental policy, research and development, and the location of the offeree company's place of business.

8.2 Supervisory authority, enforcement and litigation

This section addresses the following questions:

- Is enforcement of takeover bid rules effective, in particular with respect to guidance and penalties?
- Are there some procedural rules in non-EU jurisdictions that could be of interest?

Key concepts

- Supervisory authorities have a key function in the current re-regulation setting.
- They find that enforcing the rules is generally 'easy', except in connection with such issues as neutrality and reciprocity. A wide range of sanctions and remedies is available in the event that takeover regulations are breached. The UK provides a good example of such variety, with interesting procedures like 'cold-shouldering'. At the same time, supervisors seem somehow reluctant to use their own powers: they issue penalties only rarely and hold mixed views regarding the effectiveness of the sanctions they can impose. This conduct may be linked to the current low level of takeover activity or may indicate that supervisors lack the means to conduct their enforcement mission.
- Regarding procedure, an interesting system is the one used, outside the EU, by the Swiss supervisory authorities. Upon request, the latter grant minority shareholders (holding at least a 2% interest) the right to participate in the procedure.

8.2.1 Objectives

Key component. There can be no regulation without supervision and enforcement. This is especially true with regard to a highly sophisticated, dematerialised and international structure such as financial markets. The times of 'light touch regulation' seem essentially gone and there are widespread calls for re-regulation. In this setting, the role given to supervisory agencies is expanding.

Effective application of the Directive requires guidance by the competent supervisory authorities regarding the clarification of national transpositions of the Directive where necessary, which contributes to making takeover law more predictable. Moreover, infringements of the transposing regulation must be penalised in an effective, proportionate and dissuasive manner by the competent judicial or administrative national authorities in order to ensure that the transposition provisions are, in practice, also enforced at the member state level.

8.2.2 Transposition

Guidance by supervisory authorities

Guidance. Substantial guidance is issued in certain member states, such as the UK (where it is provided by the Takeover Panel), Ireland and Finland.[37] Supervisors (such as the AMF in France and the BaFin in Germany) issue annual reports describing the most important decisions and issues at stake or publish other documentation, such as guidance papers or statistics. Where decisions are published (e.g. in France), investors receive additional guidance.

The level of guidance available depends largely on when pre-existing takeover law was introduced in the relevant member state. In member states with a relatively new takeover law (e.g. Luxembourg or Greece), there is little guidance because only a few decisions currently exist. The level of guidance also depends on the size of the takeover markets in the respective countries. In smaller countries, few cases are at hand. Some countries, such as Romania, thus lack precise guidance.

Cooperation. The Directive has made cooperation between supervisors easier, as supervisors of member states are now working on the basis of a common framework. The Network of Takeover Regulators established under the auspices of the Committee of European Securities Regulators (now ESMA) has also provided an effective and useful forum for discussion and the exchange of views on best practice.

Enforcement by supervisors and courts

Supervisory practice. Generally speaking, supervisory practice appears to be satisfactory and no cases of particular leniency or lack of control by supervisory authorities have been reported. There are some exceptions, reported by stakeholders: i) in Greece, the current available framework of fines is not deemed adequate for protecting minority shareholders; ii) in Poland, the mandatory bid rule can be too easily circumvented (e.g. through capital contributions); and iii) in Romania, enforcement appears sometimes difficult as individuals or entities obliged to initiate mandatory takeover bids fail to comply with this obligation.

In addition, in some countries, the practice of imposing fines does not appear to be very harsh.

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[37] In Finland, there is the particularity that the Finnish Financial Supervisory Authority issues “Standards”, that is, guidelines that are partly binding and partly recommendatory.

Specialised courts. The quality of transposition and compliance with takeover bid rules depends also on the opportunity to challenge the decisions of the supervisory authorities. Some member states have introduced a specific competence of a higher civil law court for appeals against decisions of the supervisory authority, in order to concentrate specific knowledge on takeover bids in one court (e.g. in France, with the Court of Appeal of Paris; in Belgium, with the Court of Appeal of Brussels; and in Germany, with the Higher District Court of Frankfurt).

Practice of enforcement. In almost all member states, no increased litigation has been observed following the transposition of the Directive. In some countries this may be explained by the fact that the takeover law is recent or the total number of takeovers is low (e.g. Luxembourg, Estonia, Austria), and in others because the Directive did not fundamentally change the existing legal framework (e.g. the UK, France, Germany).

Sanctions

National sanctions. According to Art. 17 of the Directive, the member states are competent to determine the sanctions to be imposed for infringements of the national transposing law. Member states must take the necessary steps to ensure that the national transposing law comes into effect. The sanctions thus need to be effective, proportionate and dissuasive. The way in which enforcement is ensured in the UK is generally given as an example. Box 5 provides a short description in this respect.

Box 5. Enforcement in the UK

If the Hearings Committee finds a breach of the Code or of a ruling of the Panel, it may take the following actions:

- issue a private statement of censure;
- issue a public statement of censure;
- suspend or withdraw any exemption, approval or other special status that the Panel has granted to a person, or impose conditions on the enjoyment of such exemption, approval or special status, in respect of all or part of the activities to which such exemption, approval or special status relates;
- report the offender's conduct to a UK or overseas regulatory authority or professional body (most notably the Financial Services Authority, 'FSA') so that such authority or body can consider whether to take disciplinary or enforcement action; and

- publish a Panel Statement indicating that the offender is someone who, in the Hearings Committee's opinion, is not likely to comply with the Code. The rules of the FSA and certain professional bodies oblige their members, in certain circumstances, not to act for the person in question in relation to transactions subject to the Code, including dealings in relevant securities requiring disclosure under the Code. This is known as 'cold-shouldering'.

In the last five years (2006–11), the Panel has issued three statements of public censure and 35 statements of private censure (of which 9 were market-related, 18 related to the conduct of the persons concerned and 8 related to a failure to consult the Panel). One cold-shouldering statement has been issued (in 2010). This is only the second time that such a statement has ever been issued by the Panel.

Available measures. Measures available for private enforcement of the transposing law include the voiding of share purchases concluded in breach of the transposing law, in particular without launching a mandatory bid; the forfeiture of voting rights acquired or held in violation of the mandatory bid rule (e.g. Germany, Italy); and damages claims for shareholders or other stakeholders. In most member states, administrative sanctions and fines can be applied in case of infringement of certain provisions of the transposing law, e.g. infringement of the mandatory bid rule, omission (publishing a bid lacking content) or failure to respect minimum price requirements. The amount varies among the member states. In Germany, fines may amount to €1 million, while in Italy, the maximum that may be claimed for failing to launch a mandatory bid can equal the entire price that would have been payable under the mandatory bid rule.

Penalties for violation of guidance issued by supervisors. Most supervisors state that penalties are never issued (63%). Regarding their deterrent effect, 50% have no opinion and 38% think that penalties have no such effect. This may be linked to the fact that takeover activity has been low, so occasions to issue penalties have been few.

8.2.3 Comparison with major non-EU jurisdictions

Enforcement in major non-EU jurisdictions. It is in general difficult to assess the enforcement of takeover regulation in non-EU jurisdictions. While major markets (such as the US) seem to have substantial compliance procedures in place, the enforcement of takeover bid rules purporting to protect shareholder interests appears in certain non-EU jurisdictions to be unsatisfactory and offerors achieve the success of the bid by circumventing such rules or taking advantage of rules that are not bid-related. In Russia, for instance, rules that are not bid-related but which are applicable to special shareholder meetings

and insolvency proceedings as well as the scope of business management decisions appear to facilitate the circumvention of shareholder-protective takeover bid rules.

Swiss shareholder involvement. In Switzerland, minority shareholders may participate in the procedure. Since 1 January 2009, shareholders holding, directly or indirectly, 2% or more of the voting rights in the offeree company (so-called 'qualified shareholders') may be a party to takeover proceedings before the Swiss Takeover Board within five trading days of the publication of the offer document, or if the first order by the Swiss Takeover Board regarding the bid is published before the offer document (for example, orders relating to the pre-announcement), after publication of such an order.

Qualified shareholders, if they have not applied to obtain legal standing and have yet to participate in the proceedings, may also file an appeal with the Swiss Takeover Board against the first order issued by the Swiss Takeover Board on the bid within five trading days of publication of such an order, if published prior to or together with the offer document.

Participation. Upon admittance, qualified shareholders may participate in the proceedings, access the Takeover Board's file and challenge the Takeover Board's order before the FINMA (Swiss Financial Market Supervisory Authority).

8.2.4 Perception

Competence of supervisors. Most stakeholders consider that it is sufficiently clear which supervisor is competent to supervise takeover bids (93%) as well as squeeze-outs (84%) and sell-outs (93%). Supervisors mostly agree that the rules and principles set out in the Directive are easy – or even very easy – to enforce, with some exceptions, such as the rules regarding neutrality or reciprocity.

No significant increase in litigation. A majority of stakeholders did not perceive a significant increase in litigation since the transposition of the Directive, and stakeholders who did perceive an increase say that this is linked to the enhanced awareness of stakeholders concerning their rights (73%).

9. MAPPING THE POTENTIAL REFORMS

This chapter presents a number of potential reforms that could be undertaken to improve the regulatory framework for takeover bids in the European Union. It builds on the expertise of the authors and is not part of the report delivered to the European Commission. It has been added to this edition to stimulate the discussion on how potential reforms could be articulated and their likely impact on the market for corporate control in Europe.

Considering the various objectives of the Directive, the conflicting economic results of the assorted rules and the diversity of interests to protect, it is difficult to propose a single set of well-articulated reforms. Instead, this chapter presents a series of proposals based on premises articulated from both economic and corporate governance standpoints (giving the broadest possible meaning to these terms) and attempts to outline measures that are both precise and, when considered separately, consistent.

The proposals discussed in this chapter may be useful in furthering several objectives, among which are EU integration, the promotion of bids, a reduction of the 'social control gap' and the protection of shareholders' and other stakeholders' interests, including employees.

9.1 Major reforms

9.1.1 Mandate the board neutrality rule or breakthrough rule, or both

Rationale. Making the board neutrality rule and breakthrough rule mandatory was the original intent of the European Commission when first proposing the Directive. Mandating a single rule would promote unity and market integration, although the net economic impact of such a reform is unknown and its result could exacerbate the 'social control gap' issue. A reform in this area may come in a strong form or in three weaker forms.

Strong form: Remove optionality

Background. Removing optionality is a proposal that could be based on the following premises: i) from a corporate governance standpoint, it is linked to the shareholder primacy theory and the finance standpoint; ii) it is based on the belief that strong harmonisation would yield better results than freedom of

contract; and iii) from an economic standpoint, it is based on the premise that it is better to have more bids at a lower price than the reverse.

Debate. Mandating *neutrality* is likely to reopen the debates that took place in 2001, as its premises have not changed. In addition, some critics have argued that many member states' legal systems in place before the Directive already prevented directors from acting contrary to the interests of the shareholders, and that actually, the board neutrality rule is an unnecessary redundancy. This reform is nonetheless supported by the fact that 15 sample jurisdictions out of 22 have introduced the neutrality rule. Mandating the *breakthrough rule* appears even more difficult, as almost no member state has introduced it. Furthermore, introducing such a rule would also create the risk of incentivising companies to make more extensive use of non-regulated pre-bid defences, such as pyramid structures and cross-shareholdings. Finally, there is no obvious appetite on the part of stakeholders of the Directive for such a reform, as generally speaking, they believe that boards do not have too much power to frustrate bids and that there are sufficient possibilities to break through defences.

Weaker forms

- *The board neutrality rule as the default rule*

  Rationale. It has been suggested that the Italian regime be introduced into the Directive, thus making the board neutrality rule the default rule subject to a periodic opt-out decision by an ordinary majority at the general meeting of shareholders.[38] This version of the board neutrality rule would remove the member states from the decision-making process[39] and confer the power of making the decision to the general meeting. It has been argued that the default rule should favour the party for which it is harder to achieve the required vote, therefore the decision of opting into the board neutrality rule or not should rest with the company. This premise may be the subject of discussion, however. The analysis was originally made in the US, where shareholders' power is lower than in the EU. This reform would not be a neutral one, as it would set "default rules that tilt on the side of more contestability (in management-controlled companies) and on the side of more shareholder protection (in companies with a controlling shareholder)" (Enriques, 2009, p. 16).

[38] See Davies et al. (2010), p. 19 and Enriques (2009), p. 16.

[39] *Idem.*

Debate. As a 'weak form' of a 'major reform', this proposal is likely to rekindle the debate of 2001. As stated by its proponents, this reform is not neutral: member states that have introduced the board neutrality rule are likely to ask for a possibility to opt out from this opt-in rule, so that companies within their jurisdiction are not allowed to opt out. The other member states may resist this reform as a 'back door' introduction of neutrality.

- *Remove reciprocity*

  Rationale. Another option is to remove the reciprocity exception. This rule is not based on a microeconomic basis. As a result, it has been criticised for its inconsistency, as the wealth potentially created by a combination of two companies does not depend on the application (or not) by the offeror of the board neutrality rule.

  Debate. This reform is likely to bring back the 2001 debates, as several member states accepted the Portuguese compromise only because of the reciprocity exception. The criticism of the rule, based on a microeconomic analysis, would be confronted with two concepts: i) reciprocity is based on a macroeconomic analysis of the competition among countries and regions, a theme whose importance has grown since the 2008 crisis and the increasing role played by sovereign funds; and ii) reciprocity is also a concept based on fairness, under the traditional principle of 'do not do to others what you do not allow them to do to you'. Reciprocity can also be seen as a way to alleviate the perception of the 'social control gap' issue through a rule of procedural fairness among states.

- *Mandate the board neutrality rule with reciprocity at the non-EU level*

  Rationale. This reform would see the board neutrality rule applied only to offerors from the EU and not to foreign offerors not applying the reciprocity rule. This version of the board neutrality rule would have the merit of achieving stronger integration of the European Union, since bids from European offerors would not face opposition from the board of the offeree company.

  Debate. This reform would be consistent with the 'social control gap' concern and could receive some support on this basis. It has been tested in Spain on a reduced scale, as the reciprocity exception is not applicable among Spanish companies. This version of the board neutrality rule might be perceived as protectionist by offerors from jurisdictions outside the EU and raises concerns in this respect.

9.1.2 *Remove or amend the board neutrality rule*

Remove the board neutrality rule

Background. At the opposite end of the scale, the board neutrality rule could be removed. Offeree company boards would then no longer be restricted from applying defences and the price of the shares could rise substantially during the bid. This reform could either be linked to the US management-oriented model or to the team production model, depending on how it is structured.

Rationale: The new role of pro-offeror hedge funds. Since the board neutrality rule was first proposed as part of the draft Directive, the way in which it was meant to be implemented has changed, due to the role hedge funds now play during bids. In companies with dispersed shareholdings, the balance of power has further shifted in favour of the offeror over the company, which might not be in a position to defend itself against the bid. As a result of this unforeseen situation, the price received by the offeree company shareholder may not be optimal, and more generally, bids having negative economic consequences may succeed more easily.

Amend the board neutrality rule

Rationale. A useful distinction may be made between value-enhancing, value-destructive and value-neutral defences. Authorising value-enhancing (and potentially, value-neutral) defences may be a way to preserve the offeree company's interest while granting it a negotiating tool to enhance the bid price to the benefit of its shareholders.

Amendment. This reform would require either a generic definition of value-enhancing, value-neutral or value-destructive defences (or all of these), or more simply, a list of permitted or prohibited defences (for instance, the issuance of tender offer warrants could be authorised and the sale of assets at a discount could be prohibited). Such a catalogue of prohibited actions, e.g. actions that an offeree company board may not take without shareholder approval, exists for instance in Switzerland.

Debate. This reform would open the way for a middle ground between shareholder primacy theories (as bid values would potentially be negotiated up) and stakeholder theories (as corporate interest would always be defended). It would benefit from abundant case law in the EU and the US regarding the intrinsic value of defences.

9.1.3 Remove the mandatory bid rule or share the control premium differently

Rationale. The mandatory bid rule promotes equality among shareholders. It comes with a high cost, however, as it prevents a number of bids from taking place. Removing the rule would thus facilitate takeover bids. As an alternative, a partial sharing of the control premium could be proposed.

Background. In most member states, the mandatory bid rule was not a feature of takeover bid regulation before the 1990s. In addition, this rule is unknown in the largest financial market, i.e. the US. In a conceptual framework where shareholders are 'owners' of the company, it is consistent to consider that holders of controlling blocks 'own' their control rights and should not be forced to share the control premium with other shareholders – after all, if minority shareholders want to benefit from the control premium, it could be argued that they can either buy a block or create one through piecemeal purchases on the market.

Debate. This reform would be likely to create a very significant debate. In particular, the meaning of the equality principle would be discussed: Does it mean that all shareholders should be treated equally, or that only shareholders in the same situation should benefit from the rule? The impact of the reform on the average share price could also be discussed, more specifically when there is no expectation to share a part of a potential control premium, the share price is likely to decrease. Yet, the economic impact of this may be subject to debate: if prices go down, returns (i.e. dividends/share price) go up, which is a way for companies to lower their capital cost. Finally, as the mandatory bid rule is likely to have a positive effect on the bid premium, the proposed reform is likely to be approved by stakeholders.

Alternative opt-out approach. Instead of suppressing the mandatory bid rule, it would be possible to promote an opt-out approach. The following issues would thus need to be addressed:

- whether the opt-out possibility is granted to all EU companies or if each member state is allowed to decide whether companies may opt out;
- whether companies are allowed to opt out before any bid is announced (a 'cool' opt-out) or only after such an announcement (a 'hot' opt-out);
- which procedures are applicable (and in particular whether blockholders and interested shareholders may vote and at which majority); and
- whether the opt-out procedure leads to a full or partial exemption or sharing of the control premium.

On a comparative basis, it may be noted that shareholders of Swiss companies have the option to amend the articles of association in order to discard the duty to make a mandatory bid. Still, the decisions of competent Swiss authorities have clarified that this option may not be used as a whitewash procedure by being applied solely in view of a specific transaction or shareholder.

Combining the opt-out procedure with improved regulation of private benefits of control (PBCs). According to some studies, PBCs are a significant issue (Zingales and Dyck, 2004). PBCs generally come in two forms: one that is acceptable (synergies) and one that is not (undue transfers of wealth). It is generally acknowledged that PBCs lack in transparency and are therefore difficult to assess. One way to address the issue would be to link transparency to the PBCs and the sharing of the control premium. The mechanism could work as follows:

- Each year, blockholders could disclose their level of PBCs. This amount would be the subject of a special report audited by the statutory auditors of both the blockholders and the controlled company.
- When PBCs are based on related-party transactions (which should constitute the majority of all PBCs), appropriate procedures should be followed for their approval (as such procedures already exist at the national level or could be enhanced pursuant to new EU regulations).
- When a blockholder has thus disclosed PBCs for a certain period of time (for instance, three years), the portion of the control premium corresponding to a three-year average of these PBCs could be kept by the blockholders when control is transferred to a third party.

This mechanism would thus enhance transparency and control in the interest of minority shareholders. The details of the computation of PBCs should obviously be sufficiently specified and harmonised.

9.1.4 Grant appropriate powers to ESMA

Rationale. Improved harmonisation of EU legislation regarding takeover bids could have an attractive effect on international investors looking for simplicity and predictability. In this respect, ESMA could be attributed a broader competence, especially regarding "the rulemaking for present blanks" (Wymeersch, 2011), (for example Art. 14 of the Directive or the squeeze-out and sell-out rights) and the "coordination of national rules and practices" (*idem*). Indeed, similar to the framework put in place with the Directive on Alternative Investment Fund Managers (2011/61/EU), ESMA could be awarded the competence to issue guidance and recommendations. ESMA

could additionally be attributed the competence to mediate between the supervisory authorities.

Debate. This proposal would re-open a debate that has been recently settled, as takeovers were removed from the scope of ESMA powers when the agency was created.

9.1.5 Change the conceptual framework

Rationale. Further reforms may be based on a change of the conceptual framework on which many assumptions are based. For instance, the bid could be made subject to shareholder approval at a general meeting of the offeree company's shareholders.[40] The interest of this proposal would be to find a middle ground between opposite conceptions of companies. In the 'shareholders' primacy' view, each shareholder, on an individual basis, should be free to decide on the merits of the bid. In the 'corporate interest' view, the company should be involved in the decision. As the general meeting of shareholders is one of the governing bodies of a company, and has a collective dimension that facilitates the emergence of an open debate, it could be the place to reconcile both views.

Amendment. As a radical change in the overall approach to bids, this reform would be complex to adopt. The proposal could come in a variety of forms, depending on the position taken on the following issues:

- The meeting would need to be convened within a specified time period following the announcement of the bid.
- The agenda of the meeting should include the proposal of the offeror and any alternative proposals made by other offerors, white knights or the management.
- Only disinterested shareholders should be authorised to vote, leading to the disenfranchisement of the offeror and shareholders having acquired their shares after the announcement of the bid. This measure is necessary to protect the corporate interests of the company.
- The required majority should probably be the simple majority rule, as the vote would not lead to any forced sales.
- Any shareholder voting in favour of the bid would, at the same time, be required to tender his or her shares into the bid.

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[40] A reform based on a shareholder vote on takeovers has been proposed by US scholars.

- Shareholders voting against the bid could be offered the possibility, in the event the bid succeeds, to tender their shares into the bid during an additional period of time.
- The vote would lead to the following solutions for the offeree company: i) a bid could be rejected (in which case it would be terminated), approved under the condition that it is improved, pursuant to negotiations with the board, or unconditionally approved (in which case the offeror will benefit from the shares that are automatically tendered in connection with the approval vote); ii) in parallel, defences could be rejected (and thus prohibited), approved under certain conditions of use (such as fairness opinions on the price negotiated with the offeror), or unconditionally approved; and iii) alternative schemes of the management could be either approved or rejected.

Debate. This proposal could renew the debate on takeover bids. It could be seen either as a way to replace existing legislation (which would be a highly complex task) or as an addition to existing systems, in which case it would fall within the category of 'enabling legislation' and would be less subject to debate.

9.2 Technical reforms

9.2.1 Create true neutrality

Rationale. What is often called the 'neutrality' principle is in fact a very limited version of what neutrality could be during takeover bids. A comprehensive and unbiased view of neutrality would lead to a number of adjustments to the existing principle, to remove both pro-bid biases and undue bid obstacles.

Compensation

Compensation that is structurally pro-bid. It is of interest to address board member compensation and how such compensation facilitates bids. For example, in the US, where the existence of defensive mechanisms does not prevent the occurrence of takeover bids, it is hypothesised that this stems from boards often being compensated in stock options, which gives them an independent incentive to not frustrate the bid. Accelerated voting of stock options upon change of control, or any other form of compensation triggered as a result of a takeover bid, is likely to have a significant impact on the opinion of the beneficiaries of such extra compensation. There are three ways to address the issue:

- Disclosure may not be an appropriate remedy, as this specific information is likely to be watered down in the flux of disclosures taking place when a bid is launched.

- Suspending the ability of the beneficiaries to give their opinion on the bid may not be appropriate either, as it hands this role over to independent directors (who typically do not benefit from such compensation packages); as they are outsiders, with less knowledge of the company and a lower involvement in its activities, their advice may not be as reliable as that of insider directors.
- Thus, the ultimate (and more drastic) solution would be to prohibit (or limit) the use of such compensation mechanisms. The reform would then be a specific type of 'breakthrough' arrangement, depriving such a compensation scheme of any legal effect in the event of takeover bids. For a precise analysis of what may be accepted, the framework of the European Commission's recommendation on remuneration could be used.

Reopening the bid and similar concepts

Reducing pressure to tender through market mechanisms. As discussed above, there is the potential for the 'pressure-to-tender' effect to be high in all takeover bids. Providing the possibility to re-open the bid would reduce this pressure, given that, if a certain percentage of shares were tendered, shareholders who did not tender their shares previously would be allowed to do so. The shareholders would gain the benefit of exiting the company and the offeror would benefit by taking over a larger percentage of shares, making it easier to run the company. Examples of this system can be found in France and the UK.

Voting rules

Removing the ability for incomers to vote during the takeover bid. As discussed above, the use of pro-offeror arbitrageurs has significantly changed the meaning of decisions made by shareholders during a bid. Whereas it was intended to be a means for existing shareholders to provide their opinion on the bid, it has become a means for offerors and arbitrageurs to promote the bid's success. To remedy this, the voting rights of shareholders who acquired their shares after the announcement of the bid could be suspended in general meetings voting on defences.

9.2.2 Harmonise key concepts

Rationale. Without going as far as full harmonisation, it is possible to increase regulatory convergence through an improved harmonisation of the following key concepts: the definition of control, the definition of 'acting in concert' and the possible exemption of the mandatory bid rule.

Control

Rationale. The Directive has left the definition of control to member states. Some convergence has appeared around the 30% and 33% thresholds, but a variety of other mechanisms are used, including second thresholds, increases between 30% and 50%, de facto control and other criteria. From an economic standpoint, it makes sense to keep a certain level of flexibility, as shareholding structures differ in each country. Nevertheless, further convergence could be encouraged through a series of measures.

Possibilities to increase convergence. The following issues could be addressed:

- *Harmonising computation (including cash-settled derivatives)*. The method used for the computation could be harmonised. Reference could be made in this respect to the Transparency Directive. The specific question of the use of derivatives and in particular cash-settled derivatives should be addressed: using derivatives when getting closer to the control threshold can never be seen as a coincidence; it is typically part of the control-seeking strategy.
- *Prevent creep-up control.* To avoid significant increases of shareholdings once the threshold for a mandatory takeover bid has been exceeded (as in the Hochtief case), an anti-creep-up provision could be made mandatory. Pursuant to such a provision, a person would be permitted to increase his or her holdings only by a limited percentage within a specified time frame (e.g. 12 months). Such a provision already exists in certain member states and major non-EU jurisdictions, and should thus be largely acceptable. In addition, references to a second threshold may be introduced (typically 50%).

The issue of de facto control. If the above-mentioned principles are used, it would be tempting to recommend a ban on the use of the de facto control criterion, which provides little clarity to the market. Yet, some flexibility remains useful in this respect, as control may also be taken through preference shares without crossing a 30% or 33% threshold. To prevent de facto control, two options remain:

- *The Hungarian method*. To address the issue of shareholders obtaining the control of a company with dispersed ownership without actually crossing the applicable mandatory bid threshold, it might be possible to rely on the Hungarian method. Any person could thus be required to launch a mandatory bid if he or she acquired more than 25% of the voting shares or voting rights in an offeree company in which no shareholder other than the offeror holds more than 10% of the voting rights.

- *The Australian method*. In Australia, subject to certain exceptions, any person increasing voting rights in excess of 20% is obliged to launch a takeover bid on all of the remaining shares. Thus, this low level threshold is an interesting way to prevent the acquisition of de facto control. This trigger may be related to the trigger of poison pills in the US, which is typically set between 10% and 20%.

Acting in concert

Rationale. The definition of acting in concert varies among member states: some of them apply the definition set forth in the Takeover Bids Directive, while others combine this definition with the one provided in the Transparency Directive. In most member states, there is a certain level of vagueness regarding the concept. As this issue touches on the ability of cross-border investors to coordinate, enhancing harmonisation would be useful. At the same time, as any determination of whether a concert action exists is fact-intensive, and the potential for fraud and circumvention is high, supervisors must be left with enough flexibility. This is why a unified, precise and complete definition seems out of reach. Still, some progress could be made through the creation of positive and negative rebuttable presumptions.

Content. A potential reform could be structured as follows:

- Proposals regarding the content of presumptions should be left to level 2 legislation, in order to keep sufficient flexibility when market practices change.
- Sufficient discretion should be left to courts and supervisors, in order to avoid circumvention.
- The reform should provide for a principle of full and spontaneous disclosure of all relevant facts, by alleged concert parties, including a description of all direct and indirect contacts held among them.

Debate. The main push for harmonisation comes from institutional investors wishing to coordinate their action. The debate is thus likely to focus on when this coordination results in taking control of the company. The Italian position, which provides for a safe harbour when less than half of the board members are designated, is an interesting starting point in this respect. It seems less prone to circumvention than the UK system, which relies on the notion of independent directors to determine whether the appointment of a new slate of directors by a coordinated action of shareholders is 'board control-seeking'.

Exemptions to the mandatory bid rule

Rationale. To the extent that the mandatory bid rule is seen as a significant component of the Directive, it would be useful to consider introducing a framework for the exemptions that have been adopted by member states. More than 35 exemptions exist (the precise count depends on the nomenclature). Although most of them appear to be justified, some clarity could be introduced through the use of appropriate categories. In addition, a general case of exemption could be proposed.

Proposing a typology. The Directive, through level 2 measures, could introduce a list of available exemptions. The list should be based on principles in such a way as to leave sufficient flexibility for member states in the transposition process, as exemptions may only be granted on the basis of a fact-intensive analysis and the potential for circumvention is high.

Whitewash as a general exemption. A general whitewash exemption could be introduced. It would work as follows: to the extent that a majority of disinterested and duly informed shareholders approve the granting of an exemption at a general meeting of shareholders, such an exemption should be automatically granted. Minority shareholders may, in some cases, see an interest in the arrival of a new controlling shareholder who can bring value to the offeree company. Yet, as this transaction may be impeded by cost reasons, only a whitewash procedure could solve the issue. Of course, the new would-be controlling shareholder should be required to disclose precisely his or her intentions regarding the offeree company and any financial (or other) arrangements with existing blockholders.

9.2.3 Enhance protection of various stakeholders

Rationale. The protection of stakeholders of the Directive may be enhanced, in keeping with its objectives and a search for greater harmonisation.

Enhance disclosure requirements

Rationale. Stronger disclosure requirements serve the interests of all concerned parties – offerors, shareholders, offeree companies and other stakeholders. There is thus strong support for further disclosure requirements. The cost of such additional disclosures is minimal in the context of a bid. The proposal could be structured around amendments to Arts. 6 and 7 of the Directive.

Addressing enforcement issues. Statements made by the offeror during the bid should be adhered to after the bid. There appears to be a general lack of appropriate enforcement mechanisms in this respect. This could be addressed through three rules:

- *Requiring a positive answer*. Where offerors have a specific intent to act, it is already recognised that they should say so. This is not enough, however. Where they have no intent, they should also clearly say so.
- *12-month commitments*. The statements made by the offeror should be valid for a minimum duration of 12 months. Statements for a shorter duration, or for an indefinite period of time, are in most cases meaningless. Some flexibility should be provided, however, in the event that post-bid, new circumstances arise that are material and were not foreseeable.
- *Post-bid monitoring of the offeree company*. After the bid, the offeree company should have a duty to monitor, on an ongoing basis, compliance by the offeror with its commitments. As the offeror will at this time control the offeree company, the following rules should apply: i) the monitoring should be supervised by independent directors, ii) a quarterly report should be prepared and publicly disclosed, and iii) figures contained in the report (if any) should be subject to an independent review by statutory auditors. This self-monitoring process under the supervision of independent directors and statutory auditors, under the public eye, could be a significant move towards reducing the social control gap, which often stems from a disregard by offerors of their public commitments.

New items to be disclosed. Information known to the company regarding direct and indirect shareholdings of the company should include any known information on long positions, even if such positions result from the use of derivatives.

Enhance protection of minority shareholders

Rationale. Minority shareholder protection is one of the key stated concerns of the Directive. Although the level of protection is already high, it could be further enhanced through a series of limited measures.

Time equality and top-up clauses. After a bid is closed, it does not seem fair that an offeror can continue buying shares on the market at a price that may be higher than the bid price. As prohibiting such conduct may be considered too extreme, an option would be to require the offeror, in such a case and for a 12-month period, to pay to those shareholders who have tendered the difference between the price they received and the price paid after the bid. Such top-up provisions exist in some member states (such as Germany) as well as some major non-EU jurisdictions (such as Switzerland).

Shareholder involvement. Rules favouring shareholder involvement in takeover proceedings before supervisory authorities could be introduced. Based on the Swiss precedent, shareholders holding a minimum holding in the target company could be permitted to become a party in takeover proceedings at an early stage.

Enhance offeree company protection

Rationale. The Directive acknowledges the need to protect the ability of offeree companies to conduct their business without undue disturbances from bids. This principle could be enhanced.

Content. Two measures could be proposed:

- *Maximum duration*. The Directive provides for a maximum duration for the acceptance of a bid. Yet, offeree companies start being disturbed when the bid is announced. This issue may be addressed, as it is in certain major non-EU jurisdictions, by setting a maximum time period between the announcement of the bid and its opening, thus reducing the virtual time period.
- *Put up or shut up*. Another option aimed at reducing the 'virtual bid' period is to introduce a put-up-or-shut-up rule along the lines of those existing in the UK or in France.

Enhance employee protection

Rationale. Employee protection is addressed in the Directive in a very minimalist way and enforcement is poor. A few simple rules could be introduced to enhance employees' rights.

Content. The following rules could be proposed:

- *Employee representatives*. When bodies representing employee representatives at group or European levels exist, it is these bodies that should be consulted to issue advice, not the employee representatives of the holding company.
- *Employee vote*. To make sure that employees have the ability to express their opinion, employee representatives should be entitled to consult all the employees of the offeree company (or group) through an employee voting system.
- *Costs*. Assessing the bid and its potential impact on an offeree company is a complex exercise that requires specific competencies. To the extent that employees or employee representatives require expert assistance, the associated costs should be borne by the offeree company, insofar as these costs are reasonable considering the size of the offeree company.

- *Consultation process and meeting with the offeror*. As bids are always an unsettling event for employees, it is better to organise an open debate to diffuse fears and address all issues that are on the table. To this effect, i) a consultation process could be mandated instead of an information process, and ii) employees or employee representatives, such as in France, should have the right to hear the offeror before they give their opinion (and the offeror should have the obligation to attend the meeting).
- *Providing for adequate sanctions*. Financial sanctions are a poor deterrent when it comes to providing adequate information to employees in the context of a bid, as the very high amounts at stake tend to dwarf any penalty that may be imposed. In other words, the risk is that companies may prefer to pay rather than comply. A solution would thus be to provide for i) the nullity of the bid in the event of gross violations of employees' rights in the context of the bid and ii) a quick resolution procedure that could take place during the bid to make sure that only companies persisting after a court or administrative decision that condemns them for their gross violation would suffer the imposition of an annulment. Obviously, the nullity sanction could only be used in friendly bids, as otherwise the violation of employee rights would be used as a defensive tactic.
- *Protecting employees*. A more far-reaching reform could be proposed. Given that, from an economic standpoint, transferring undertakings or acquiring control of a company are similar in many respects, a proposal could be made to apply the no-dismissal rules contained in the Directive on transfers of undertakings (2001/23/EC) to takeover bids made pursuant to the Directive. As a result, a mere reference to the takeover could not be used as a legitimate ground to proceed with lay-offs.[41]

Debate. This proposal is based on the view that companies are i) legal entities where various stakeholders have legitimate interests, and ii) overall economic efficiency depends in part on the ability to protect and develop investment in firm-specific human capital and avoid 'hold-up' problems (as described in the team production theory). Those having a different corporate governance or economic analysis background may thus oppose the proposal.

[41] Art. 4 of Directive 2001/23/EC.

10. CONCLUSIONS

The Directive has been transposed in all the sample countries and no substantial compliance issue has emerged. Although the completion of its transposition is recent, and the 2008 crisis makes it difficult to compare pre-Directive and post-Directive periods in any meaningful way, some conclusions may be drawn from this study.

10.1 The Directive is at the centre of broader corporate governance and economic debates

Conflicting standpoints. In a reflection on the Directive in a broader perspective, the rejection of a first draft by the European Parliament in 2001 may be considered a starting point. There are two reasons for this:

- First, this rejection was the basis on which a compromise was built. The compromise is characterised by a high level of optionality, based on i) the right for member states to opt out from the board neutrality and breakthrough rules (Art. 12), and ii) an extensive right to derogate from the Directive (pursuant to Arts 4.5 and 5.4), subject only to compliance with a limited number of general principles.
- Second, the compromise reflected a debate between shareholders' and stakeholders' positions, as provided for in Art. 3.1(c) of the Directive, which states that "an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid". This debate has not faded away and is fuelled by corporate governance and economic analyses.
- Before any detailed analysis is carried out, it is therefore critical to understand the corporate governance and economic concepts underlying the Directive.

10.1.1 Corporate governance analysis

Main systems. Three main systems of corporate governance, which basically represent three successive stages of corporate governance thinking, are relevant when reviewing takeover bid regulations. They are outlined below.

- *Traditional view*. In the 19th century, when large corporations started to develop on a significant scale, there was little debate about corporate governance. The relationship between shareholders and employees, described as 'capitalists' and 'workforce', was analysed from a philosophical, political and economic standpoint. The main concern was the sharing of the surplus, seen as a political issue, not a technical one. The time of takeover regulation had not yet arrived.
- *Shareholder primacy view*. The 'agency' issue in the relationship between management and shareholders became a dominant theme of corporate governance in the 20th century, with the emergence of a growing number of large, listed companies with dispersed shareholders. The main question became shareholder control over management – in order to prevent the latter, through laziness or theft, from squandering shareholders' wealth. This led to the emergence of the shareholder primacy view, which applies a principal/agent theory assuming that shareholders are a 'weak' party and is based on the concepts of 'alignment of interest'. Under this theory, pre-bid defences should be removed and post-bid defences should be subject to shareholders' approval within the framework of a 'no frustration' rule.
- *Team production view*. The shareholder primacy view has been criticised since the end of the 20th century. At least three criticisms have been formulated: i) the shareholder primacy view leads to short-termism; ii) shareholders are not in a weak position, especially compared with employees; and iii) neglecting other stakeholders creates negative externalities. As a result, alternative models have been designed, among which the team production theory has emerged. Under this theory, shareholders should be prevented from unduly extracting team production value in a move that would disincentivise employees from making useful firm-specific investments (the so-called 'hold-up' problem). As a result, management should act as 'mediating hierarchs', balancing power between shareholders and employees. In the event of a takeover bid, the management must be able to act in the interest of the company as a whole and, in this setting, to use defences.

Figure 2 in subsection 3.2.2 encapsulates the views developed above.

10.1.2 Economic analysis

Takeovers. The impact of takeovers on the economy is complex and not necessarily straightforward. Takeovers can have positive effects on the economy by disciplining management and promoting a more efficient allocation of resources. Yet, takeovers may also generate negative externalities,

due to three economic issues: free-riding, agency conflicts and pressure to tender. At the core of these three issues is the problem of asymmetric information, and thus the nature of the relationship between offerors and shareholders and between shareholders and managers. Still, several aspects of the economic theory remain open to different interpretations. Most notably, there are conflicting views regarding the question of whether the mandate of the management should be shareholder-oriented or company-oriented, in other words whether it should maximise shareholder value or protect firm-specific investments and the long-term value of the company as a whole.

The Directive. The Takeover Bids Directive strives to balance shareholder protection and the protection of long-term specific investments within the company. Through its interaction with corporate governance and capital market regulations, the Directive has economic effects on multiple areas, such as investor protection or the proportionality between ownership and control. The specific effects of the Directive, however, crucially depend on the prevailing market structure in each jurisdiction, whether concentrated (blockholder-based) or dispersed. The effectiveness of regulatory thresholds therefore hinges on factoring in these structural elements. Similar takeover rules can have diverging effects depending on country-level and company-level characteristics, which also determine the effectiveness of such rules in achieving their original objectives. For instance, diverse legal systems have important effects on investor protection and corporate decision-making processes.

Regulatory objectives. In its balancing exercise, the Directive reveals the existence of important trade-offs and conflicting objectives. For instance, control contestability may induce managers to behave in line with the interests of shareholders and maximise share value instead of managerial benefits. At the same time, control contestability reduces the incentives of management to carry out long-term firm-specific projects, as the pattern of returns may not maximise shareholder value in the short term. The contestability of control may also reduce the incentives of other stakeholders to commit to the firm, for instance in making medium to long-term investments in human capital.

10.2 Assessing the Directive

10.2.1 What has changed?

No radical change. The transposition of the Directive has not led to radical changes in the legal framework of most member states. This is due to three factors: in a number of countries (e.g. the UK), the Directive prescribed rules that had been in existence for a long time; in other countries (e.g. Germany), changes were introduced in view of the future adoption of the Directive; and in

several other cases (e.g. Italy, Hungary or recently, the UK), the most important changes were introduced in reaction to sensitive bids or the economic situation, without there being a direct link with the Directive.

Overall improved harmonisation. Nevertheless, the Directive has led to improvements (in view of its stated objectives) that should not be underestimated: harmonised rules regarding cross-border bids have been adopted; a set of common general principles is applied throughout the European Union; a basic set of common disclosure rules applies; and the mandatory bid rule, squeeze-out rule and sell-out rule have been introduced in all member states. Some smaller member states, which previously had no takeover regulations, now have an almost complete set of rules. If harmonisation has thus progressed, it should nonetheless be noted that ESMA has no coordinating role, which may be seen as an obstacle to more detailed harmonisation.

Overall mapping. A mapping of changes that have been introduced in connection with the Directive shows that the legal system is more shareholder-oriented[42] as a result (Table 21).

Table 21. Mapping the changes introduced by the Directive

	Significant changes	**Some changes**	**No significant changes**
More shareholder-oriented	Cyprus, Czech Republic, Estonia, [Germany], Greece, [Hungary], Luxembourg, Netherlands, Poland, Slovakia, Spain	Belgium, Finland	[Germany], Romania
More stakeholder-oriented	[Hungary], Italy	France, Ireland, Portugal	
Neutral			Austria, Denmark, Sweden, UK

Source: Authors.

[42] Still, whether a system is more or less 'shareholder-oriented' is subject to debate. Detailed explanations on this table, including as to why some countries appear in two different boxes, are provided in chapter 2 of this report.

10.2.2 *What has worked (or not)?*

Assessment of the main provisions

Mandatory bid rule. The mandatory bid rule, which is based on UK law, is specific to the EU (and to legal systems derived from UK law). It enhances minority protection but reduces the number of bids, thus acting as a de facto anti-takeover mechanism – a feature that, in the context of concentrated shareholding, is in part associated with the existence of private benefits of control.

The mandatory bid rule is perceived as effective, although questions are raised regarding some of the (numerous) exemptions that exist, for instance in connection with shareholders acting in concert without acquiring shares, certain corporate transactions (such as capital increases), and certain entities (such as foundations). Stakeholders do not perceive any significant issues regarding the exemption for companies in financial distress, which is frequently used, or for exemptions coupled with whitewash procedures. Price adjustment, although possible, seems to be rare in practice. Some frustrations seem to arise from the following areas:

- the definition of acting in concert, which is viewed as potentially too broad by institutional investors; in this respect, it is worth noting the detailed rules that exist in the UK and in Italy;
- the use of cash-settled derivatives to build up an interest in connection with a takeover bid – an issue that is currently being addressed in the proposed revised version of the Transparency Directive;
- the propensity to try to obtain de facto control through an interest remaining just under the threshold triggering a mandatory bid (e.g. 29.9% interest), a risk that is specifically addressed by Hungarian legislation and is minimised in Australia, where a 20% threshold applies; and
- voluntary bids launched at a low price in order to get slightly above the triggering threshold (e.g. 30%), which allows the offeror to increase its stake in a second step without triggering a mandatory bid – an issue that is addressed in several member states through the use of additional thresholds for shares acquired above the threshold triggering the mandatory bid.

Defences. The Directive's provisions regarding defences present a mixed picture:

- The board neutrality and breakthrough rules are both incomplete rules. The former applies only to conduct that is likely to frustrate a bid and not to mechanisms that create an inherent pro-bid bias, such as stock

options (or other similar types of remuneration) that vest upon a change of control, while the latter does not apply to all control-enhancing mechanisms, as for instance pyramid structures are outside its scope.

- The board neutrality rule is a relative success (15 sample countries out of 22), as is reciprocity (12 sample countries out of 22, with 7 sample countries opting out of neutrality and 5 opting in). The breakthrough rule, however, is a failure: only one sample country is concerned, and no use has been reported. In addition, compensation of 'broken-through' shareholders remains an issue, as there is no consensus on how such compensation should be computed. In addition, some member states, such as France and Italy, apply a partial breakthrough rule.
- The flexibility left to member states on neutrality, breakthrough and reciprocity has given rise to creative systems. For instance, in Spain, reciprocity exists but is not applicable to bids launched by Spanish companies (which raises the ancillary question of what the result would be if all member states were to adopt the same rule at the national or EU level). In Italy, companies are authorised to opt out from the board neutrality rule (which is otherwise mandatory). In France, reciprocity is given its full effect through the potential use of tender offer warrants, a type of shareholders' rights plan requiring shareholder approval.

A comparison of the Directive with legal systems outside the EU shows that some major markets allow the use of defences – mostly the US, but also countries like Canada, Japan and Australia. All of these countries make use of poison pills, a defence for which the interest lies in its effectiveness without destroying value for the company and its shareholders if the bid fails (in contrast with such defences as sales of assets at a discount).

In this context, the debates that led to the optionality of the neutrality and breakthrough rules have not faded away; the above-mentioned issues regarding shareholder value and stakeholder interest, together with the issue of the social control gap, remain significant. There is no clear consensus on how to move on the optionality and reciprocity issues, and generally speaking, there seems to be little appetite to change these rules. This appears to be rooted in two factors:

- At the country level, there seems to be both a fear that there is more to lose than to gain as a result of a possible change (this is true for the main EU jurisdictions, notably the UK and Germany) and a need to absorb the new EU rules stemming from the Directive (this is the case for other EU jurisdictions for which the transposition has led to significant changes).

- At the level of issuers along with investors and intermediaries, feelings regarding defences are mixed. First, such defences are perceived as both creating a risk of bid failure and a means to increase bid prices; and second, there is a general perception that there are not many possibilities for board defences or sufficient means to break through existing defences. Regarding barriers to takeovers that are not addressed by the Directive, such as pyramid structures and cross-shareholdings, there is both a general desire to remove undue obstacles to bids and doubt as to whether any measures in this respect would be efficient and not counter-productive.

Disclosure regime. A majority of stakeholders is satisfied with the disclosure requirements set out in the Directive. This majority also supports the adoption of further disclosure requirements. The main concern relates to the statements to be made by offerors, particularly,

- the lack of precision of such statements;
- the time period during which commitments remain valid; and
- the absence of appropriate enforcement mechanisms, since typically neither the supervisor, the company (or any independent committee thereof) nor its stakeholders are in charge of following up commitments made by the offeree company.

Squeeze-out and sell-out rules. The squeeze-out and sell-out rules are generally approved. The former are frequently used, while the occurrence of the latter seems rare. The 90% and 95% thresholds are generally approved, with a preference for the former; in particular, a popular strategy among speculative investors seems to be to acquire a 5% (or 10%) interest in order to block the squeeze-out and attempt to negotiate a higher price with the offeror. Still, solutions exist to limit the risk of not acquiring all shares (an example being the German 'top-up' rule). The risk may also be avoided by facilitating alternative means of acquiring 100% control for cash (such as cash-out mergers or schemes of arrangement).

Overall assessment of the Directive by the stakeholders

Overall satisfaction. Generally, there is a reasonable level of satisfaction among stakeholders regarding the Directive: a majority of stakeholder considers it clear, enforcement is not generally deemed to be an issue and the allocation of competences between supervisors has not raised practical issues. Furthermore, the protection of minority shareholders is seen as having been enhanced by the Directive, the disclosure regime is not contested and seems to be essentially complied with, and the mandatory bid, squeeze-out and sell-out regimes are in substance approved.

Employee representatives. Yet one category of stakeholders, employees, is not satisfied with the Directive. Employees generally view takeovers as creating high risks of lay-offs and voluntary retirements at the level of the acquired company, an assessment that is shared by issuers along with investors and intermediaries. Employees perceive risks regarding working conditions and early retirements, and consider that these risks also exist at the level of the acquirer (an analysis that is generally not shared by other stakeholders). In addition, they consider that the consultation process is not organised in a satisfactory manner and regret the absence of appropriate enforcement mechanisms when offerors do not act in compliance with the intentions they stated during the bid period. Finally, employees consider that the no-dismissal rules contained in Directive 2001/23/EC should be applicable to takeover bids, given that from an economic standpoint, transferring undertakings or acquiring the control of a company are in many respects similar.

10.2.3 What has been the economic impact of the Directive?

Assessment of the main provisions of the Directive

Mandatory bid rule. The mandatory bid rule enhances the protection of minority shareholders, particularly in concentrated ownership structures, by forcing the offeror to offer the control market premium to all shareholders. The rule may have a negative impact on the volume of takeovers, however, as it raises the cost of deals *ex ante* and incentivises incumbent shareholders to increase their holdings close to the triggering threshold. Further clarification is needed on whether the application of the mandatory bid rule contributes to increased shareholder concentration, which would compromise its shareholder protection objective. Since the rule shows its effects *ex ante*, no conclusive evidence (*ex post*) has been found in the empirical analysis regarding the scale of the impact of the mandatory bid rule on the market for corporate control. Nevertheless, a negative relationship with volumes has been observed and is statistically significant. In addition, the harmonisation in the EU of the triggering threshold at around 30% has produced a reduction of the average size of the initial stake in the company subject to takeover just below this level, which suggests a strategic use of the threshold by incumbent blockholders. For all these reasons, the effect of the mandatory bid rule in influencing the governance and the impact of a takeover can be estimated as 'high'.

Ownership transparency. Ownership transparency appears to have a beneficial impact on all key objectives of the Directive, and in particular on the volume of takeovers and the protection of minority shareholders, since potential offerors are able to see the composition of the ownership structure

and plan their offer accordingly. This positive effect may disappear where it comes to the disclosure of subsequent purchases of shares. The disclosure of purchases above a certain threshold makes 'creeping-in' takeovers more difficult, enhancing shareholder value. At the same time, transparency may also discourage takeovers, since it can raise the costs of building up an initial stake before launching a takeover bid if the disclosure thresholds are low. Overall, the impact on takeover bids of this rule is moderate.

Squeeze-out and sell-out rules. Owing to their very high thresholds, squeeze-out rights and sell-out rights both have a positive but very limited impact on the volume of takeovers. The squeeze-out right protects the offeror from shareholder free-riding, while the sell-out right strengthens the power of minority shareholders, thereby reducing the incentive to increase ownership concentration.

Breakthrough rule. The breakthrough rule could have a substantial positive impact on the volume of takeovers and the protection of minority shareholders if it managed to eliminate control-enhancing mechanisms. Yet, the rule may also create incentives to increase direct control by raising the stake in the company, leading to higher ownership concentration. Furthermore, it may be arbitraged using alternative mechanisms, such as pyramid structures. If coherently devised and consistently implemented, the breakthrough rule would produce a very high impact on the ownership structure of firms, especially in those jurisdictions where ownership and governance are more concentrated. In any case, the limited transposition of the rule means that not enough information is available to extract evidence on its impact on takeover bids and governance of the company.

Board neutrality rule. The board neutrality rule may increase incentives to launch an offer by removing post-bid defences, thereby increasing control contestability, particularly where ownership is dispersed. The empirical analysis in this study, however, shows a slight decrease in cumulative abnormal returns, which suggests that the board neutrality rule may have reduced the potential premium paid by the offeror, since it also reduces the extent to which future controlling shareholders may extract benefits from the company. Moreover, the board neutrality rule may induce incumbent shareholders to entrench before any offer is launched, thereby raising the cost of acquiring control for the potential offeror (with an additional impact on dispersed ownership structures). The overall impact of the rule is more balanced and is thus considered 'moderate' (Table 22).

Table 22. Impact of takeover regulation (± relationship and intensity)

Takeover Bid Directive rule	Volume of takeovers		Protection of (minority) shareholders		Disproportionality between ownership & control		Overall impact
	Concentrated ownership	*Dispersed ownership*	*Concentrated ownership*	*Dispersed ownership*	*Concentrated ownership*	*Dispersed ownership*	
Mandatory bid	–	– –	+ +	+	+	+ +	**High**
Ownership transparency	+	+ +	+	+ +	–	–	**Moderate**
	–	– –					
Squeeze-out	+ +	+	–	–	+	+	**Low**
Sell-out	– –	–	+ +	+	– –	–	**Low**
Breakthrough	+ +	+	+ +	+	+ +	+	**Very high**
Board neutrality	+ +	+	+	–	+	+ +	**Moderate**

Source: Authors.

Overall impact of the Directive

Empirical analysis. Finally, the empirical analysis performed in this study illustrates that the Directive has had an impact on the market for corporate control and the economy. Yet, this impact is marginal (with low intensity) and is affected by a fragmented transposition across member states and by the effects of the still ongoing financial crisis. The market for corporate control does not appear to be 'more contestable' than before the introduction of the Directive. In terms of relations, no overarching conclusions can be reached on the basis of this preliminary analysis; however, the results suggest that the Directive has had a positive impact on cumulative abnormal returns (and indirectly on the volume of takeovers), a positive impact on market capitalisation (but no significance), a positive impact on competitiveness and a negative impact on financial development.

Competitiveness. The impact of the Directive on competitiveness and growth is limited but consistent with the priorities of the Europe 2020 Agenda. A detailed analysis of the contribution of takeovers to competitiveness reveals their potential to increase the efficient allocation of resources, but also the existence of several market failures and trade-offs. The different provisions in the Directive can have mixed effects on competitiveness and growth, calling for further reflection as to their individual and joint impact.

Employment. *Ex ante*, takeovers have a similar chance of affecting employment levels negatively or positively, depending on the business plans of the acquirer. Still, in the short term, pressure to recoup the costs incurred in the transaction can lead to a reduction of employment levels. The Directive protects employees by giving them consultation rights, but the board neutrality rule confers the decision-making power on shareholders alone.

PART II
ECONOMIC ANALYSIS

11. THE ECONOMICS OF TAKEOVER REGULATION

11.1 Introduction

The second part of this study discusses the economic foundations of takeover regulation and the incentives that drive actors along the process, as well as the rationales of the Takeover Bids Directive and the role of regulation. In general, it illustrates why and when a regulatory framework for takeovers is needed. Finally, the study sets forth an empirical analysis of the effects of the Directive, done through an econometric analysis. Section 11.2 describes the takeover bid process and how transfers of control typically happen. Section 11.3 illustrates the market failures that call for regulatory intervention in the takeover bid process. The section defines the coordination problems emerging during the process and generating failures. Section 11.4 briefly describes the types of regulatory tools that can be used to intervene. Chapter 12 goes through each of the five key areas of the directive, mapping implementation and showing market data, as well as running simple econometric testing to gather general evidence on its impact on the market for corporate control. The final two chapters (13 and 14) undertake a theoretical assessment of the potential impact of takeovers on competitiveness and employment.

11.2 The takeover bid process

Takeover. A takeover can be technically defined as a takeover bid to acquire the control of a company listed on a public market.[43] 'Control' is achieved when the offeror has acquired enough shares of the offeree company to be able to appoint directors to the company's board (Davies and Hopt, 2004). 'Control' may therefore be shared by one or more controlling shareholders or exercised by the board of directors that represents all shareholders and the company (fully dispersed ownership). A transfer of control can be achieved in two ways (Bebchuk, 1994; see also Table 23): by means of a private sale of control or a public bid to all shareholders. In both cases, the transaction may concern shares listed on secondary markets.

[43] 'Public market' refers here not only to the main market where companies originally listed their shares, but also to all secondary markets where shares are actually traded.

Table 23. Control transfers

Sale of control	Takeover bid (takeover)
No coordination problems (bilateral)	Coordination problems (multilateral)
Controlling shareholders–acquirer	Offeror–shareholders–management Among shareholders
Private offer	Public offer
Control premium	Market premium
Low transparency	High transparency

Source: Authors.

Private sale. A private sale of control is a bilateral negotiation between the acquirer and the acquiree (usually the controlling blockholder). Private sales of control will take place more frequently in an environment with full or partial concentration of ownership and control, where (owing to coordination problems) it would be difficult to organise a private sale in a dispersed ownership environment. In the case of private sales of control, the acquirer will offer a premium that is tailored to the controlling shareholders' willingness to sell the benefits they are able to extract from minorities (so-called 'private benefits of control' or simply PBCs).[44] PBCs are not necessarily value-expropriating (e.g. self-dealing); rather, they can also be value-creating, i.e. by increasing the utility of the controller without damaging minority shareholders or the company's value (for instance by using otherwise unused internal research for productive purposes; Zingales and Dyck, 2004). From a purely economic standpoint, PBCs create incentives for value-creating takeovers by giving the acquirer additional, measurable benefits from the acquisition (Berglöf and Burkart, 2003). Yet the existence of PBCs has led regulators to introduce more general principles into the Takeover Bids Directive (2004/25/EC), such as the equal treatment of shareholders (Art. 3.1(a)).[45]

Public bid. A takeover is a general public bid for all shares of a listed company to acquire control of the latter. It is a public bid in which the premium over the current share value is the result of market considerations.

[44] PBCs are the benefits enjoyed by controllers through the exploitation of corporate resources (e.g. self-dealing; Jensen and Meckling, 1976). PBCs can also be calculated as the difference between the market price in the tender bid and the price after the takeover is completed. In effect, market prices usually go down after a change of control as a result of market value discounting the cost of the PBCs that the offeror had to pay to the offeree company's controlling shareholders.

[45] See also the *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* by Winter et al. (2002), p. 1.

An additional premium also comes in the form of an "abnormal return", which is the difference between the realised and expected return during the offer period (Burkart, 1999). This does not necessarily reflect the market premium, but rather the additional benefit brought to the share value by the control transfer on its own over a specified time span. Takeovers are intrinsically more transparent than private sales of control because the details of the transaction are usually disclosed to the market and publicly available to all investors. Transparency allows the creation of an implicit auction process, which tends to allocate resources to those who value the shares the most. The possibility of a competing bid for the offeree company increases gains for offeree company shareholders.

Takeover process

The takeover process is split into three phases (Tirole, 2006):

- the building of interest in the company (by purchasing a 'toehold') and potential set-up of *ex-ante* takeover defences (by increasing potential offerors' costs);
- the launch of the takeover bid
  - with a uniform price for all voting shares or a portion of them;
  - with a multi-tiered bid involving different thresholds;
- reactions to the bid by the offeree company board or shareholders (or both)
  - no reactions (friendly takeover); and
  - post-bid defences (hostile takeover).

In addition to *ex-ante* and *ex-post* defences, a public bid may also provoke coordination issues among shareholders that may not emerge in a bilateral setting. The two main coordination issues are a 'pressure-to-tender' problem and a free-riding problem.

11.3 Rationales for takeover regulation

Rationales

Takeovers are generally viewed as an important institutional tool to promote allocative efficiency through an active market for corporate control (European Commission, 2007a; Tirole, 2006; Winter et al., 2002; Burkart, 1999; Romano, 1992; Manne, 1965). Two classical rationales promote takeovers:

- the better allocation of resources through the transfer of control to those who value the company the most. More allocative efficiency will

ultimately reduce the cost of capital. This statement assumes that all takeovers are value-increasing, because shareholders will not tender shares for a value-decreasing deal; and

- a tool to address managerial behaviour by threatening managers with a change to their status quo (as an alternative to shareholder activism, which produces a "disciplinary effect"; Fama and Jensen, 1983b; Grossman and Hart, 1982) and the dissemination of good practices and know-how. This statement assumes that the market is able to recognise poorly performing companies and to replace misbehaving managers (even if their failures are only minor), and in particular that share prices are always a good proxy of the real value of the company.

Regulatory framework

A well-functioning market for corporate control is part of a continuous auction process around the company's value. As a consequence, the regulatory framework must create the conditions to stimulate takeovers over time, and so lower the costs of capital. Designing a regulatory framework for each phase of a takeover transaction may support *ex-ante* efficiency and the quality of the auction process (including the use of defences).

Market failures

The negative externalities generated by market failures are another reason to regulate takeovers. In practice, market failures stem from the following sources:

- coordination issues among offeree company shareholders (or the 'collective action' problem);
- empire-building transactions (in which competitors are swallowed);
- agency problems (shareholders vs. managers, or controlling vs. non-controlling shareholders); and
- insufficient investments in firm-specific assets and human capital (Blair and Stout, 2005).

To reduce the negative impact of these failures, corporate governance regulation can increase the voice or provide exit rights for those parties negatively affected by them.

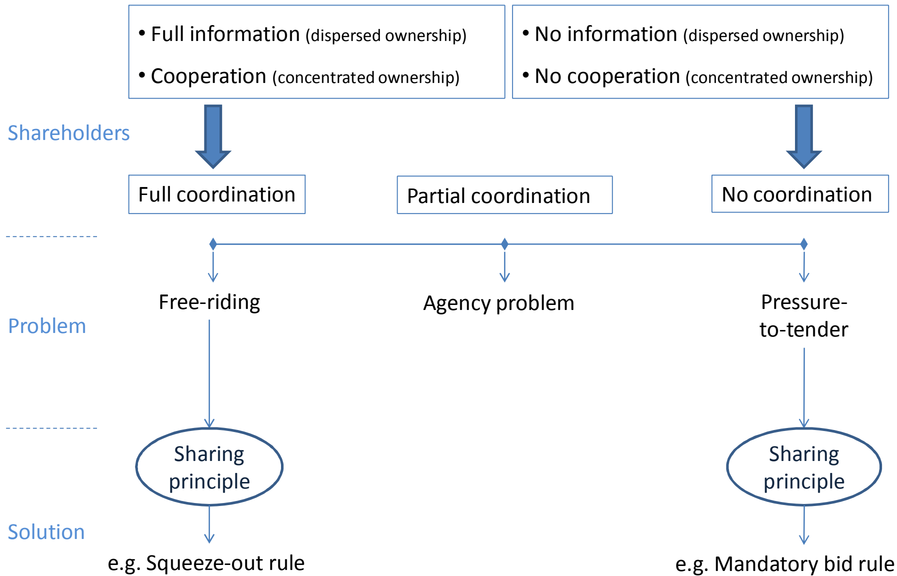
11.3.1 Coordination issues

Coordination among shareholders

There are two coordination issues among shareholders in a dispersed ownership environment: the free-riding problem and the pressure-to-tender

problem. Both problems relate to the post-takeover value of the shareholding. Figure 6 presents a graphical representation of these.

Figure 6. Coordination issues among shareholders



Source: Authors.

Free-riding

The free-riding problem, first identified by Grossman and Hart (1980; see also Cohen, 1991), arises when there is full coordination among shareholders, i.e. shareholders have full information about the bid and can coordinate among themselves (e.g. because there is a concentrated ownership environment with few blockholders) in order to determine *ex ante* whether the bid will be successful. In effect, fully informed shareholders may directly or indirectly[46] coordinate and keep their shares in order to benefit from the *ex-post* higher value, thus increasing transaction costs for the offeror to a level that may discourage the launch of a bid (creating a so-called 'hold-up' problem). As a result, the more shareholders reject the acceptance of the offer, the less benefit for the offeror, who may end up with a minority stake in the company. Non-

[46] Even without talking to one another, shareholders with full information (and understanding) will behave in a coordinated fashion in the same direction, since this is the best strategy to take with the available information.

tendering shareholders thus free ride on the increased post-takeover value that the offeror and accepting shareholders are actually generating. This situation may discourage any attempt of potential offerors to acquire control. In practice, since shareholders cannot be fully informed *ex ante*[47] about the future success of a bid (full coordination), the free-riding problem is in fact limited to a residual stake of the company, particularly when the offeror has already acquired the majority and is looking to take over the remaining stake. Free-riding can also succeed in a situation where shareholders hold partial information; however, the probability that it will succeed is lower, as shareholders have fewer chances to coordinate directly or indirectly with other shareholders. In such a case, minority shareholders may individually decide to hold up the offeror in order to extract a higher payoff. Therefore, in line with the principle that shareholders should share the same conditions in a bid (the sharing principle, Art. 3.1(a) of the Directive; see also Winter et al., 2002, p. 1),[48] takeover regulation usually applies a squeeze-out rule, which allows the offeror to force the remaining shareholders to sell their shares on the same terms offered to the other shareholders. Moreover, if shareholders are not fully informed, the free-riding problem in the acquisition of a majority stake is less significant in an environment in which the private benefits of control are high enough to provide incentives for bids with a higher-than-expected market premium (see McCahery and Renneboog, 2003). Still, the presence of blockholders may facilitate coordination through cooperative behaviour practised with a view to extracting greater benefits from the potential bid.

Pressure to tender

The second coordination issue, the pressure-to-tender problem, arises in a dispersed or concentrated ownership environment when shareholders have insufficient or no information at all about the post-takeover value, with no opportunity to coordinate their behaviour indirectly or directly. The shareholders’ concern is whether to tender, with the risk that a shareholder may make a distorted choice and thus suffer unequal treatment. A distorted choice would arise in relation to shareholders’ expectations concerning the post-takeover value of minority shares (Bebchuk, 1985 and 1987). The causes of the problem are twofold. First, pressure to tender may come from insufficient information about the bid and the company in question, which may induce shareholders to tender because of uncertainty about the post-takeover value of

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[47] Lack of full information means that shareholders cannot derive from the information available the exact probability distribution of future events.

[48] This principle was first elaborated by Jennings (1956) and Andrews (1965).

their stake and the impossibility of cooperating. They are only aware of the current value of the company and cannot predict the success of a bid with very little information. This certainly increases the pressure to tender. Second, a distorted choice may result from a partial or two-tier bid (price discrimination), which creates uncertainty about the success of the bid and conveys insufficient information to produce coordination among shareholders. In effect, a partial bid may create a 'prisoner's dilemma' for offeree company shareholders (Burkart, 1999) and allow the offeror to extract more benefits. Let us take an example, which can apply to both a dispersed and concentrated ownership environment,[49] of when a potential offeror – who may or may not own a small non-controlling stake in the company – decides to acquire control of the company. The situation is even clearer if we consider that there is no controlling shareholder or controlling pact, since otherwise the offeror would make a direct bid for the controlling stake. The offeror launches a bid to acquire the controlling stake (partial offer), which may be 51% or lower. Let us narrow the situation down to two offeree company shareholders (A and B) with a non-controlling stake in the company who cannot cooperate. If the bid does not succeed, the payoff will be 1 (as the additional, post-takeover, net present value (NPV) of future cash flows with no controlling shareholders but with increased market appetite after the offer). The bid can only succeed if at least one of the shareholders accepts an offer for it, but since the shareholders do not have full information, they are not aware and so cannot bargain with the offeror (this is particularly likely to happen in a dispersed ownership environment). For the sake of simplicity, we consider the marginal shareholders, i.e. the last two who are crucial for the transfer of control.[50] If the bid succeeds, the expected payoff is 2 instead (1 plus an additional market premium of 1) for those accepting the bid, and -1 for those who do not tender, since the new setting with a controlling shareholder lowers the NPV of future cash flows, as we assume the controller will extract benefits from minorities. Minorities therefore perceive that the additional 1 is lost, so their payoff is -1. Four outcomes will thus emerge:

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[49] Yet in a more concentrated environment (with blockholders), shareholders may cooperate and indirectly share information about the post-takeover value of their stake. Therefore, there may be some degree of coordination.

[50] This allows the situation to be illustrated in a less complex fashion; however, the results would be the same in the more complex model.

1) If shareholder A tenders and B does not, A (first payoff) will get 2[51] and B will get -1, as the additional post-takeover NPV of future cash flows, which is negative in comparison with the original payoff when there is no controlling shareholder who can extract the private benefits of control from minority shareholders.[52]

2) If shareholder B tenders and A does not, B will get 2 and A will get -1 (vice versa).

3) If both shareholders tender, they will get the premium times the probability that their bid will be accepted (p=0.50), as we assume that the offeror bids only for what is necessary to gain control. Only one of the two will be allowed to tender. If we assume that all shareholders have the same information and the same chance to be counted in the takeover bid and that no shareholders have a controlling stake, this probability should be 50% or below that level for each marginal shareholder.[53] Therefore, p*2 will be 1 or less. Considering that the offeror wants to acquire formal control (51%), the expected payoff for both shareholders will be p*2 + (1-p)*(-1), which equals 0.50.

4) If neither shareholder tenders, they will both get 1, as the additional post-takeover NPV of future cash flows with no shareholder able to extract private benefits of control.

Therefore, the shareholders need to decide *ex ante*, with limited or no coordination, between 'tendering' (T) and 'not tendering' (NT). If they individually decide to tender, the sum of the two potential payoffs – irrespective of the other's decision – will be 0.50+2, which is higher than the potential payoffs if the decision is not to tender (-1+1). Both shareholders will therefore choose to tender. As a result, if parties cannot cooperate, they will end up with a sub-optimal payoff (TT) (see Table 24).

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[51] This is basically 1 (50% premium) plus the expected payoff (which the parties do not know) of 1.

[52] We do not use expected values for the payoffs 'tender' (T) or 'not-tender' (NT) because we assume, for the purposes of easier illustration, that we are dealing with marginal shareholders, i.e. with the decision to tender or not of those two shareholders who determine the acquisition of the 51%, whatever stake of the company they own. The change of control will occur if at least one of the two tenders.

[53] As mentioned in the previous footnote, to model the game (a prisoner's dilemma) with simple payoffs, we assume that we are dealing with the marginal shareholders, i.e. the last two shareholders before the offeror acquires 51% of the company.

Table 24. The prisoner's dilemma

		A	
		T	**NT**
B	**T**	0.50; 0.50	-1; 2
	NT	2; -1	1; 1

Note: The first from the left of the two payoffs in each cell is A's payoff.
Source: Authors.

In effect, the dominant decision for both will be to tender anyway and therefore the final payoffs will be 0.50; 0.50 (with a total value of 1.00), which is a suboptimal equilibrium compared with the common decision 'not to tender' (NTNT) with a total value of 2. Pressures to tender, in an 'uncoordinated' environment, lead marginal shareholders (who are determinant for the success of the offer) to tender, even when it would be better for them to hold their shares in case a chance to access more information arises.

Solutions

Solutions to the pressure-to-tender problem can be multiple. First, prohibiting partial (or two-tier) bids (e.g. through a mandatory bid rule) will reduce pressures, but at a cost. Second, by increasing the flow of information in favour of offeree company shareholders, it is possible to reduce pressures to tender and thus distortions in the choice of offeree company shareholders. This can be achieved in two ways: i) by introducing disclosure requirements to the market that would allow shareholders and other investors (who may be interested in launching a competing offer) to obtain enough information to make an informed choice; and ii) by combining the takeover bid with shareholders' voting on the full proposal submitted directly to shareholders for approval (Bebchuk and Hart, 2001). Voting shareholders would then not be able to hold up their shareholdings if approved, which would solve the free-riding problem. The board may also be required to look for a white knight to launch a competing bid and thus provide more choice for shareholders (Mucciarelli, 2006). This could be costly, however, and would not necessarily be effective, as the board would look for someone who would preserve its position of control.

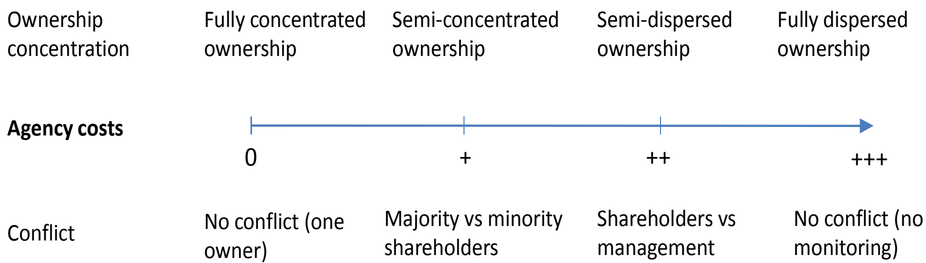
11.3.2 Agency problems

Information asymmetry

As shown earlier, there are situations in which shareholders may have some degree of information; this setting applies to a vast majority of takeovers. In practice, offeree company shareholders may not have enough knowledge to

acquire and process complex information, and thus cannot ordinarily be considered to be fully informed about the company's post-takeover value. Conversely, shareholders usually receive some degree of information from the offeror to avoid strong pressures to tender. In this case, free-riding and pressure-to-tender issues are less frequent, but open up space for other issues such as agency costs, i.e. costs that a party will suffer owing to the asymmetry of information with the other party (see Ross, 1973; Fama and Jensen, 1983a; Milgrom and Roberts, 1992). Information asymmetries may arise among shareholders and between shareholders and management, as individuals process information differently. With or without a legal mandate in their favour, shareholders may experience information gaps with the management of the company or the majority shareholders, especially concerning the monitoring of both. Monitoring costs may be high enough to create moral hazard (Holmstrom, 1979). Agency costs will therefore potentially increase as ownership becomes more dispersed (see Figure 7).

Figure 7. Agency costs and ownership concentration



Source: Authors.

Agency costs

In practice, in a fully concentrated environment, the owner is usually identifiable with the executive officer (manager) who deals with the company's daily affairs; certainly, management is very loyal to the owner. In contrast, in a fully dispersed environment with no corporate governance rules (e.g. general meetings and proxy voting), shareholders hold a small stake in the company and may be unwilling to participate in the company's activities (i.e. may display 'shareholders' apathy') because it is too costly. Therefore, there will be no monitoring of the persons running the company. In addition, two further intermediate situations are highly relevant for corporate law and takeover regulation (including as a result of interaction with regulation). Each situation raises a different conflict. First, with a semi-concentrated ownership structure, the agency conflict is between majority shareholders (who control the company and appoint the board) and minority shareholders, assuming that there is an

indirect mandate by majority shareholders to work indirectly in the minority shareholders' interest. Second, with a semi-dispersed ownership structure, clusters of non-controlling shareholders may be interested in monitoring the board and management, as well as in steering the company's strategy in a certain direction. Therefore, a conflict may arise between the respective self-interests of shareholders and managers regarding the way in which the company should be run.

Remedies

To reduce agency conflicts, mechanisms of voice and exit rights should be made available respectively to minority shareholders and clusters of shareholders (e.g. proxy voting) in order to lower monitoring costs and give investors sufficient incentives to invest in equity ownership. Concerning takeovers, agency costs may favour potential offerors who can actually exploit the coordination issues among shareholders, for instance by siding with management in a dispersed ownership environment, thus minimising the possibility of takeover defences from the offeree company launched by the management. Overall, the contestability of control is typically higher in the case of dispersed ownership structures than in the case of concentrated ones, making it easier for blockholders to entrench around their controlling stake. Finally, there is also an agency conflict between the offeror and the board of the offeree company (since the offeror cannot immediately appoint new directors), especially concerning corporate strategy.

11.3.3 Empire-building transactions

Business strategies

Another market failure pertaining to takeovers may come from an attempt to monopolise the market and charge a mark-up on competitive prices by constraining volumes. A lack of competition may lead a major incumbent to launch a takeover of the main competitor (usually a smaller company). After the takeover, the company will be 'swallowed' by the parent and taken out of the market if the sunk costs to integrate the business are too high or merged with the swallowing company where the costs to integrate the former competitor are sustainable. These market operations are thought to be frequent, but in many countries competition authorities take steps to neutralise such attempts.

11.3.4 Protection of company-specific investments

Company value

Some authors (including Blair, 1995 along with Blair and Stout (2005) advocate a new way of looking at corporate governance and thus takeover regulation. Regulation should not focus on a purported mandate to maximise shareholder value (Manne, 1965) but rather on the value of the company as a whole, which is intrinsically related to the protection of company-specific investments and long-term contracts (Williamson, 1979).[54] The transaction-cost model disputes Coase's theory that the company is a nexus of contracts used "only" as a point of reference to minimise the transaction costs of dealing directly with single agents (Coase, 1937, and strengthened by the principal–agent model discussion of Jensen and Meckling, 1976), suggesting rather that it is a legal tool to protect company-specific assets from being attacked by agents' creditors. In effect, the company's assets are shielded from shareholders' (and other agents') personal creditors thanks to the company's legal entity. Elevating the principal–agent problem to the company level, instead of treating it as a specific contractual issue, does not give sufficient importance to legal personality. As a result, directors and management should maximise the company's value, which is erroneously identified with shareholder value. The value of a company often resides in company-specific assets acquired through high 'sunk' costs that cannot be recovered (i.e. know-how). Employees and creditors are part of those company-specific assets, as they cannot switch from one company to another in the way investors can switch from one financial instrument to another.

Value-creating transactions

The implication of recognising the pre-eminence of the transaction-cost model over the contractual approach is twofold: i) the objective of takeover regulations would not be the equal treatment of shareholders and maximisation of share value, but rather the fostering of value-creating transactions; and ii) regulation would then offer greater protection to those agents that provide more company-specific capital (human capital, know-how, tailored services, etc.), such as employees and creditors. Consequently, the monitoring of management results would be carried out not only by shareholders (and thus by the market), but also by the entire group of relevant stakeholders having direct or indirect participation along with the board. Greater protection for employees and creditors means, among other things, increasing their voice and exit rights. For employees, for instance, this could

[54] In effect, when an offeror launches a bid to gain control of a company, shareholders have the most liquid asset in the company (even if it is a partial offer).

imply a stronger voice on the board (such as in the German co-determination process) rather than the option for a lump sum amount when offeree company shareholders decide to accept the offeror's bid. For creditors, on the other hand, greater protection would entail some sort of involvement in the decision-making process of the company rather than a lump sum for their credit when the offeror takes control or the possibility to swap their credit for convertible bonds to be exercised when the offeror launches the public bid.

Consumer protection

Another company-specific asset may be a set of consumers (with low elasticity) that represents a stable client of the company over time. In this respect, greater consumer protection would consist of regulation of the offeree company, as consumers do not have any means to protect themselves from sudden unexpected changes of control.

Current takeover regulation tries to combine shareholder value maximisation and equal treatment with some level of protection for major stakeholders, which can lead to conflicting objectives and to potential deadlocks.

Box 6. Control as a 'corporate asset'

A relatively old but nevertheless important theory (Berle and Means, 1932) argues that the benefits of a takeover transaction (control premium) should go to the company's corporate treasury, since "control" is a corporate asset. This theory advocates an even stronger equal treatment rule than the one proposed by Jennings (1956) and Andrews (1965) (see footnote 48), i.e. one that puts all providers of inputs (capital, human capital and so forth) on the same level. Moreover, in this case, there is no recognition of shareholder supremacy.

11.3.5 Other relevant issues

The decision to launch a takeover and its outcome are also affected by other relevant variables, which are linked to the structure of corporate governance and the rules in place:

- ownership concentration;
- governance rules and decision-making models and how they affect offerors' expected profits (control-enhancing mechanisms or CEMs, and defensive measures);
- shareholder/investor protection; and
- abnormal returns (unpredictable gains).

Ownership concentration

First, the concentration of ownership and control has relevant implications. In particular, in an environment with a highly concentrated ownership, a potential offeror may be forced to reach an agreement with blockholders and provide an additional premium for the private benefits of control that they are enjoying. The control premium would not be easy to calculate, as there is no clear market benchmark, and it would entail a high risk of free-riding by incumbent shareholders by means of 'acting in concert' (through disclosed and undisclosed agreements). In this context, management is nominated and closely monitored by controlling shareholders and the conflict of interest is between controlling and minority shareholders. The rationale for regulatory intervention in this case would be to protect minority shareholders from potential expropriation by managers and large blockholders in the event of a takeover.[55] In a dispersed ownership structure, on the other hand, there may be less room for blockholders' opportunism and the premium may be more easily calculated, as the market price represents a reliable benchmark to start with. The difficulty that shareholders have in monitoring management exacerbates the conflict among them. Thus, takeover regulation needs to facilitate the transfer of control for poorly performing companies and minimise the costs of hostile takeovers in order to generate sufficient pressure and to discipline management. Addressing this conflict would also improve overall shareholder protection.

[55] As mentioned above, this objective is challenged by a solid stream of literature that links the expropriation of minority shareholders and extraction of private benefits of control to the overall protection granted to investors by the national legal system, rather than to a particular governance culture alone (Zingales and Dyck, 2004). Therefore, the best way to tackle 'expropriation' would be to reinforce investor protection rules throughout the entire legal system, avoiding expensive (in terms of efficiency) actions in the framework of takeover regulation.

Governance rules

Second, the statutory rules and self-regulatory actions that govern a company have a relevant impact on the offeror's incentives to launch a bid. In particular, the report by Winter et al. (2002) and in part the EU takeover regulation endorse the principle of proportionality (i.e. the principle that establishes some sort of proportionality between the ultimate risk borne by the shareholder and the level of control held over the company). Recognition of the validity of the proportionality principle (between ownership and control) would confirm the endorsement by the EU takeover regulation of a one share–one vote principle – thus setting boundaries to the freedom to contract and to create new mechanisms to increase voting power without entailing a proportional economic risk (CEMs; see Shearman & Sterling et al., 2007 for a full taxonomy of CEMs). CEMs may, in effect, reduce the appetite of a potential offeror for the offeree company by worsening the free-riding problem, with relevant implications in terms of resource allocation in the economy and hence potentially leading to less growth and innovation (see Levine, 1997; Morck and Yeung, 2004). At the same time, CEMs can also help distinguish long-term firm investments from market 'short-termism' and commercial strategies (e.g. empire-building transactions). The takeover regulation attempts to find the right balance between the freedom to contract and the proportionality principle by allowing a flexible approach to CEMs (e.g. the breakthrough rule as an option).

Decision-making models

Moreover, the established models of decision-making may influence the success of a takeover bid and the incentives of a potential offeror to promote the bid in the first place. There are two main models (Davies and Hopt, 2004, p. 164): one is shareholder-oriented and the other management-oriented. The first model can be further split into two sub-categories, which are i) legal regimes (e.g. the blockholder model in Continental Europe) that grant block shareholders the full decision on defences, and ii) other regimes that in addition strongly limit *ex ante* any potential action to frustrate bids (e.g. the UK). In effect, the board can engage in a few defensive measures,[56] for instance by looking for a white knight or simply persuading shareholders not to accept the bid. Moreover, there is no ban on pre-bid (*ex-ante*) defensive measures, such as some CEMs. Still, this decision-making model gives almost full control

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[56] The UK City Code on Takeovers (Rule 21) requires the management to seek shareholders' approval for any action that may result in the frustration of a bid.

of the offeree company over the bid process to shareholders, who are usually seen as the last claimants of the companies' assets and thus must benefit from a specific mandate to operate in their interest. In cases involving a more management-oriented model (widespread in the US and applied, in some respects, in EU countries such as Germany),[57] the board and shareholders jointly decide on defences, as there are supposedly stronger safeguards against management skirting its responsibilities owing to the role of fiduciary duties (e.g. the US duty of loyalty and care). In this context, the management may be authorised to issue 'poison pills'[58] to reduce the post-takeover value of the equity for the offeror or even to sell strategic assets to make the offeree company less attractive. Rationales for such a model rely on greater control, for instance in the US, by judicial review of the actions of the management of the offeree company to ultimately protect business. In addition, the clustering of offeree company shareholders in a widely dispersed ownership structure may be extremely expensive.

Investor/shareholder protection

Third, the level of investor/shareholder protection granted by the legal system matters for the ownership structure and thus indirectly for a potential offeror. In effect, countries with greater investor protection are able to attract more capital (La Porta et al., 2000) and thus create better conditions for a more active market for corporate control.

Abnormal returns

Fourth, abnormal returns are the difference between realised and expected returns during the event period (Burkart, 1999; Humphery-Jenner, 2010), i.e. the unpredicted returns above the natural benchmark. Abnormal returns are typically higher around the announcement date, more specifically when the market price gradually begins to discount information about the deal. Timing depends on the specific aspects and deal information disclosed, and on the previous performance of the company.

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[57] In Germany, shareholders (at a general meeting) may authorise the board of management in advance to use defensive measures for up to 18 months, with a 75% majority and the consent of the supervisory board (Section 33(2) Securities Acquisition and Takeover Act).

[58] Poison pills are typically special rights of the offeree company shareholders to purchase additional shares at low prices or sell shares at higher ones after the raider has acquired a stake in the offeree company.

Table 25 confirms positive abnormal returns around the announcement date for roughly 80% of 991 offeree companies domiciled in the European Union subject to takeovers between 2003 and 2010 in which the bidding company's initial stake was below 50%. The calculations are based on four different time ranges (days before and after the formal announcement). Abnormal returns are calculated as the cumulative sum of the difference between the intraday market returns of share prices and the intraday market return of related sector indices.[59] They are the difference between the expected and the effective market return. Abnormal returns decrease as the announcement date draws closer and prices become more informative. They show the additional impact (on the market premium, i.e. the expected return) of the takeover, as some sort of measure of value-increasing deals (in the short term). In addition, Figure 8 shows an increase in abnormal returns with the transposition of the Directive while Figure 9 presents some descriptive statistics.

Table 25. Abnormal returns around the announcement date

	[-41;+41]	Weighted avg. AR (%)	[-10;+10]	Weighted avg. AR (%)	[-5;+5]	Weighted avg. AR (%)	[-2;+2]	Weighted avg. AR (%)
Positive AR	810	17.17	821	13.66	813	11.47	827	10.82
Negative AR	199	-	188	-	196	-	182	-

Sources: Authors' calculations based on Thomson Reuters SDC Platinum, Datastream and STOXX sector indices.

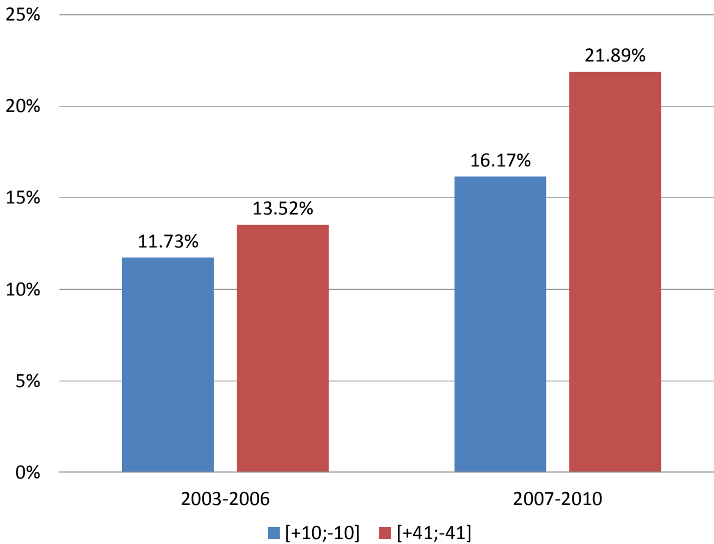
Table 26. Descriptive statistics

	Mean	Stand. deviation	Min.	Max.	Median
AR [-41;+41]	0.258916252	0.382896343	-1.351175882	3.305239172	0.200317776
AR [-10;+10]	0.200443098	0.296759647	-0.777467044	2.327778113	0.147980205

Sources: Authors' calculations based on Thomson Reuters SDC Platinum, Datastream and STOXX sector indices.

[59] Stoxx supersector and industry sector indices have been used to define a proper benchmark for abnormal returns. The formula for the calculation of the cumulative abnormal returns for company i is $CAR_i = \sum_{t=1}^{n}[(p_t - p_{t-1}) - (sir_t - sir_{t-1})]$, where p_t is the market price at day t and sir_t is the value of the sector index (benchmark) at day t (t can be any day before or after the announcement date).

Figure 8. Abnormal returns (by period, weighted average)

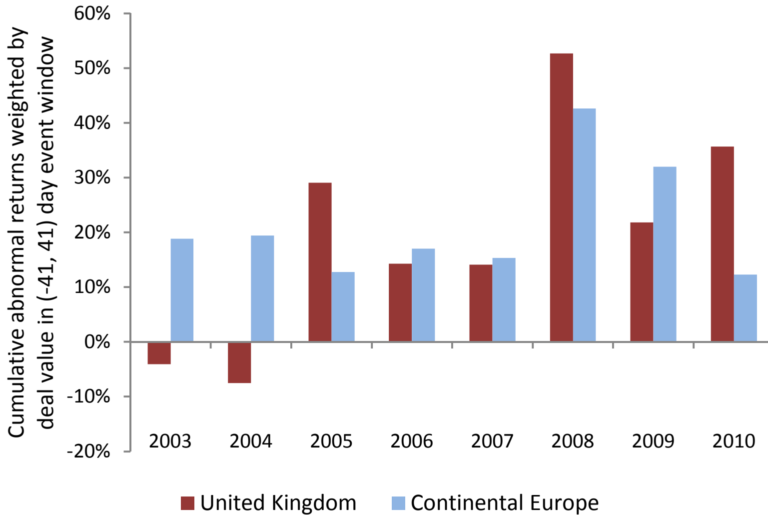


Sources: Authors' calculations based on Thomson Reuters SDC Platinum, Datastream and STOXX sector indices.

As suggested in Figure 9 for the UK in 2003 and 2004, abnormal returns can also be negative, which means that – despite the market premium – the takeover deal does not bring additional value to the company if the premium is adjusted over a longer time horizon than the announcement date (when the market acquires information about the market premium). Additional links between abnormal returns and the Directive are further discussed in Box 7 along with the empirical analysis in Box 8.

More interestingly, recent research (Bebchuk et al., 2010) suggests that abnormal returns decrease when the market is able to price companies' performance better. Therefore, aspects other than company performance (such as investor protection rules and the absence of important corporate governance requirements) may have less influence on abnormal returns. However, improving governance (and thus takeover) regulation would give incentives to the market to look better at company performance indicators and increase investors' interest in the governance of the company at the same time, so improving the likelihood that market prices will more closely track the fundamentals of the company.

Figure 9. Abnormal returns in Continental Europe vs. the UK



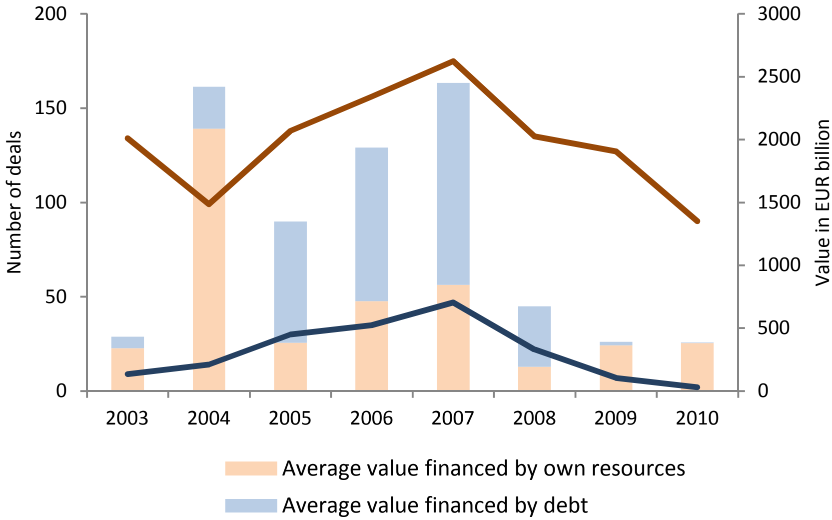
Sources: Authors' calculations based on Thomson Reuters SDC Platinum, Datastream and STOXX sector indices.

Box 7. Market evolution and the introduction of the Directive

The market for corporate control has evolved together with the economic cycle in Europe. Takeovers experienced an upward trend after 2003, in both number and value. In the run-up to the financial crisis, the use of leverage measured as loan proceeds grew exponentially to finance ever-larger deals. The collapse of financial markets and the global recession had a direct impact on the market for corporate control in Europe, leading to complete deleveraging. In 2010, the average value of deals was back to the level in 2003 while the number of deals had decreased even further.

Figure B7.1 suggests that debt was used in no more than 25% of deals, but reached 70% of the value of takeovers in 2007. Therefore, the availability of credit appears to have had a significant impact on the market for corporate control between 2005 and 2008. This situation reflects the impact of monetary policies and the overall economic situation on this market. The Takeover Bids Directive was transposed into national legislation in most member states in 2006 and 2007, just before the meltdown in financial markets. The effects of the Directive on the market for corporate control in Europe may be difficult to disentangle from those of the financial and economic crisis.

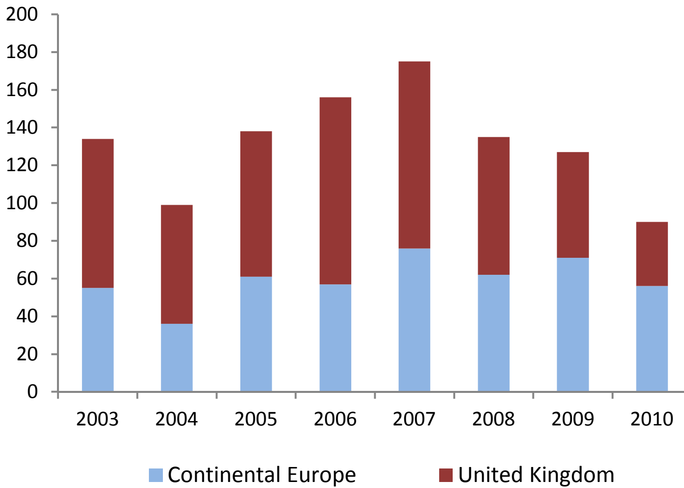
Figure B7.1 Evolution of takeovers in Europe



Sources: Authors' elaboration based on Thomson Reuters SDC Platinum.

The most liquid financial market in Europe, the UK, seems to lead takeover activities in Europe (see Figure B7.2). Yet this leadership has been challenged since the financial crisis, as the number of UK takeovers has declined over the past three years while remaining relatively stable in Continental Europe.

Figure B7.2. Number of takeovers in the UK

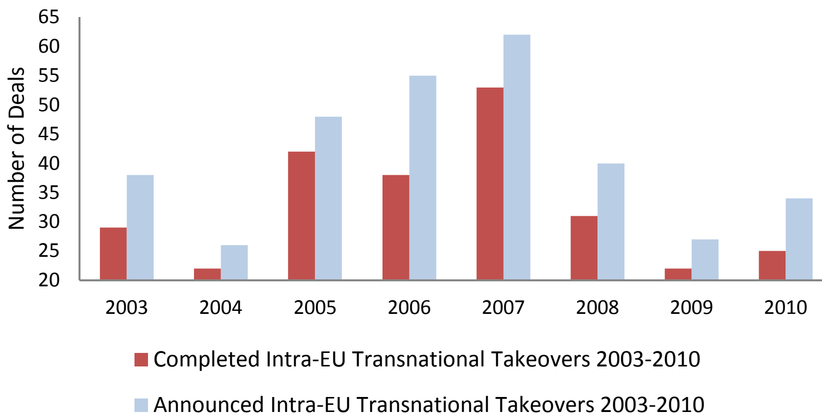


Sources: Authors' elaboration based on Thomson Reuters SDC Platinum.

Historically, the UK market for takeovers has been over 50% of the entire EU market for corporate control. With the financial crisis, however, the number of takeovers completed in the UK has consistently shrunk over time, in particular during 2008–10.

The overall intra-EU market for corporate control has consistently shrunk since 2007, again owing to the financial crisis as shown in Figure B7.3.

Figure B7.3. Number of intra-EU takeover deals 2003–10



Sources: Authors' elaboration based on Thomson Reuters SDC Platinum.

The number of deals crossing EU countries is currently low, but the overall number of EU deals has continually grown over past years. Still, fiscal and legal barriers remain impediments to a fully-fledged European market for corporate control.

Box 8. The dataset

The empirical part of this study builds upon the analysis of a dataset kindly provided by Thomson Reuters from its SDC Platinum Database. The dataset considers completed deals where the offeree company is domiciled in the EU. The geographical scope of the empirical analysis is limited to a selection of member states (Austria, Belgium, Cyprus, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovenia, Spain, Sweden and the UK). As well as excluding those deals where the acquirer held an initial stake in the offeree company above 50%, the dataset has also been filtered to exclude deals where there was no novel acquisition of control.

In terms of the breadth of the dataset, Thomson Reuters provided CEPS with deal-level information, both descriptive and quantitative. Information about the parties involved in the transaction included name, nationality, industry, and a range of financial and stock-market variables. For each deal, Thomson Reuters provided information regarding value, stake held and acquired, consideration paid, debt proceedings and such elements of the deal history as the recommendation of the board or the presence of competing offerors. In addition, Thomson Reuters provided information about stock prices from its DataStream database, which CEPS used to calculate the offeree company's cumulative abnormal returns (-41, 41) in a trading day window around the date of announcement of the deal. A total of 991 takeover transactions are integrated in the final dataset used in this empirical analysis.

To complement the market data provided by Thomson Reuters, and based on the legal review by Marccus Partners, CEPS built a series of scores to capture the quality of transposition of the main provisions of the Takeover Bids Directive by each member state (see Marccus Partners and CEPS, 2012). The aim of these scores is to allow an econometrical analysis of the effects of different transposition across countries. CEPS also considered macroeconomic data and competitiveness indicators from the World Economic Forum to carry out this analysis. For further information, see the appendices.

The empirical analysis carried out in this study also considers a range of stakeholder protection indices. CEPS and Marccus Partners ran a research project to survey and score the level of protection afforded to different stakeholders by national legislation. The initial findings have been used in the econometric analysis conducted for the present study on the Directive.

11.4 Designing takeover regulation

Voluntary vs. mandatory rules

As shown above, takeovers can increase or reduce a company's value. Regulation thus strives to minimise the number of value-decreasing transactions and maximise those that do not negatively affect a company's value. Regulation in corporate governance certainly matters in terms of its implications for markets and thus ownership structure (and its link to investor protection; see Demsetz and Lehn, 1985; La Porta et al., 1996, 1997 and 2000; Levine, 1999). The design of corporate governance (and takeover) rules has typically been an object of discussion, with some advocating a set of voluntary rules (self-regulation) and others advocating mandatory ones. Takeover regulation tries to find a delicate equilibrium between mandatory EU rules (harmonisation) and individual national approaches (through optional requirements), which are often supported by self-regulatory actions (Table 27).

Table 27. Voluntary vs. mandatory rules

Voluntary rules	Mandatory rules
High flexibility	Low flexibility
Moral hazard	Regulatory capture
Low compliance costs	High compliance costs

Source: Authors.

Mandatory rules imply low flexibility (once approved), high compliance costs and the risk of regulatory capture by specific market interests. Voluntary rules, in contrast, are more flexible and can be easily modified, which results in low compliance costs (because they are tailored to market needs); however, they may generate moral hazard, as the monitoring costs (for the establishment process and oversight) may be too high, resulting in circumvention or insufficient application. For takeovers, the EU opted for an intermediate solution, which consists of a Directive that grants high flexibility on how to apply certain given principles and leaves member states the option to apply some of its rules.

Default rules

Enriques (2010) argues that, since regulation is not able to distinguish between value-increasing and value-decreasing control transactions, takeover regulation should follow a different approach based on default rules, i.e. regulators should set rules that do not impede or promote takeovers. In Enriques' view, companies should be free to choose how control is reallocated and should, in particular, be able to opt out of default rules (e.g. takeover rules). Yet this proposal may indirectly leave the achievement of any distributional objective (whether equal treatment or other) and other objectives (the weight of majority shareholders) to the discretion of some agents within the company, depending on the voting mechanism that is set. This voting mechanism would need to be designed around specific (and non-conflicting) regulatory objectives (e.g. solely shareholders' or stakeholders' equal treatment).

12. THE ECONOMICS OF THE DIRECTIVE

Objectives

The Directive represents a European effort to design a common regulatory framework for takeovers.[60] The Directive tries to find an equilibrium between the ability of shareholders to determine the way corporate control is exercised and the need to provide effective tools to deal with free-riding, pressure-to-tender and agency (self-interest) problems, thus increasing shareholder protection (Art. 50.2(g), TFEU).[61] The legislative text tackles these issues in two ways:

- a minimum harmonisation approach (a level playing field to facilitate the restructuring of corporate assets and to lower transaction costs); and
- equal treatment of shareholders (e.g. the one share–one vote principle and protection of minority shareholders).

Optionality

Through the use of exceptions and derogations, the Directive aims at achieving some level of flexibility and minimum harmonisation in the way both newly developed and long-standing governance structures in the European market for corporate control should be considered in regulatory terms (Recital 6 of the Directive). In its original conception, this approach also sought to limit the adoption of protectionist national legislation (which typically protects incumbent shareholders and management); to stay in line with the TFEU (Art. 49); to avoid regulatory competition between jurisdictions (for fear of race-to-the-bottom incentives); to promote greater economic integration by producing greater efficiencies and facilitating merger and acquisition (M&A) transactions; and to allow opt-in and opt-out mechanisms to make the text flexible enough to suit the peculiarities of different member states.

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[60] For a review of the process that led to the Directive, see Moloney (2004), pp. 810-818.

[61] As mentioned in the earlier section on transaction-cost theory, the Treaty can also be interpreted as promoting the protection of all parties who contribute to the company's value (shareholders, employees, creditors, etc.). In that case, the current approach to takeover regulation may radically change.

Equal treatment

The Directive advocates the equal treatment of shareholders through greater protection of minority shareholders and the removal of voting restrictions, and it limits any special rights if not in line with the Treaty (Recitals 9, 19 and 20 of the Directive), which are distributional concerns. Additionally, the text recognises a greater involvement of employees in the consultation process concerning the takeover bid (Art. 14 of the Directive). In practice, despite the predominance of the non-frustration model and shareholder supremacy, Continental countries like Germany and the Netherlands give the same relevance to the role of employees in the takeover process. The Directive thus, despite its strong shareholder protection principles, seeks to find a balance between these two views by granting some flexibility in applying the main parts of the legislative text (e.g. the breakthrough rule) by means of a specific clause (Art. 4.5 of the Directive). In general, EU corporate law is a hybrid model that tries to balance the interests of all stakeholders (Goergen et al., 2005).

Key areas

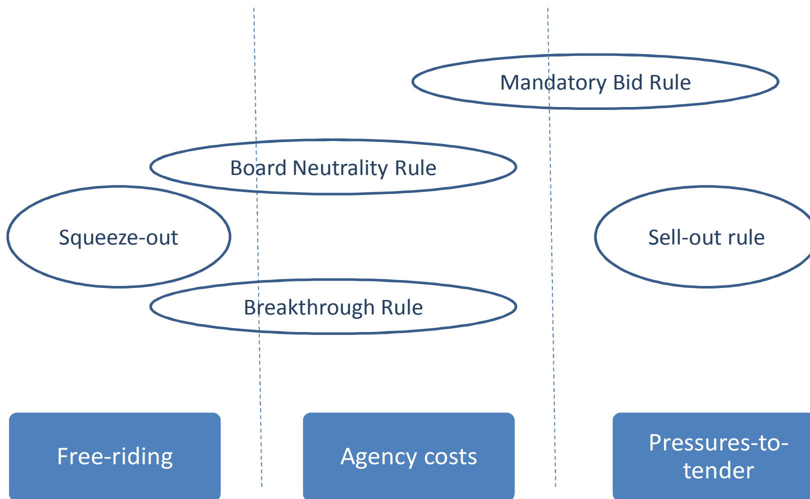
The Directive has four main rules:

1) the mandatory bid rule (MBR),
2) the board neutrality rule (BNR),
3) the breakthrough rule (BTR), and
4) squeeze-out and sell-out rules.

These four tools, plus important disclosure requirements, were included in the Directive to tackle the three major, recurrent economic problems in connection with takeovers: free-riding, pressures to tender and agency costs. Still, only the first and the fourth rules are mandatory; member states can opt out of the second and third rules, in case of reciprocity by single companies.

As indicated in Figure 10, the mandatory bid rule aims at reducing pressures to tender but may also increase opportunistic behaviour (agency costs), as it may raise costs for a potential raider. The board neutrality rule forces the board to become neutral to takeovers, thus reducing opportunistic behaviour. The breakthrough rule levels voting powers among shareholders, thus reducing opportunistic behaviour and the risk of free-riding. Finally, the squeeze-out and sell-out rules target, respectively, free-riding and pressure-to-tender problems.

Figure 10. The Directive's tools



Source: Authors.

12.1 The mandatory bid rule

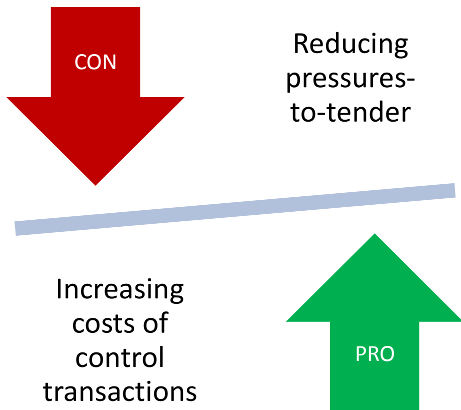
Introduction. The mandatory bid rule minimises the coordination issue (pressure-to-tender problem) for non-controlling minority shareholders and increases investor protection through the equal treatment of shareholders in the event of a transfer of control.

12.1.1 Key elements

Objectives. The mandatory bid rule (Art. 5.1 of the Directive) provides that when a natural or legal person (acting individually or in concert) acquires a share of a company above "a specified percentage of voting rights" that may give him/her control of the company, such person must launch a bid and offer the same terms to all shareholders. The primary economic objective of this rule is to minimise the coordination issue (the pressure-to-tender problem) among non-controlling minority shareholders, even if a partial bid may occur below the triggering threshold (Enriques, 2004). The secondary objective of the rule is to increase the protection of minority shareholders (by giving them an equal opportunity to participate in a control shift), preventing value-decreasing transactions and thus reducing the cost of capital. The literature is divided on the question of whether these objectives are actually achieved. It is nonetheless united in its suggestion that the mandatory bid rule may potentially have negative effects, as it focuses exclusively on distributional concerns rather than efficiency. In this respect, inefficiencies increase the overall costs of a transfer-

of-control transaction, while 'overprotection' may end up reducing shareholder activism. In effect, despite the fact that the MBR increases *ex-post* shareholder protection (after the launch of the takeover bid, by forcing the offeror to offer the same market premium to all shareholders), it also produces *ex-ante* negative effects by reducing incentives for potential offerors to launch a bid or (better) a competing one, which would ultimately increase the final price of the bid (Figure 11). Paradoxically, the result can be to the detriment of all shareholders, including minorities.

Figure 11. Main trade-off of the mandatory bid rule



Source: Authors.

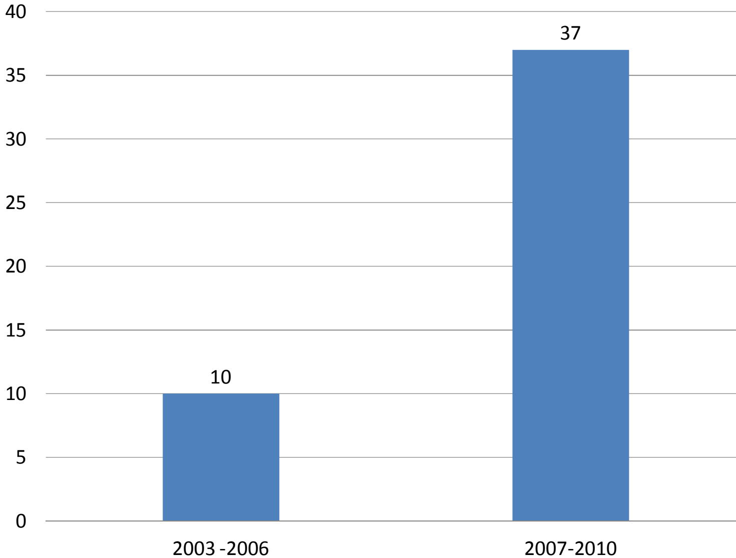
Key aspects. The Directive specifies four main elements of the MBR:

- acquisition of shares (e.g. "acting in concert", Art. 2.1(d));
- threshold of voting rights (Art. 5.3);
- acceptance period (Art. 7); and
- equitable price (Art. 5.4).

Circumvention. New shares may be acquired by being purchased directly on secondary markets or through cooperation among shareholders to gain control of the company. The definition of "acting in concert" leaves space for national financial authorities and judicial review to define "cooperation" and the existence of an oral or written "agreement" (see Marccus Partners and CEPS, 2012). The risk of circumvention and arbitrage among EU countries is potentially high, therefore weakening the actual transposition of an absolute voting-rights threshold. As shown in Figure 12, the number of mandatory bids has remained relatively low since the transposition of the Directive (roughly 5% of the total bids), although it is still higher than for the preceding period.

Even so, this information does not help us to reach any definite conclusion, since the MBR typically affects the incentives of potential offerors *ex ante*.

Figure 12. Number of mandatory bids (by period)



Source: Thomson Reuters SDC Platinum.

Effectiveness of the rule. Reasons for such a trend may be related either to the effectiveness of the rule in ensuring that potential offerors do not violate the equal treatment principle or to specific exemptions and the application of loose definitions (such as "acting in concert") in some important countries, which may have limited the transposition of the rule. Moreover, the mandatory bid rule is most effective *ex ante* in that it affects incentives to bid. Nevertheless, it is hard to measure *ex ante* potential effects with no real indicators. Figure 13 shows that more mandatory bids were launched in 2008 and 2009, although the proportion was still less than 10%. In 2010, the amount was below the number of mandatory bids before the transposition of the Directive. This result may be explained by both a transposition that has left room for national exceptions and circumvention, and the lower overall number of takeover transactions in 2010. For instance, the absence of a common definition of when "cooperation" should be considered "concert" is a relevant regulatory gap (Papadopoulos, 2007).[62]

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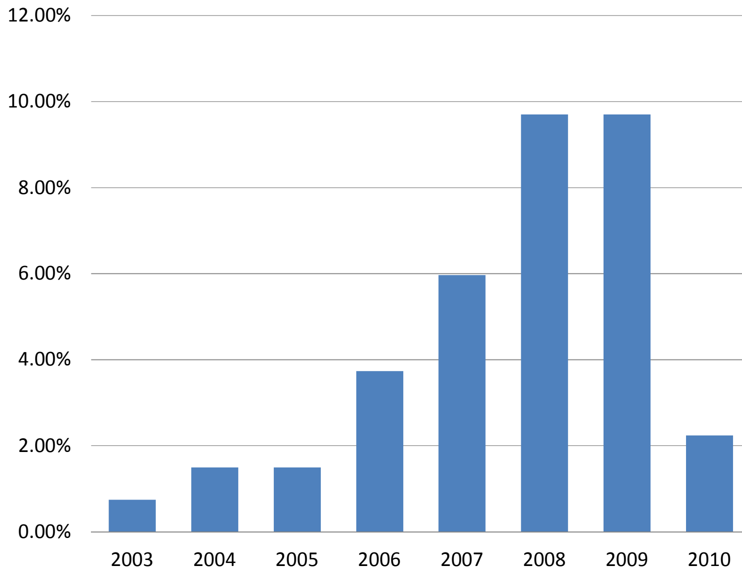
[62] The author suggests using the same definition as the UK City Code by looking at shareholders' proposals at the general meeting. If these proposals are "board control-

Figure 13. Share of mandatory bids (% of total number of takeovers, per year)



Source: Thomson Reuters SDC Platinum.

Threshold. A threshold of voting rights is applied to the acquisition of new shares, above which the Directive assumes that some sort of (working) control of the offeree company has been reached and that remaining shareholders should receive the same treatment. Exceeding the threshold triggers the obligation to launch a takeover bid for all shares. As shown in Table 28, thresholds are defined on a country-by-country basis and overall the threshold, with the exception of three countries, is between 30% and 33%.[63]

seeking", parties are considered to be acting in concert. Notably, however, this stance does not consider the ways in which shareholders can exercise some sort of joint control in other EU jurisdictions. It may also discourage shareholder activism if applied too strictly.

[63] A few countries have opted for a higher threshold to take into account only those acquisitions that ensure full control of the offeree company.

Table 28. Thresholds for the mandatory bid rule

Country	(%)	Country	(%)
Austria	30	Ireland	30
Belgium	30	Italy	30
Cyprus	30	Luxembourg	33
Czech Republic	50	Netherlands	30
Denmark	50	Poland	33
Estonia	50	Portugal	33
Finland	30	Romania	33
France	30	Slovakia	33
Germany	30	Spain	30
Greece	33	Sweden	30
Hungary	33	UK	30

Source: Marccus Partners.

Ownership structure. 'Control', however, changes across countries as the ownership structure varies (Burkart and Panunzi, 2003). As a result, in a concentrated ownership structure the offeror will be forced to extend the market premium bid, including the NPV of the private benefits of control, to non-controlling shareholders. Takeovers thus become more expensive, reducing the likelihood of both value-increasing and value-decreasing transactions (the "chilling effect"; Bebchuk, 1994), in line with the idea that pursuing distributional objectives reduces the likelihood that there will be gains at all (Easterbrook and Fischel, 1982). In this way, the MBR protects minority shareholders *ex post*, but reduces the likelihood of value-increasing transactions (*ex ante*). Furthermore, it does not provide any incentive to reduce the risk of majority shareholders extracting benefits, as this possibility depends on the general framework of corporate law and in particular its rules for the protection of minorities (Zingales and Dyck, 2004). Additionally, the rule incentivises shareholders to cluster and blockholders to adjust their stake close to the threshold in order to extract more from potential offerors. The MBR may thus promote greater ownership concentration. Ideally, the MBR would be most effective in a fully dispersed ownership structure, where the offeror who really wanted to gain control and exploit PBCs would pay for them and give an exit right to other shareholders, who bought their shares with a completely different ownership structure. As an example, let us consider the case of one controlling blockholder (with working control) where the remaining ownership is mostly dispersed. With no MBR, there are two options: the offeror launches the bid for 51% of shares or makes a deal with the shareholder

to obtain working control (it is indifferent to the offeror whether he or she has working or formal control).[64] The offeror has limited contractual power to exercise with the controlling blockholder. In effect, it is easier for the offeror to ask the blockholder for working control; however, the price that will have to be paid can go up to the value of 51% of the shares at market price, which is the alternative bid to avoid bargaining with the blockholder. In contrast, with the MBR, the shareholding of the blockholder has more value if it is close to the triggering threshold, which we assume is 30%. In this case, the offeror can certainly bypass discussions with the blockholder; but to gain either working or formal control it has to trigger the MBR threshold, particularly if the blockholder has acquired a stake of, for instance, 29.9% in the company. The alternative is to hold discussions with the blockholder in order to persuade the latter to sell his/her controlling stake. In this case, the controlling blockholder will be able to ask a price for the control up to the value of 71% of the shares (the alternative cost for the offeror that will trigger the mandatory offer). With the MBR, blockholders can extract more value from their stake if they increase its size close to the triggering threshold. In an ownership structure with few controlling blockholders, the value that they can extract is lower, and decreases with the level of concentration.

Static threshold. The use of a 'static threshold' certainly comes at the cost of not being able to control the effects of a specific ownership structure on the acquisition of control. If the threshold does not take into account ownership structures, assuming that countries apply the MBR in the same way and with the same exceptions, this may give rise to disparities of treatment among countries. For instance, in some countries control may be obtained with a threshold lower than 30% (the current threshold in many countries, e.g. the UK), while in countries with a greater ownership concentration, such as Italy, it may most likely be reached only at a threshold well above 30%. This potentially makes acquisition of control more expensive in Italy than in the UK. In effect, if the threshold is set well above the controlling stake, the rule will be ineffective in both dispersed and concentrated ownership structures for ensuring equal shareholder treatment in control transfers (Table 29).

[64] Even if the offeror goes for 100% of the company, the results of the example do not change.

Table 29. Impact of the threshold level

Level of threshold	MBR effectiveness	MBR costs
Above control stake	Low	Low
Equal to control stake	High	Moderate
Below control stake	High	High

Source: Authors.

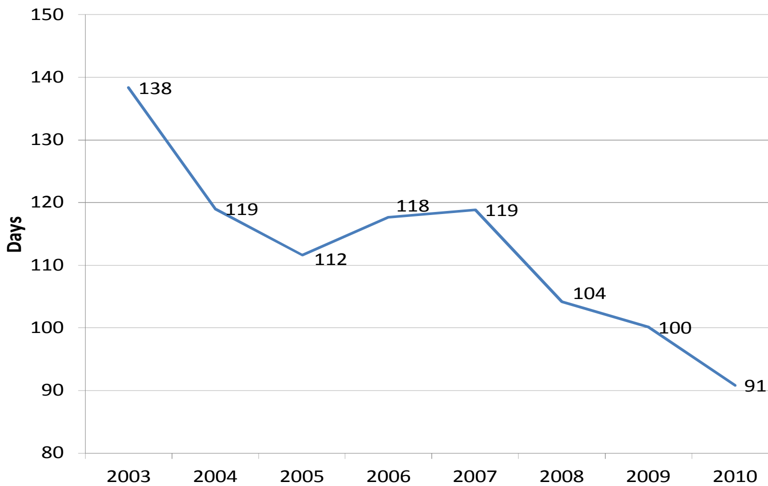
Dynamic threshold. An alternative option to the static approach is to set a 'dynamic' threshold. The threshold could be equal to the national mean for a controlling block (Sepe, 2010) or equal to the actual controlling stake in the company, as long as the same definition of 'working control' is shared among member states. In this way, the MBR would certainly be more effective in both concentrated and dispersed ownership countries, thereby minimising disparities among countries but on average increasing the costs of takeovers for all investors.

Acceptance period. Additionally, Art. 7 of the Directive defines the acceptance period that must be specified in the offer document. The period should not be less than two weeks or more than ten weeks, which provides enough time for shareholders to reflect on the information and for potential competing offerors to make a counter-offer. This rule also seeks to reduce pressures to tender, as well as to reassure offerors that the acceptance period will not last too long, increasing costs for offerors (e.g. the management's search for a white knight).

Completion time. Figure 14 shows that the average completion time for a deal (in the above-mentioned dataset) fell drastically to about 10-15 weeks[65] after member states started transposing the Directive. In the period after transposition, this average remained lower in all countries except Spain, Belgium and Austria.

[65] The execution time is calculated as the difference between the date of announcement (first public disclosure) and the date effective, which can either be when all conditions of the bid have been fulfilled (for conditional deals) or when the deal has been completed (for unconditional deals).

Figure 14. Average completion time



Source: Authors' calculations based on Thomson Reuters SDC Platinum.

12.1.2 Other economic issues

Additional aspects that affect the economic impact of the Directive, and specifically the mandatory bid rule, are the 'toehold' or initial stake, disclosure requirements and the sanctioning mechanisms.

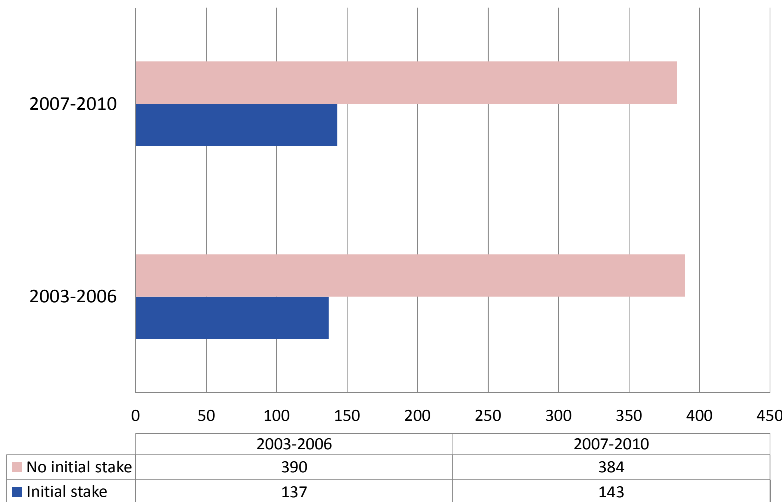
Initial stake. First, the acquisition of an initial stake by the potential offeror in the company increases the likelihood that he or she will obtain control of the company, and also incentivises the offeror to overbid because he or she may receive a higher price from a competing offeror (for his/her initial stake) or more easily obtain control of the company. Still, there are conflicting views as to whether a toehold only makes offerors more aggressive (Bulow et al., 1999) or induces them to overbid in some instances (Burkart, 1995). There is certainly a risk of an inefficient outcome caused by overbidding, i.e. the 'winner's curse', if the offeror is only interested in provoking a competing bid to extract more gains. By being more aggressive, a competing offeror will become more conservative and perhaps refrain from raising his/her offer. Yet if one considers takeovers as an English or a Vickrey auction,[66] the purchase of

[66] An English auction is the most common type of auction, in which offerors compete with each other by offering subsequent bids, always higher than the previous ones. A Vickrey auction is an auction in which the final price is the second highest bid paid by the offeror who offered the highest one (also called a 'second-price sealed-bid auction').

a toehold by an offeror interested in obtaining control of the company is the best strategy, regardless of whether in the end he or she succeeds in gaining control of the company. In effect, gains obtained through ownership of an initial stake are equal to the initial stake multiplied by the difference between the share value under current management and the share value under the offeror's control. If the offeror knows that at least his/her takeover bid will increase the post-takeover value, irrespective of whether the offeror obtains control and assuming that there are no inefficient defences and that offeree company shareholders do not know the post-takeover value, the acquisition of a toehold is the strategy to pursue. If all competing offerors have an initial stake in the company, prices will be higher, but the initial offeror may have a greater chance of winning the auction because competitors will behave more conservatively (Bulow et al., 1999).

Figure 15 suggests that in both the period before and after the transposition of the Directive, the number of takeovers in which an offeror had an initial stake was around 27% (26% in 2003–06 and 27.13% in 2007–10).

Figure 15. Deals with and without the acquirer's initial stake

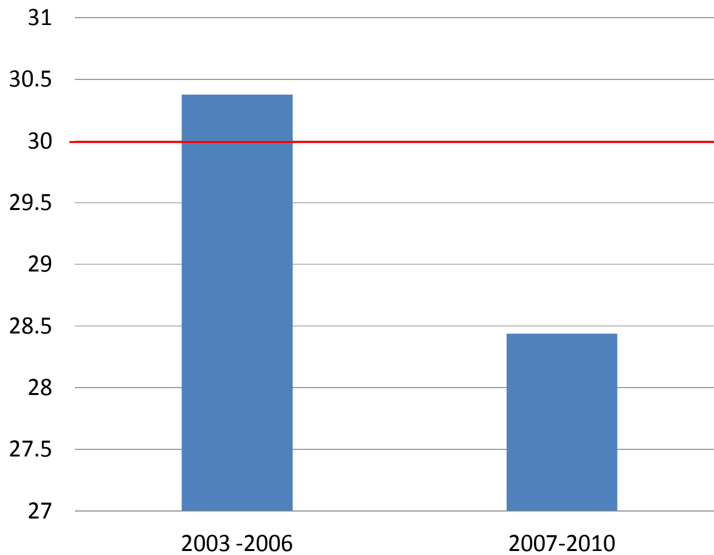


	2003-2006	2007-2010
No initial stake	390	384
Initial stake	137	143

Source: Thomson Reuters SDC Platinum.

As Figure 16 shows, the weighted average size (by deal size) of the initial stake dropped from 30.38% to 28.4% in the period after the transposition of the Directive, below the lowest triggering threshold applied by member states (30%).

Figure 16. Weighted average size of the initial stake



Sources: Authors, based on Thomson Reuters SDC Platinum.

Disclosure threshold. The disclosure threshold of the acquisition of an initial stake, on average set by member states between 2% and 5%, may signal the potential competing offeror's attempt to gain greater influence (if not control) over the company, thus increasing shareholder value and decreasing the potential offeror's expected profits. At the same time, the acquisition of an initial stake in the company increases costs for potential offerors and is a primary source of profit for the offeror who knows the post-takeover value of the company and stimulates a higher competing bid on his/her own holdings. A disclosure threshold set too low may thus reduce the incentives to launch a takeover bid. The disclosure of a holding also ensures that investors receive more information on who exercises working or formal control of the company. Moreover, it reduces incentives for creeping-in takeovers and overbidding (Burkart, 1995), as well as opportunistic behaviour by incumbent blockholders who try to add unexpected costs and hold potential offerors up. Nevertheless, the transparency requirements can be somewhat softened by acquiring call options with the strike price just below the price of the takeover bid, which increases the possibility of gains from the offeror's own bid and the possibility to minimise the total cost of the takeover.

Equal treatment. Overall, disclosure requirements foster equal treatment among shareholders. In particular, Art. 10 of the Directive requires companies to disclose detailed information on key aspects of the company, based on the

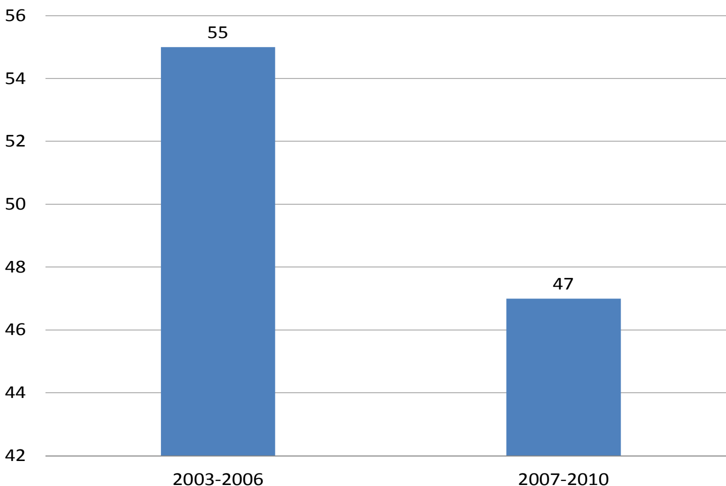
assumption that capital markets have semi-strong efficiency and are therefore able to process past and current material information into prices that approximate the present value of future cash flows (Gilson and Kraakman, 1984, 2003). This assumption would place companies that are not performing well (in terms of expected cash flows) under the threat of a change of control in favour of parties who expect to obtain a higher cash flow by controlling the management of the former.

Further disclosure. The Directive also prescribes a broader set of disclosure requirements regarding the bid (minimum content requirement, Art. 6), the disclosure of the bid (Art. 8(e)) and information about listed companies governed by the laws of the member states (Art. 10). These rules aim at

- improving price informativeness and stimulating a more efficient market for corporate control; and
- increasing shareholder and investor protection.

Market efficiency. By providing more information to markets, market prices should become more informative with regard to companies' performance. Based on the assumption of semi-strong market efficiency, this should stimulate greater contestability of corporate control and more competing bids in the bidding process. Yet as suggested in Figure 17, the transposition of the Directive seems to exclude an improvement in terms of the contestability of control for ongoing bids.

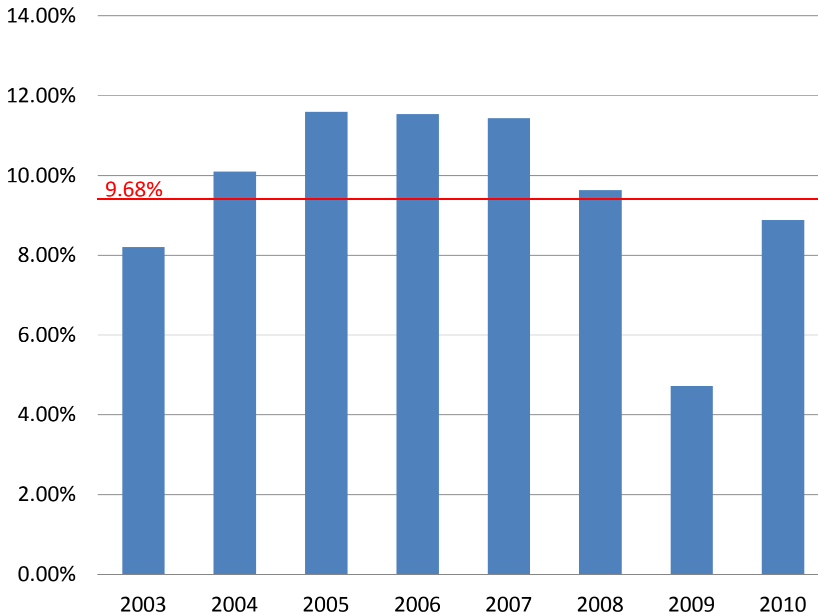
Figure 17. Number of takeovers with competing bids



Source: Thomson Reuters SDC Platinum.

The share of deals involving competing bids (of the total per year) continually declined (see Figure 18) after the widespread transposition of the Directive, showing no or a negative impact. This figure subsequently fell below the weighted average for the entire period between 2003 and 2010.

Figure 18. Share of competing bids (of total deals, per year)



Source: Thomson Reuters SDC Platinum.

Competing bids. The launch of a competing offer is nonetheless primarily affected by other important factors, such as credit availability and the economic outlook (see Box 8 on the description of the dataset). As a result, the impact of the recent financial crisis may certainly be considered greater than the impact of applying stricter disclosure requirements, which were already in place in some of the member states.

As indicated in Figure 19, the number of potentially hostile takeovers has generally increased since the transposition of the Directive, from 36 in 2003–06 to 49 in 2007–10. Still, as the increase is so minimal, it would be inappropriate to draw any conclusions.

Figure 19. Hostile deals

Source: Thomson Reuters SDC Platinum.

Information flow. Greater information about the post-takeover value of the company helps shareholders to make more rational and informed choices about the bid and therefore reduces information asymmetry. An excessive flow of information, however, may undermine shareholder ability to understand complex information and therefore make rational choices. Finally, sound rules on how the bid should be disclosed (Art. 8 of the Directive) pave the way for the fair disclosure of information and help to prevent the creation of false markets, i.e. the publication or dissemination of false or misleading information (Moloney, 2004).

Sanctions. Apart from specific exceptions applied to the MBR, the Directive does not define any sanctioning mechanisms if companies do not comply, which dramatically weakens the effectiveness of the rule. Moreover, member states have applied sanctioning mechanisms in different ways, perhaps owing to different legal systems and judicial traditions. For instance, violating the MBR by not launching the takeover bid for all shares is sanctioned differently in Italy from the way it is in Germany (Mangiaracina, 2010). The Italian financial authority (Consob) can force the offeror to launch a mandatory bid on all shares in the case of a violation (with administrative and potentially criminal charges), while the German financial authority (BaFin) has no such power. Where it is not possible to enforce the mandatory takeover bid or where the remedy of selling shares above the triggering threshold is

insufficient for those shareholders who have suffered a potential loss,[67] in Italy a company violating the MBR would be condemned to pay damages to the shareholders who have not benefited from the application of the rule. Italian jurisprudence seems conflicted on what kind of protection (for damages) shareholders should receive (contractual or non-contractual liability; e.g. Sai-Fondiaria case law; Poliani, 2009; Desana, 2009). In both Italy and Germany, voting rights are suspended on the shares above the triggering threshold (Rule 59, German Securities Acquisition and Takeover Act). In Germany, however, the only sanction that is immediately applicable is an administrative fine (section 60, German Securities Acquisition and Takeover Act) equal to 5% interest on the price of the takeover bid for the duration of the violation, to be paid to all remaining shareholders or only to those who have accepted the offer. If the German regulator cannot force the company to launch the mandatory offer, the company may simply decide to keep violating the rule as long as the benefits of the violation outweigh the costs imposed by the administrative fine. Therefore, the mandatory application of the rule may be ineffective. Alternatives to the MBR are considered in Box 9.

Box 9. Alternatives to the mandatory bid rule

As mentioned above, the mandatory bid rule can be effective but at the same time costly. Hence, alternatives to the MBR have been discussed over the years. Among others, Bebchuk and Hart (2001) argue that regulation should give offeree company shareholders the option to vote on the launch of a takeover bid (binding authorisation); if approved, all shareholders would need to tender. This solution would solve both the pressure-to-tender and free-riding problems, even though it is essential to control what kind of information is disclosed to offeree company shareholders (*ex ante*) to avoid a 'pressure-to-approve' issue. Another proposal is the extension of the acceptance period if the bid is successful (Enriques, 2004), but it is not clear whether this would imply the acceptance of partial or two-tier bids, which could cause pressure-to-tender issues for those shareholders who would need to decide to tender before the bid succeeds.

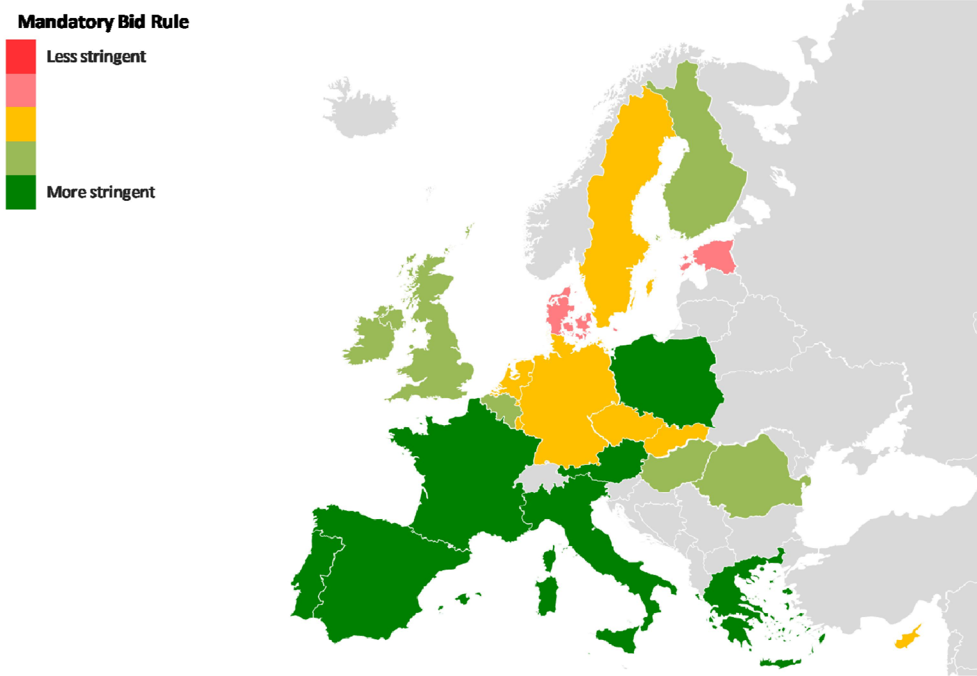
12.1.3 Implementation score

All member states considered in this study have transposed the mandatory bid rule into their legal systems. That being stated, in some countries the real transposition of the MBR has been softened by other rules, such as derogatory

[67] Such a situation could arise because the company has been acquired anyway or the tender bid would affect the current value of the company.

powers given to competent authorities, which may ultimately have distorted its impact to some extent (Figure 20).

Figure 20. MBR implementation scores



Note: For details of the calculation of the scores, see Appendix 3. In this section, we use the terms 'transposition' and 'implementation' interchangeably.

Source: Authors (see Appendix 3).

Countries transposing the mandatory bid rule in a more stringent manner are mainly southern European countries and a few others, such as France, Austria and Poland. A number of other countries (such as the UK) have also transposed the rule with an almost full score. The only two countries that have transposed the rule in a less stringent manner are Denmark and Estonia.

Finding #1. Evidence regarding the effects of a mandatory bid rule in Europe is mixed. The benefits of greater *ex-post* shareholder protection must be weighed against lower *ex-ante* incentives to engage in a takeover transaction because of the greater costs. The application of the rule has been partially watered down by exemptions at the member state level and diverse interpretations of key sections of the Directive (e.g. acting in concert). Nevertheless, more mandatory bids have been launched since the Directive was transposed, and stakes held before the launch of the bid have declined below 30%. Overall, data used in this study suggest that the market for

corporate control has not become more open or contestable since the transposition of the MBR. For all these reasons, the impact of the rule appears to be marginal and to have different implications across member states.

12.2 The board neutrality rule

Introduction. The board neutrality rule limits the capacity of the board to adopt defensive measures by shifting decision-making to shareholders. It aims at promoting the market for corporate control by enforcing shareholder decision-making and reducing the scope for takeover defences. The rule reduces agency and free-riding problems.

Objectives. The board neutrality and breakthrough rules in the Directive pursue complementary objectives by addressing both post-bid and pre-bid defences respectively. These rules seek to facilitate takeovers and promote shareholder supremacy. In this regard, the board neutrality rule limits the capacity of the board to adopt defensive measures, thereby shifting decision-making from board members to shareholders. By reducing the scope for defences, the Directive seeks to promote an active market for corporate control (Kirchner and Painter, 2000). In many member states, board neutrality rules existed in one form or another prior to the transposition of the Directive (Marccus Partners and CEPS, 2012). Breakthrough rules, on the other hand, were rare and remain an extreme expression of the one share–one vote principle (ibid.).

Context. The board neutrality rule needs to be analysed in the context of corporate law at large. The rule does not prohibit defensive measures, but simply allocates to shareholders the power to decide whether to adopt any. It is therefore not a substantive rule but a procedural provision, which needs to be considered in the broader framework of decision-making within the corporation (Goergen et al., 2005). Different decision-making arrangements are foreseeable to allocate power between management and shareholders when approving potential defensive measures. Decision-making power is ultimately held by shareholders, but may be delegated to management either temporarily or indefinitely. A temporary granting of discretion to management usually requires an ordinary resolution (majority voting), while a qualified majority may be necessary where discretion is granted on an indefinite basis or shareholders relinquish some of their core ownership rights, such as pre-emptive rights over the issuance of new stock. Management may be granted the power to adopt defensive measures either before or after the announcement of a takeover bid. The board neutrality rule in Art. 9 of the Directive requires the board to ask shareholders for approval of any defensive measures following a takeover announcement. Figure 21 presents three

alternative procedural arrangements for adopting defensive measures within the company. The arrangement set out by the board neutrality rule is represented as solution B.

Figure 21. Procedural arrangements for adopting defensive measures

Less restrictive → **More restrictive**

Time	*Solution A*	*Solution B*	*Solution C*
Management	May request powers indefinitely (modification of statutes or bylaws)	May request powers for a limited period	May not request powers
Shareholders	Approval by majority	Approval by majority	–
Takeover announcement			
Management	Not obliged to ask permission to use powers as a takeover defence	Obliged to ask permission to use powers as a takeover defence (board neutrality rule)	May not request powers
Shareholders	May call a meeting to revoke powers by majority voting	Approval by a majority	May call a meeting to confer powers (approval by a majority)

↓ (Solution B)

Model followed by the Takeover Bids Directive

Source: Authors.

Timing. Good timing in shareholder decision-making is a crucial aspect of the passivity rule in the Directive. Under solution B, shareholders may grant managers discretion at any point in time, although this discretion will need to be renewed in the event of a takeover. It overcomes the problem highlighted by Davies et al. (2010): "in the absence of a board neutrality rule shareholders may have to accept the cost of enhancing managerial discretion in relation to a bid in order to reap the benefits arising from management's increased discretion in a non-takeover scenario". Requiring only pre-bid shareholder authorisation as in solution A does not protect shareholder interests

sufficiently, because investors face a perception bias and information asymmetries before a takeover is announced. Moreover, while shareholders may call a meeting in solution A to revoke managerial powers or remove management altogether, the board neutrality rule is a more efficient instrument to control management during a takeover bid given the practical difficulties in reversing any defensive measure already applied as well as the time constraints in the conduct of a takeover. Compared with solution C, where authorisation to apply defensive measures may only be requested after the takeover announcement, solution B remains a better alternative as it affords a reasonable degree of flexibility to make defensive measures effective if authorised by shareholders. In sum, solution B protects shareholders, overcoming their rational apathy before the offer, without disabling takeover defences where they benefit from their support. In addition, the rule in the Directive is easily applied, since it takes into consideration only the likely effect of the defensive measure and not any subjective elements, such as intent or bad faith, which would increase the risk of litigation (Davies et al., 2010).

Availability of defences. There have been extensive discussions in academia regarding the practical importance of the board neutrality rule to the extent that takeover defences are available and effective in the first place. Gerner-Beuerle et al. (2011) thoroughly analyse company law statutes and case law in the UK, Germany and Italy to assess the availability of takeover defences in each of these countries. This research concludes that there is little opportunity to effectively apply takeover defences in these jurisdictions to begin with, notwithstanding the board neutrality rule (see also Gordon, 2004). While limits to defensive measures in general corporate law would result in board neutrality not being invoked frequently in practice, it should not be concluded that the rule is irrelevant per se. A broad board neutrality rule prevents the appearance of new defence mechanisms, for which there might be no specific limitation in general corporate law. The discussion on the *ex-ante* availability of defensive measures in company law is pertinent to frame the context of takeover regulation. In any case, board neutrality brings in additional value as described above, and given its clarity and over-arching scope, makes circumvention difficult.

'Neutral' defences. The board neutrality rule does not prohibit defensive measures, but prescribes the procedure for their adoption. In some cases, however, an outright prohibition of some defensive measures might be desirable. The challenge is to distinguish defensive measures that manage to neutralise the bid without causing harm to the company from those which result in substantive harm, such as some sales of assets. Sjåfjell (2010a) considers that only the takeover defences that are destructive for the company

should be forbidden by an *ex-ante* rule, while defences that are neutral for the company itself but inhibit the offeror from acquiring its offeree company should be left to the discretion of the board, with the consent of shareholders. In this regard, Art. 9 of the Directive provides an exception to board neutrality, which allows managers to seek a competing offer, given that competition among offerors will generally benefit shareholders without any detriment to the company (Mucciarelli, 2006).

12.2.1 Economic impact

The board neutrality rule aims at protecting shareholders. In this respect, it appears to be an effective way to enforce the managerial duty of loyalty to shareholders and prevent circumvention of the latter in a takeover. By reducing the ability of incumbent management to adopt defensive measures, board neutrality reduces managerial entrenchment and makes the threat of a takeover more credible, encouraging management to better perform its duties vis-à-vis shareholders (Enriques, 2010; Fama and Jensen, 1983b). An active takeover market is supposed to result in more efficient companies. Yet, while the positive impact of board neutrality in promoting takeovers is apparent, there is reason to question the positive economic impact of the rule from two angles: first, the level of ownership and control concentration; and second, the protection of stakeholder and company interests.

a) *Level of ownership and control concentration*. Where ownership and control are dispersed, the board neutrality rule helps shareholders overcome their collective action problems. In the absence of board neutrality, fragmented shareholders would have difficulty in reaching the threshold necessary to call a general meeting to revoke the power of management to adopt defensive measures (compare solution A with solution B in Figure 21 above). The rule also helps shareholders overcome rational apathy and perception bias when granting management discretion to adopt potentially defensive measures before a takeover is announced. By contrast, where ownership is concentrated and blockholders control management directly, there is no agency problem between management and shareholders that the board neutrality rule might address (Liu, 2010; Kirchner and Painter, 2000). Instead, there is an agency problem between majority and minority shareholders for which the board neutrality rule provides no answer (Ventoruzzo, 2008). Nevertheless, board neutrality is also effective when control is held by several large shareholders together, so that an alliance between some of them and some minority shareholders could win a majority vote (Davies et al., 2010).

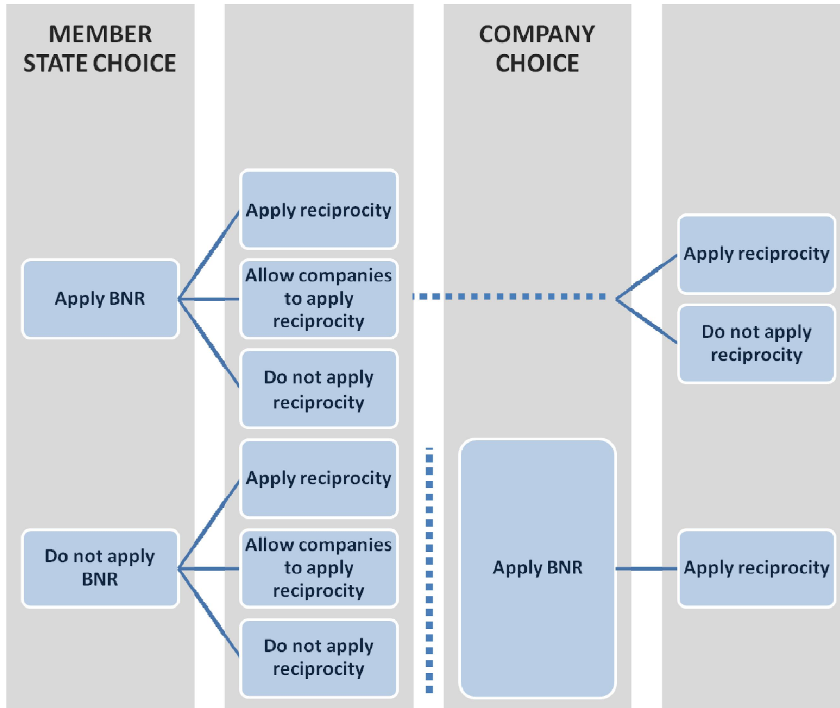
b) *Protection of stakeholders and company interest.* The board neutrality rule places the emphasis on shareholder supremacy to accept or reject a

takeover bid. It may not allow for the proper balancing of the interests of all stakeholders, including employees but also including customers and creditors. Proponents of this view consider that shareholders are not in a position to balance the interests of the company as a whole (Davies et al., 2010; Clarke, 2010b; Kirchner and Painter, 2000). In effect, shareholders decide whether to tender their shares in isolation, which exacerbates their preference for liquidity (Sjåfjell, 2010a). While the risk of managerial entrenchment that the board neutrality rule attempts to address is certain, so are the negative consequences of managerial rotation and disregard of the interests of stakeholders. Short-term management bias reduces the incentives for stakeholders to undertake firm-specific investments, and may curtail performance. It is feared that these problems are intensified by board neutrality. As an alternative, the authors mentioned above propose an increase of the discretion of the board to enact takeover defences in the interest of the company as a whole, as in solution A in Figure 21 above. Kirchner and Painter (2000) believe that allowing *ex-post* shareholder voting to veto defensive measures would be an effective mechanism if expedited through electronic means. It is also feared that board neutrality, by reducing managerial discretion, may lead to foregone opportunities where these require swift action by management (Davies et al., 2010).

12.2.2 Optionality

The optionality clause in the Directive grants discretion to member states to decide whether to transpose the board neutrality rule into their jurisdictions. Notably, however, there is one limit to this discretion: member states that opt out must allow companies to be able to opt back into the rule. In addition, member states must decide whether to transpose reciprocity. The decision tree is represented in Figure 22. Crucially, the introduction of the board neutrality rule in countries where it does not apply depends on the initiative of shareholders – as opposed to the application of reciprocity, which depends on the initiative of management. A company's decision to apply the board neutrality rule is reversible and must be taken following the procedure established to modify the company's articles of association, which usually requires the agreement of a qualified majority. In conclusion, the adoption of board neutrality at the company level is subject to a number of procedural hurdles that add to shareholder coordination problems. In practice, no case has been found where shareholders opted back into the board neutrality rule (Marccus Partners and CEPS, 2012; Davies et al., 2010).

Figure 22. Decision tree



Source: Authors.

Level at which optionality is made available. Optionality at the member state level is frequently portrayed as catering for the specific characteristics of each national market for corporate control, including in particular the structure of control and the dispersion of ownership. The evolving nature of control and the differences in its concentration among companies within a member state nonetheless call into question the convenience of placing optionality at the member state level. In this regard, commentators argue that optionality should be placed solely at the company level, and that board neutrality should apply by default in all cases given shareholders' coordination problems (Davies et al., 2010; Enriques, 2010). It would then be the responsibility of management to find a majority of shareholders who would back a proposal to opt out of the board neutrality rule. Authorisation to refrain from applying board neutrality would either be granted for a limited period in the absence of a takeover announcement, or after the announcement of a bid and for that bid alone, in order to mitigate rational apathy, cognitive biases and asymmetry of information.

Default rule. Two elements are of relevance with regard to optionality: the level at which optionality is placed and application of the default rule. The

Directive places optionality at the member state level, which opens the door to political considerations. In Europe, there is no consensus on the role of the board or how best to balance stakeholder interests to maximise company performance over the long run. The board neutrality rule is central to this divide between shareholder- and stakeholder-oriented systems. If board neutrality is not to be discarded outright, regulatory coherence in the single market may benefit from removing discretion from member states and placing it at the company level. The choice then would be whether board neutrality should apply by default as proposed above (Davies et al., 2010; Enriques, 2010) or whether a corresponding request by shareholders should be required. Under these arrangements, the business plan of the incumbent management would compete with the plans put forward by potential offerors. The general meeting of shareholders would have the power to decide on the application of board neutrality, perhaps requiring super-majority approval. Placing optionality at the company level would set incentives for management to look after the value of the company as a whole, rather than to please only the controlling shareholders.

12.2.3 Reciprocity

Under the Directive, member states may allow offeree companies to refrain from applying the board neutrality rule where the offeror is not subject to this rule itself. The reciprocity exception seeks to level the playing field with companies from countries within and outside Europe where board passivity does not apply. Reciprocity, however, may deter value-creating bids from companies established in countries where boards have discretion to adopt defensive measures. The economic rationale for reciprocity is therefore difficult to justify, since it bears no relation to the economics of the bid. In the words of Becht (2003), "reciprocity in takeovers is not desirable since it unduly restricts the pool of offerors and reduces the potential benefits of contestable control". Reciprocity is therefore based on industrial policy considerations, given both a concern about foreign acquisitions and a desire to protect so-called 'national champions'. While it has been argued that some companies could introduce board neutrality to avoid situations where potential offeree companies invoke the reciprocity exception (Davies et al., 2010), no evidence has been found of companies opting into board neutrality (Marccus Partners and CEPS, 2012).[68]

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[68] Davies et al. (2010) conducted an in-depth survey of the countries where the board neutrality rule applies but reciprocity is left to the discretion of the companies. These are France, Greece, Slovenia, Portugal and Spain. Only in the case of France is there a significant opt-in to the reciprocity provision, namely by about one-fifth of the CAC 40

Formulation. There are also concerns about the way reciprocity is regulated in the Directive. Shareholders need to approve the application of reciprocity at the company level. Yet they cannot simply do this for a single specific bid, but rather must do so for all bids during a certain time period. Authorisation may therefore be requested where no threat of takeover exists and shareholders suffer from rational apathy, cognitive bias and asymmetry of information (Davies et al., 2010). On a different note, strict phrasing in the Directive may allow offeree companies to invoke reciprocity if the offeror does not apply the board neutrality rule but an equivalent provision. Some jurisdictions have nonetheless transposed the Directive more leniently and consider measures of equivalent effect sufficient to overcome the reciprocity test (Marccus Partners and CEPS, 2012).

Circumvention. Possible circumvention of the reciprocity provision is also a cause of concern. The application of the board neutrality rule by the offeree company may be assured, circumventing the reciprocity requirement, by using a subsidiary to launch the bid. In this scenario, a parent company that is not subject to the board neutrality rule but which retains the economic interest in the acquisition would use a subsidiary that is subject to the rule for conducting the deal. It is uncertain whether national supervisors monitor the ultimate economic interest or entity behind each transaction; but the potential for circumvention could undermine the objective of the reciprocity rule in the Directive.

12.2.4 Implementation score

The transposition of the board neutrality rule has been fragmented across EU countries (see Figure 23). While some countries, such as the UK and Sweden, have made the rule mandatory with no reciprocity requirement, other countries, such as Germany and the Netherlands, have left companies the choice of whether to opt into the rule. The latter countries attain a lower score, since it is unlikely that companies in their jurisdictions would opt in given the risk that competitors might not choose to do so.

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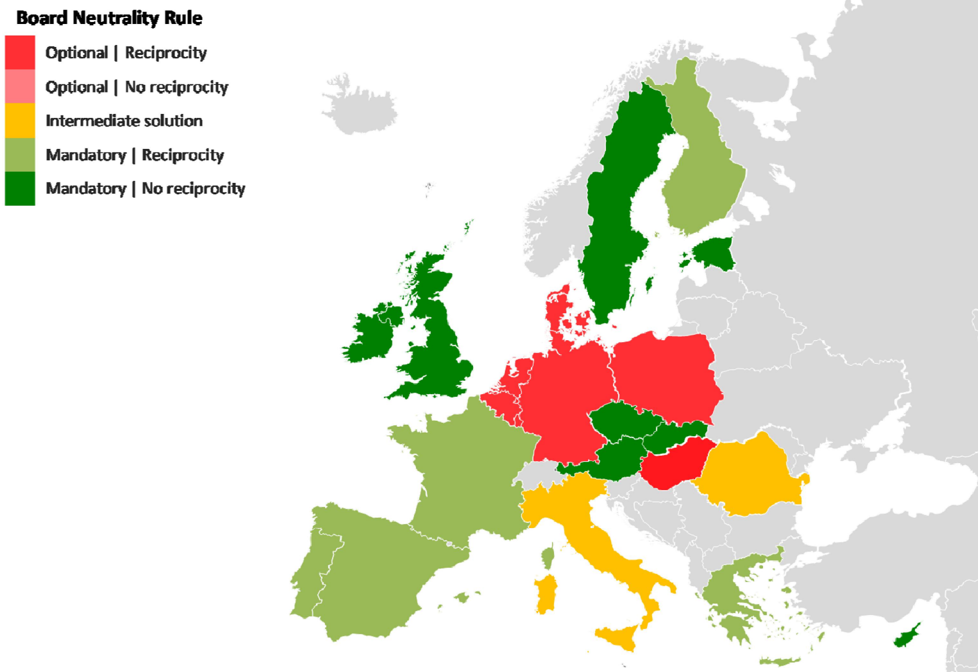
companies according to Davies et al. (2010). We would advance several reasons for this phenomenon: a) the possibility to issue defensive warrants in France; b) a relatively high degree of state intervention and ownership; c) the fact that reciprocity may act as a form of commitment by several shareholders; and d) the non-application of the breakthrough rule.

Figure 23. BNR implementation scores



Note: For details of the calculation of the scores, refer to Appendix 3.
Source: Authors (see Appendix 3).

Finally, Italy has adopted board neutrality as a default rule by making it mandatory but leaving companies the possibility to opt out. It is likely that Italian companies would opt out where they face a takeover threat in order to raise barriers to the potential transaction or if they fear being more vulnerable to potential offerors.

Finding #2. The board neutrality rule protects shareholders in a pre-bid situation, when they suffer rational apathy, while allowing them to adopt defensive measures once the bid has been announced. The rule addresses agency problems where ownership is dispersed. Optional transposition of the rule appears beneficial given the diversity of corporate governance structures across Europe. That being stated, placing optionality at the member state level fails to account for company-specific characteristics. Conditionality based on reciprocity is not backed by a straightforward economic rationale. Board neutrality reduces the scope to factor the interests of other stakeholders into the takeover process.

12.3 Taxonomy of defensive measures

Defensive measures. In an environment with information asymmetry about the post-takeover value, defensive actions – aimed at increasing costs for the potential acquirer – may be deployed. Defensive measures may be pursued by shareholders or directly by management if such parties' information/perceptions about the post-takeover value of the company is different from the offeror's, and they wish to try to extract more value from the offeror. Management may also deploy defences to avert a hostile takeover, independent of the market premium offered by the offeror. Following Tirole (2006), defensive measures (whether statutory or not) can be classified into two types:

- actions expanding control of the company (*ex-ante* measures); and
- actions diluting raiders' equity (*ex-post* measures).

Expanding control. First, shareholders exercise defences that aim at maintaining greater control of the company. *Ex-ante* defensive actions include the following practices:

- a staggered board (a practice through which only a fraction of the board is elected at a time so that a potential acquirer has to go through several proxy fights to gain full control of the company);
- the super-majority rule (e.g. so-called 'business combination rules' requiring more than 50% of votes for the approval of a merger or a reorganisation);
- a fair price clause (constraints on voting power if a 'fair' price is not offered to all shareholders);
- differential voting rights (privileged voting rights for shares held over an extended period);
- dual-class recapitalisation and other multiple voting shares (which give some shareholders more votes than are proportional to their actual share in the capital of the company);
- control acquisition rules (requiring shareholder approval before the offeror can exercise its voting rights);
- other control-enhancing mechanisms (such as pyramid structures and cross-shareholdings);
- disgorgement rules (obliging the offeror to transfer away all profits by selling the shares of an offeree company in a failed offer);
- moving the legal headquarters or place of listing (to benefit from a regulatory setting that is less favourable to takeovers); and

- conditional sales (sales of company assets that are conditional to the success of a takeover bid).

Diluting equity. Additional defences may be established by management (typically approved by the board but not necessarily by shareholders) in order to dilute the raider's equity (*ex post*) and so push it to retire the bid or cause the bid to fail. The following actions fall under this category:

- scorched-earth policies (selling 'crown jewel' assets to reduce the value of the company or selling assets that could create valuable synergies with the potential offeror);
- litigation with the raider (to increase its acquisition costs and the time needed to complete the offer);
- poison pills (to reduce the value of the equity by using, for instance, equity derivatives; see next section);
- a white knight strategy (a common management practice that consists of looking for an alternative acquirer who is able to offer more or to save the management from removal);
- green mail actions (a management practice that consists of buying, with company money, the raider's block at an additional premium); and
- buybacks (acquiring shares on the market in order to increase the market price and cause the offeror's bid to fail).

Despite the Directive's implicit preference for the one share–one vote principle in relation to voting powers (although it contains no mandatory rules in this regard), some defensive measures are not prejudicial and may even be beneficial for the company (see Table 30).

Table 30. Defensive measures

Potential benefits	**Potential drawbacks**
Protects long-term projects	Protects managers' short-term self-interests
Provides greater information to the offeror	Impedes the flow of information into market prices
Solves issues of shareholders' coordination	Controlled by few
Promotes competition among offerors	Favours specific blockholders

Source: Authors.

Benefits. In effect, defensive measures may be used to protect the long-term projects of the company and to make sure that the offeror is also offering a reasonable price for such projects. Furthermore, a defensive measure helps

the offeror to obtain more information about the interests and the strategies of the company's management. In countries with a dispersed ownership structure, such as the US, shareholders may be too numerous and uncoordinated, with the result that managers can negotiate (i.e. leverage their power to impose defensive measures) and cut a deal in the interest of shareholders (or in the interest of the company). Finally, such defensive measures as the white knight strategy may stimulate a competing offer, which tends to increase the gains for offeree company shareholders.

Drawbacks. On the other hand, defensive measures may harbour disadvantages, as managers can use them discretionally to protect their interests from the intrusion of the acquirer. Defensive measures may impede the correct flow of information into prices by affecting them for reasons not strictly related to the company's fundamentals. In addition, governance rules may not necessarily require the approval of defensive measures by a majority of shareholders, in turn allowing such tools to be used in the interest of certain shareholders whose interests may not be aligned with those of general shareholders or of the company as a whole. Lastly, in concentrated ownership structures, defences may allow controlling blockholders to defend their position by building upon complaisant management (nominated by the controlling shareholders themselves).

12.3.1 Shareholder rights plans

Poison pills. Shareholder rights plans (poison pills) are a type of defensive measure frequently used in the US, where shareholders retain the right to acquire additional shares at a discount when one shareholder acquires a stake overtaking a certain percentage of the capital. They are therefore based on the issuance of new stock carrying rights that are only triggered during a takeover bid. A poison pill results in "discriminatory dilution" of capital, which increases the cost of the takeover for the offeror (Hill, 2010). In the US, poison pills can generally be adopted by management without shareholder approval, in stark contrast to the board neutrality rule in the Directive. The key characteristic of these pills is that they deter takeovers without harming the business of the offeree company, unlike for instance the sale of key assets. In addition, their effectiveness carries a powerful deterrent effect, which means pills are rarely triggered in practice (Davies et al., 2010).

Taxonomy. There are two main types of shareholder rights plans: *flip-in pills*, which provide options to purchase shares in the offeree company, and *flip-over pills*, which allow shareholders to purchase shares in the offeror after a merger (Gerner-Beuerle et al., 2011). An example of a flip-in pill is given by Gordon (2004): assuming an offeree company has 100 shares of stock outstanding and the offeror acquires more than 15 shares, the remaining

shareholders would be allowed to acquire 85 shares at a 50% discount. The resulting dilution effect is so strong and creates such an increase in the cost of conducting the takeover that a flip-in pill effectively saves the company against hostile bids. Boards in the US may also introduce barriers to the redemption of the pill through *dead hand pills*, which can only be redeemed by the directors who established the pill, and *no-hand pills*, which cannot be redeemed during a certain period of time.

Effectiveness. The effectiveness of poison pills relies on two elements of the broader corporate governance framework: the existence of a staggered board in the offeree company and the right to issue shares and forego pre-emptive rights without shareholder authorisation (Hill, 2010; Gerner-Beuerle et al., 2011). In a staggered board, the removal of every member at a single point in time is not possible, except where expressly provided for by law. Under these circumstances, the board does not face the risk of dismissal by the shareholders due to the application of defensive measures. Conversely, without a staggered board, a proxy fight could force the board to renounce triggering the pill. Nevertheless, staggered boards are not a feature of European company law (Marccus Partners and CEPS, 2012). As to the right of the board to issue shares and forego pre-emptive rights without shareholder authorisation, while Delaware Law allows flexibility in this regard, in Europe the Second Company Law Directive (77/91/EEC) requires shareholder authorisation for any issuance (Art. 25 of the Directive). Furthermore, rules on the equal treatment of shareholders do not allow discrimination against the offeror. The possibility to launch a poison pill in Europe is therefore very limited (Ferrarini, 2000). Gerner-Beuerle et al. (2011) find that there is no legal authority in the UK, Germany or Italy to launch a standard poison pill (see Table 31). The authors arrived at this conclusion by performing a detailed survey of company law and practice in the relevant jurisdictions, without considering the application of the board neutrality rule.

Table 31. Availability of poison pills in key EU jurisdictions

UK	Germany	Italy
- Possible but requires *ex-ante* shareholder approval	- Not available in its standard form - Convertible bonds (without redemption rights) have been used; there may have been a defensive purpose in some cases	- Issuance of warrants possible - Uncertainty whether the offeror could be excluded from exercising the warrants (principle of equality among shareholders)

Source: Adapted from Gerner-Beuerle et al. (2011).

The strength of poison pills combined with staggered boards allows managerial entrenchment, which has led to pressure for regulatory reform in the US to better protect the rights of shareholders. Hill (2010) reports a sharp decrease in staggered boards and poison pills in the US in recent years following pressure by institutional investors.

12.4 The breakthrough rule

Introduction. The breakthrough rule attempts to introduce the one share–one vote principle when shareholders decide upon the adoption of post-bid takeover defences. It aims at facilitating takeovers by reducing the scope for entrenchment by managers and blockholders, thus reducing agency costs and limiting free-riding problems.

Objectives. The breakthrough rule in the Directive attempts to limit the power and use of pre-bid takeover defences. It introduces the one share–one vote principle by dissociating control and ownership, moving decisional power away from control groups to the wider shareholder base. In the Directive, the rule appears together with the board neutrality rule, since any limitation of post-bid defences (BNR) introduces incentives to adopt pre-bid defences and vice versa (Ferrarini and Miller, 2010). Proportionality between ownership and control allows the offeror to overcome possible post-bid defences. The breakthrough rule therefore complements the board neutrality rule, which limits the capacity of the board to adopt post-bid defensive measures, enforcing shareholder supremacy. Both rules are based on the principles of shareholder decision-making and proportionality (Mülbert, 2003). While board neutrality has been transposed in most member states surveyed in this study, the breakthrough rule has only been fully transposed in Estonia (Marccus Partners and CEPS, 2012). By reducing the scope for defences, the Directive seeks to promote the market for corporate control (Kirchner and Painter, 2000; Coates, 2003; Ferrarini, 2006).

Control-enhancing mechanisms. Ownership and control are dissociated through multiple control-enhancing mechanisms, such as dual-class shares, multiple voting rights, non-voting shares, pyramid structures, voting rights ceilings, golden shares or cross-shareholdings. In 2006, the European Commission undertook a study on the proportionality between ownership and control in listed companies in the EU (Shearman & Sterling et al., 2007), which revealed the widespread use of control-enhancing mechanisms across member states. The results of this study, which surveyed the 20 largest listed corporations per country and a number of small and recently listed companies, highlighted the differences in the use of control-enhancing mechanisms in Europe (see Table 32).

Table 32. Presence of control-enhancing mechanisms in European companies

	Companies surveyed	At least one CEM	**At least one CEM (%)**	Multiple voting rights	Non-voting shares	Non-voting preference shares	Pyramid structures	Voting right ceilings	Ownership ceilings	Golden shares	Cross-shareholdings	Shareholders' agreements	Total CEMs present	Total CEMs possible	**Overall CEM prevalence (%)**
Belgium	32	16	**50**	0	0	0	11	0	0	1	0	10	22	288	**8**
Denmark	23	8	**34**	5	0	0	0	2	1	0	0	0	8	207	**4**
Estonia	14	2	**16**	0	0	0	2	0	0	1	0	0	3	126	**2**
Finland	25	10	**40**	8	0	0	0	2	0	0	0	1	11	225	**5**
France	40	29	**72**	23	0	0	7	4	0	0	2	7	44	360	**12**
Germany	40	9	**23**	0	2	5	5	1	0	1	1	0	16	360	**4**
Greece	31	16	**51**	0	0	1	10	2	3	0	0	2	18	279	**6**
Hungary	22	13	**60**	1	0	1	7	4	0	6	0	1	20	198	**10**
Ireland	23	9	**39**	0	1	4	0	1	1	1	0	1	9	207	**4**
Italy	39	23	**59**	0	0	7	11	3	7	6	1	9	44	351	**13**
Luxembourg	19	3	**16**	0	0	1	6	0	1	1	0	0	9	171	**5**
Netherlands	23	15	**65**	10	0	0	3	0	0	0	2	1	16	207	**8**
Poland	40	17	**43**	10	0	0	2	5	0	5	0	0	22	360	**6**
Spain	24	15	**62**	0	0	0	4	7	1	3	0	3	18	216	**8**
Sweden	29	19	**65**	17	0	0	14	1	1	0	5	2	40	261	**15**
UK	40	12	**31**	1	0	12	1	2	2	0	0	1	20	360	**6**

Source: Adapted from Shearman & Sterling et al. (2007).

Scope. The scope of the breakthrough rule in the Directive addresses the problem of control-enhancing mechanisms partially. It extends to a) multiple-vote securities belonging to a separate class, b) restrictions on voting rights, c) extraordinary rights of shareholders to appoint or remove board members, and d) restrictions on the transfer of securities. These control-enhancing mechanisms are also subject to disclosure requirements (Art. 10 of the Directive), the importance of which for pricing and governance should not be underestimated (Ferrarini, 2006). Legal doctrine discusses the extent to which the formulation of the breakthrough rule in the Takeover Directive allows for circumvention. Bearing in mind that the rule has only been transposed in Estonia, lack of practice and case law mean that only theoretical discussion is possible. For instance, Papadopoulos (2008) considers that certificates of shares and non-voting depository receipts would allow shareholders to circumvent the breakthrough rule. Under these financial instruments, voting rights are separated from their shares and transferred to an administrator. A certain potential for circumvention of the breakthrough rule using these certificates arises from the absence of rules requiring detached voting rights to revert to the shareholders in the event of a takeover. Even so, disclosure provisions apply to the use of depository receipts.

Formulation. Papadopoulos (2008) considers that the formulation of the breakthrough rule is both too wide and too narrow. It is too wide given that the rule may encompass neutral and takeover-friendly instruments, such as pre-emption rights, option rights, sale agreements with deferred settlement or agreements to accept a takeover bid (Sjåfjell, 2010a). It is too narrow given that some of its requirements discriminate among instruments with similar economic functions but different legal architectures. In this regard, the Directive defines shares as carrying voting rights – potentially excluding non-voting shares – and defines multiple-voting as belonging to a separate class, apparently leaving out ceiling and time-lapse shares, which also carry varying voting rights but do not formally belong to a distinct class of securities.[69] The Directive also fails to address the use of proxies by financial institutions, which frequently hold interests in the company and therefore face a conflict of interest.

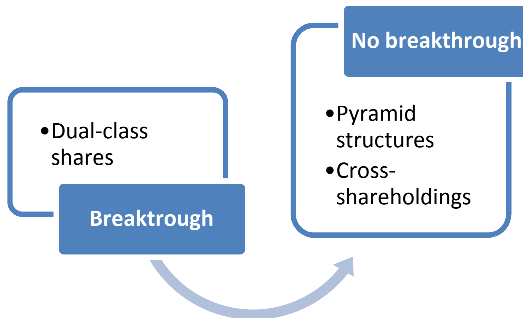
Circumvention. Crucially, the breakthrough rule does not apply to pyramid structures or cross-shareholdings, two of the most powerful mechanisms to dissociate ownership and control. Pyramids allow end shareholders to achieve control in a given company through a chain of interposed entities, holding a lower amount of capital overall than would have

[69] See Arts. 2.1(e) and 2.1(g) of the Directive.

been necessary to achieve the same level of control through direct shareholding. Pyramids are relatively opaque structures when compared, for instance, with dual-class shares, as they increase the difficulty for outside investors to understand, evaluate and monitor control (Coates, 2003). Both multiple-vote securities and pyramids fulfil the same economic objective: they allow blockholders to enhance control by leveraging more voting power than is proportionate to their ownership share. In spite of this, only multiple-vote securities are addressed in European takeover regulation. From an economic standpoint, it is difficult to justify the selective application of the one share–one vote principle only to a selection of control-enhancing mechanisms. Cross-shareholdings where one company holds a stake in another and vice versa should be distinguished, since they not only enhance control but also allow for coordination.

Solutions. Lack of consistency in addressing control-enhancing mechanisms would dilute the intended effect of the breakthrough rule if transposed by member states. Instead of enforcing the one share–one vote principle in a takeover event, as intended by the Directive, the current formulation of the rule rather induces blockholders to switch from multiple-voting shares to pyramid holdings, leaving their status quo intact in the event of a takeover (Figure 24). Still, this phenomenon has not been observed empirically, as the breakthrough rule has not been fully transposed in any country except Estonia and has been partially transposed only in France (see Marccus Partners and CEPS, 2012). According to Shearman & Sterling et al. (2007), multiple voting securities are frequent in France, Sweden, the Netherlands, Poland, Finland and Denmark, but are rare in most other jurisdictions. Conversely, pyramids are commonly used in Sweden, Belgium, Italy, Greece and the Netherlands (see Table 32 above). It follows that the application of the breakthrough rule will have dissimilar effects across companies in different member states. Yet choosing a regulatory instrument to address the use of pyramid structures is not simple. In the 1930s, the US introduced double taxation of inter-corporate dividends as a declared policy to avoid the use of pyramids (Ferrarini, 2006). The scope for addressing pyramids in a simple and effective manner through takeover regulation needs to be further researched. The main difficulty lies in distinguishing ordinary corporate groups from cases where pyramids are being used.

Figure 24. Breakthrough rule



Source: Authors.

12.4.1 *Economic impact*

Market impact. The breakthrough rule affects companies where there are several classes of shares with different voting rights attached. Bennedsen and Nielsen (2004) studied the effects of this rule on control. They analysed the distribution of voting and cash flow rights in more than 1,000 companies with dual-class shares in ten European countries. The authors found 3% to 5% of companies where controlling owners held more than 50% of voting rights but less than 25% of the shares, therefore making them subject to a direct loss of control in the face of the breakthrough rule in the Directive. The majority of these companies were located in Denmark, Germany, Italy and Sweden. In addition, 11% to 17% of companies were controlled by less than 50% of voting rights and less than 25% of shares, and were hence subject to a potential loss of control. Meanwhile, according to the authors' estimations, existing control would not be affected by the rule in about 80% of companies.

Market responses. While the breakthrough rule is meant to reduce the costs of the bid and promote takeover activity, it introduces an incentive for controlling shareholders owning a disproportionately low amount of outstanding shares to acquire a higher proportion of low voting shares (Bennedsen and Nielsen, 2004). Bearing in mind that the impact of the rule does not depend solely on the existence of dual-class shares but also on the disproportion between votes and cash flow, if controlling shareholders consolidate their position, the breakthrough rule could result in higher ownership concentration. Already, in a large number of listed companies, blockholders exercise control by owning the largest share of capital without diverging from the one share–one vote principle (Coates, 2003). The opposite thesis is put forward by Papadopoulos (2008), who believes that uncertainty about control rights that diverge from the one share–one vote principle could

lead to dispersed ownership. This observation, however, fails to consider that it may be cost-efficient for controlling shareholders to top up their ownership stake in order to keep their private benefits of control.

Private benefits of control. Disproportionate control is linked to the extraction of private benefits by the controlling shareholder. Here, private benefits refer to precisely those benefits that spring from the discrepancy between the level of ownership and control held by the incumbent blockholder (European Corporate Governance Forum, 2007). From this perspective, reducing the disproportion between ownership and control would redistribute benefits more uniformly among shareholders. Notably, two caveats apply. On the one hand, some of these benefits can be considered compensation for the costs involved in monitoring management (Zingales and Dyck, 2004). Uncertainty about control rights reduces the incentives for incumbent blockholders to perform monitoring and undertake other company-specific investments, although the one share–one vote principle provides an incentive for institutional shareholders to engage (Becht, 2003). On the other hand, private benefits of control also arise where the one share–one vote principle applies, to the extent that there is concentrated ownership. For instance, the controlling shareholder may capture business opportunities on preferential terms through its affiliates. The breakthrough rule therefore only concerns private benefits arising from the use of control-enhancing mechanisms.

Economic impact. The breakthrough rule may increase the cost of raising capital. Bennedsen and Nielsen (2004) suggest that the rule discourages companies from issuing new shares to parties other than the controlling shareholders, and instead provides an incentive to use more expensive channels to raise capital. Alternatively, companies may be prompted to buy back their own shares. Still, this effect is unlikely to materialise in practice, given that the rule does not apply to pyramids or cross-shareholdings. Incumbent shareholders will likely find that it is more cost-efficient to switch the mechanism through which they hold control and build up a pyramid scheme. Pyramids remain an effective and relatively inexpensive means of holding control without owning the majority of the shares in a given company. The widespread permissibility of pyramid structures and cross-shareholdings brings further uncertainty as to the effect of the breakthrough rule with regard to ownership concentration and control. It frustrates the objective of the rule, namely to apply the one share–one vote principle in the event of takeover in order to facilitate the change of control. Furthermore, the opacity of these structures may have a negative impact on capital markets (Coates, 2003).

One share–one vote. Ultimately, the economic analysis of the breakthrough rule reverts to the discussion on the rationale for introducing stricter

proportionality between ownership and control. Enforcing the one share–one vote principle in a takeover event is separate from its outright enforcement in corporate law (Coates, 2003). That notwithstanding, measures affecting takeovers have an impact on the use of control-enhancing mechanisms by blockholders over the medium to long term. From this perspective, coherency among takeover rules within the overall framework of corporate governance is desirable. The breadth of that discussion greatly exceeds the scope of this study, however (see Adams and Ferreira, 2008; Clottens and Geens, 2010).

12.4.2 Equitable compensation

Quantification. The Directive provides for the payment of "equitable compensation" to shareholders whose rights are broken through (Art. 11.5). This provision is in line with the protection of private property and the requirement to compensate the loss of enjoyment in case of expropriation. Yet difficulties arise when it comes to applying these principles in practice. Appraisal procedures to quantify compensation may delay the takeover process, particularly if appeals are permitted and adjudication steps in. Papadopoulos (2008) considers that delays in quantification exacerbate the pressure-to-tender problem, since shareholders risk seeing the value of their shares decrease over time. A straightforward method of quantification should reduce delays and make it clear to the offeror *ex ante* what consideration is needed to gain control. Nevertheless, even a straightforward method would not afford full certainty to the offeror *ex ante*, since total compensation will still depend on the number of shareholders who refuse to tender – above the threshold provided in the Directive. Where no convergence is observed, terms for determining compensation and the arrangements for the payment of the compensation are left to member states (see Marccus Partners and CEPS, 2012).

Proxy measurement. Ferrarini (2006) assesses the difficulties in pricing compensation for preferential voting rights, since the value of the latter depends on the private benefits of control derived from their exercise. These benefits are intrinsically opaque and difficult to value. Zingales and Dyck (2004) compute them as the difference between the price per share paid for the controlling block and the market price of a share after the change of control is announced. The former would reflect the value of preferential shares, while the latter would reflect the value of ordinary shares (Barclay and Holderness, 1989). This methodology illustrates that an *ex-ante* calculation is difficult in practice. Moreover, the principle of equal treatment of shareholders does not allow for a different price to be paid for controlling shares under the Directive. If an exact quantification is not possible, two options arise for regulators: either to forego compensation altogether or to establish a proxy measurement. A proxy measurement should be easy to calculate *ex ante* to allow potential

offerors to factor in the cost of equitable compensation. It could be subject to limited adjudication to better protect blockholder rights while preventing delays in the takeover process. For instance, restrictions could apply as to the timing of adjudication, starting after the takeover deal has been completed, and the quantum that might be awarded, limited to a certain percentage of the proxy measurement. Additional research would be required to devise a proxy measurement applicable throughout Europe.

12.4.3 Optionality and reciprocity

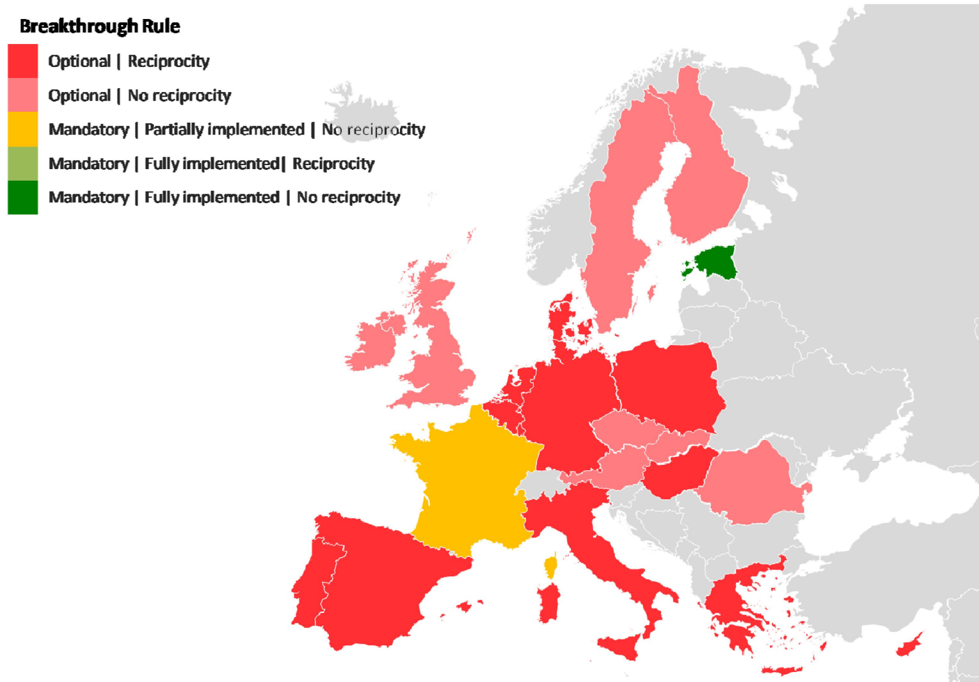
Optionality. The Directive grants discretion to the member states as to whether to transpose the breakthrough rule. Like the board neutrality rule, member states that have opted out of the breakthrough rule must provide the possibility for companies to opt back into the rule. In addition, member states must decide whether to transpose reciprocity. The decision tree is represented in the earlier section referring to board neutrality. All member states of the EU surveyed in this study have opted out of the breakthrough rule except Estonia, and to a certain extent France (Marccus Partners and CEPS, 2012). Two elements are of relevance with regard to optionality: the level at which it is placed and the default rule. The Directive places optionality at the member state level. While for board neutrality, there are arguments for placing optionality at the company level (see the earlier discussion in this study), these arguments do not apply to the breakthrough rule. It would be irrational to allow blockholders to decide on the limitation of their voting rights in the case of a takeover.

Lack of transposition. Lack of transposition of the breakthrough rule by member states highlights concerns about the impact on the structure of corporate ownership and the functioning of capital markets. An in-depth cost-benefit analysis would be required to assess the convenience of removing optionality and introducing the breakthrough rule across the Union. As stressed before, enforcing the one share–one vote principle in a takeover event has an impact on the use of control-enhancing mechanisms by blockholders over the medium term. The discussion on the economic costs and benefits of proportionality between ownership and control exceeds the scope of this study, but it is an open debate where no clear-cut answers have been found (Clottens and Geens, 2010; Adams and Ferreira, 2008). If the one share–one vote principle is to be introduced in Europe, this should take place after careful consideration of the overall framework for corporate governance. Besides by these fundamental concerns, lack of transposition by member states is also explained by the current formulation of the breakthrough rule, which only partially covers pre-bid takeover defences, as explained above.

12.4.4 *Implementation score*

Hardly any of the member states have transposed the breakthrough rule in the Directive. The reasons explaining this situation are twofold. On the one hand, the formulation of the rule would render it ineffective in inhibiting the use of control-enhancing mechanisms, whereas it might induce companies to switch to a different type of control of the governance structure, e.g. from dual-class shares to a pyramid structure. On the other hand, there might be no consensus among member states on the one share–one vote principle, given its overarching consequences for corporate governance and industrial organisation. The rule has only been fully transposed in Estonia (see Figure 25).

Figure 25. BTR implementation scores



Source: Authors (see Appendix 3).

France has partially transposed the rule, allowing no reciprocity, while some countries (such as the UK) have made it optional for companies to opt into the rule, but with no reciprocity. Finally, countries such as Germany, Italy and Spain have left it to companies to decide whether to opt in, but with reciprocity.

Finding #3. The current formulation of the breakthrough rule encompasses only a restricted number of control-enhancing mechanisms,

inducing regulatory arbitrage and frustrating the objective of the rule. The limited transposition of the rule means that there is not enough information to draw definite conclusions regarding its impact. The application of the one share–one vote principle in company law is a fundamental step, which would require an in-depth cost-benefit analysis and consensus among member states.

12.5 Squeeze-out and sell-out rules

*Introduction***.** The squeeze-out right allows the offeror to acquire any residual shares following a successful offer, with the result that it gains full control of the offeree company. It also reduces the incentive for incumbent shareholders to hold up their shares (free-riding on other shareholders) and facilitates acquisitions. The sell-out right appears as a quid pro quo whereby residual shareholders may force the acquirer to buy their shares, thus reducing pressures to tender at an inferior price.

Objectives. The squeeze-out and sell-out rights are similarly structured in the Directive, but pursue markedly different objectives. On the one hand, the squeeze-out right benefits offerors by mitigating the incentive for incumbent shareholders to hold up their shares. In so doing, the right allocates a larger portion of takeover gains to the offeror at the expense of some shareholders. On the other hand, the sell-out right benefits minority shareholders by allowing them to force the acquirer to buy their residual shares. It may discourage bids that do not seek to control all the shares of the offeree company. Crucially, while the squeeze-out rule reduces the hold-up problem, the sell-out rule has the opposite effect. By reducing the pressure to accept the tender, the sell-out right may result in higher share prices and a higher overall cost of the takeover, allocating a larger share of profits to the incumbent shareholders at the expense of the offeror. Table 33 summarises the effects of the squeeze-out and sell-out rules considered in isolation. The subsequent subsections consider the effects of both of these rights in greater detail.

Table 33. Impact of the squeeze-out and sell-out rights

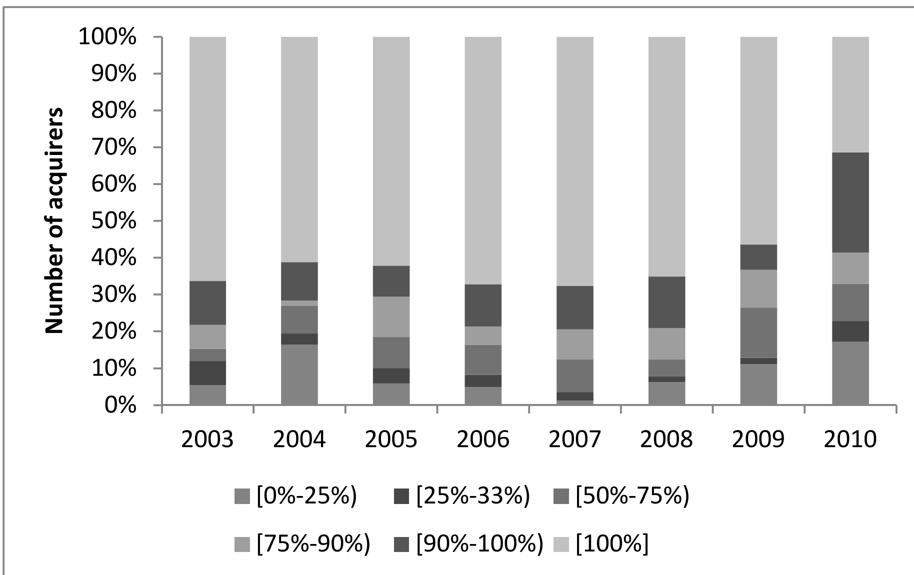
	Squeeze-out	**Sell-out**
Pressure to tender	⇔	⇩
Free-riding	⇩	⇧
Total consideration	⇩	⇧
Shareholder profits	⇩	⇧
Offeror profits	⇧	⇩

Source: Authors' elaboration.

12.5.1 Squeeze-out right

Full control. Offerors are frequently interested in gaining full control, which is commonly considered a basic condition for their acquisition planning. The squeeze-out right is an instrument sometimes present in takeover regulation that allows the offeror to force residual shareholders to sell their shares and gain full control. Evidence suggests that use of the squeeze-out right by offerors is widespread (Van der Elst and Van den Steen, 2006; Martinez and Serve, 2010). Figure 26 illustrates the extent to which takeover deals lead to the acquisition of full control in Europe.

Figure 26. Stake owned by the acquirer after a takeover transaction



Source: Authors' elaboration based on Thomson Reuters SDC Platinum.

Full ownership may have a higher value than majority or large majority ownership for a variety of reasons (Van der Elst and Van den Steen, 2006; Ventoruzzo, 2010):

- facilitating the recouping of the costs of the offer;
- avoiding costs associated with retaining a small number of shareholders, in particular transaction costs;
- aligning the strategy and management of the acquired company with those of the parent company within a group of companies;

- going private, thereby avoiding the costs of public ownership (the direct cost of listing and the indirect cost of complying with the legal requirements for listed companies, including transparency provisions);
- benefiting from accounting consolidation for tax purposes, which in some jurisdictions requires full ownership;
- reducing legal uncertainty in those jurisdictions where minority shareholders may claim part of the control premium *ex post*; and
- in the case of private-equity leveraged buyouts, replacing all equity with debt that is tax-deductible.

Hold-up. Regardless of whether the offeror discloses the stake it wishes to acquire, it faces a problem of hold-up by incumbent shareholders (Van der Elst and Van den Steen, 2006; Grossman and Hart 1980). Hold-up by investors has three main sources: i) shareholder preferences are not homogenous and thus their supply functions have different slopes; ii) shareholders may reasonably anticipate that the price offered by the offeror is lower than the value of the company; and iii) shareholders may anticipate that the margin of shares required to gain full control has a higher value for the offeror. As a result, a small number of investors may decide not to tender at the offered price, holding up their shares and forcing the offeror to pay a higher premium for the residual stake necessary to attain full control. Holding up is therefore likely to increase the cost of takeovers and reduce the volume and efficiency of the market for corporate control (Burkart and Panunzi, 2003). In addition, when holding up, some shareholders free ride on the others, attempting to capture a higher fraction of the takeover premium. In sum, holding up and free-riding appear together in practice but affect two distinct aspects of takeover regulation: balancing the protection of incumbent shareholders against the efficiency of control transfers, and ensuring the equal treatment of all shareholders.

Compensation. The squeeze-out right, by forcing residual shareholders to sell, reduces the hold-up problem. The rule needs to be understood in conjunction with the principles that serve to fix the price that would be paid for the residual shares. Broadly speaking, the Directive prescribes compensation equal to the price paid to the other shareholders in the case of a successful mandatory bid, thereby enforcing the principle of equal treatment and avoiding free-riding among fellow shareholders. The determination of the squeeze-out price has a direct impact on the economic efficiency of the acquisition. Goergen et al. (2005) consider that as long as squeeze-outs do not raise the premium for shareholders, they are likely to reduce the overall consideration paid in the tender and allocate a larger part of the takeover gains to the offeror, increasing the efficiency of the transaction. As they enforce the

principle of equal treatment, the rules on price determination in the Directive are unlikely to result in an increase of the overall consideration. Where the squeeze-out right reduces the overall consideration to a level lower than the post-takeover value of the company, offerors will tend to make their acquisitions conditional on reaching the squeeze-out threshold (Burkart and Panunzi, 2003).

Threshold. The threshold for exercising the squeeze-out right is also important. The optimal threshold depends on the level of shareholder concentration in the offeree company (Van der Elst and Van den Steen, 2006, 2009). Yet, regulators have so far not succeeded in finding a formula to determine the optimal threshold at the company level. Instead, a single threshold is applied to all companies within the same jurisdiction. This solution is simple but sub-optimal, since ownership and control concentration are not homogenous even within the same country. Most corporate law systems have converged towards a threshold of over 90% using trial and error (Van der Elst and Van den Steen, 2006).

Shareholder rights. At a fundamental level, fixing the threshold needs to balance a) the protection of the rights of investors over their shares and b) the interest of the offeror in acquiring full control. A low threshold would infringe the rights of incumbent shareholders, who legitimately may not wish to sell at the price offered by the offeror because they have a low preference for liquidity and expect higher value from retaining their shares. In the US, corporate law adopts a different perspective and considers shareholding not as a property right but rather a financial interest in the corporation that requires a lesser degree of protection (Ventoruzzo, 2010). Following this approach, regulation of squeezing-out (freezing-out) is more permissive in the US than in a majority of EU member states. At a fundamental level, however, the existence of a squeeze-out right is based on the assumption that the acquisition of full control by the offeror is socially useful and justifies the limitation of shareholders' property rights. Nonetheless, caution is required in this respect, as full control may be profitable for the offeror but not always socially useful. For instance, full control allows the offeror to recoup more easily the costs of the bid from the assets of the offeree company. There is hence a risk that easy squeeze-outs may marginally encourage value-decreasing takeovers.

Practical thresholds. The Directive provides for a threshold above 90% but below 95% of the shares/votes, and affords member states some discretion. Van der Elst and Van den Steen (2006) assess the practical explanations behind these thresholds. On the one hand, a threshold above 95% would make it difficult to solve the practical problem of both untraceable and intractable shareholders, that is, shareholders who cannot be found or who refuse to accept the sale even on reasonable terms. On the other hand, a threshold below

90% would disrupt a large number of Continental European companies characterised by a high ownership concentration. The authors also point out the link between squeeze-out thresholds and the thresholds to obtain tax benefits in several member states.

Scope. Squeeze-out procedures exist in some jurisdictions irrespective of how the threshold has been reached. The economic rationales behind full control do not depend on the underlying transaction and would justify squeeze-outs independent of the way in which the stake had been acquired. Nevertheless, coherence between takeover and merger regulations with regard to squeeze-outs has not yet been fully achieved in Europe (Papadopoulus, 2007). Outside a takeover transaction, the determination of an equitable price is more difficult given the absence of a reference price for control, such as the one offered in the context of a mandatory bid. Appraisal by the courts of justice is expensive and dysfunctional (Ventoruzzo, 2010).

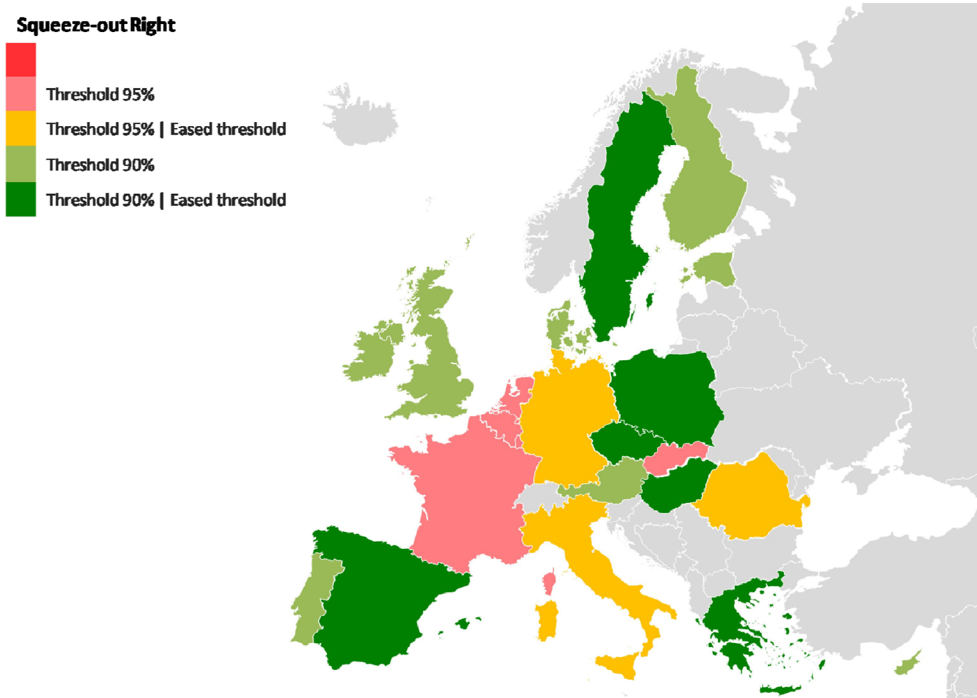
Harmonisation. Differences in the regulation of squeeze-out rights across member states are significant (Van der Elst and Van den Steen, 2009). The importance of homogeneous squeeze-out rules for achieving consistency throughout the single market should not be underestimated. There has been little research on squeeze-out rights beyond that by the few academics cited here who focus on this issue; yet this is a crucial element for the achievement of integrated financial markets and equal shareholder protection in the EU. Squeeze-out rules carry significant economic importance given the interest of offerors in gaining full control and going private. Facilitating squeeze-outs is likely to promote the market for corporate control. Following this rationale, Ventoruzzo (2010) considers the thresholds in the Directive too high, arguing that they give excessive relevance to a small minority of the minority shareholders. Ventoruzzo favours a more pragmatic and simple approach that simply sets the threshold at 75% of the shares in order to stimulate activity in the market for corporate control. A low threshold, however, would probably not suit the level of shareholding and ownership concentration prevalent in most European economies. Given uncertainty about shareholder rights, a relatively low threshold would likely discourage investment and shareholder engagement. It might also exacerbate a short-term focus on investing. Quite apart from the level of the threshold, compensation for shareholders needs to be equitable to avoid discouraging investment. The level of shareholder compensation determines how the benefits of full control are spread, but distributional issues affect stakeholders at large. As such, there is no easy answer to the question regarding the social desirability of squeeze-outs.

Indirect squeeze-out. Finally, an indirect squeeze-out may occur through statutory mergers or de-listing, which can impose lower valuations on remaining shareholders. In practice, the threshold for the approval of such deals is far below the squeeze-out threshold (e.g. 75% of voting rights for statutory mergers in Germany; Papadopoulos, 2007).

12.5.2 *Squeeze-out rule implementation score*

The squeeze-out rule has been widely adopted across Europe in line with the Directive, but with some differences. Some countries, such as Spain and Sweden, have opted for the least restrictive application of the rule, with an eased threshold of 90%. In this case, all kinds of shares may contribute to the reaching of the threshold. Other countries, such as the UK, apply a threshold of 90% as a percentage of shares with voting rights (Figure 27).

Figure 27. Squeeze-out implementation scores



Source: Authors (see Appendix 3).

Germany and Italy apply a squeeze-out rule with a 95% eased threshold. Finally, France, Belgium and the Netherlands, among others, have adopted a squeeze-out rule of 95% as a percentage of shares with voting rights.

12.5.3 Sell-out right

Sell-out. The sell-out right of incumbent shareholders is best understood as a provision mirroring and balancing the squeeze-out right of the acquirer. The latter carries the most economic importance while the former is devised as a sort of quid pro quo (Burkart and Panunzi, 2003). As previously mentioned, the sell-out rule awards residual incumbent shareholders the right to force a successful acquirer to purchase their shares at a fair price. In isolation, the sell-out right could be an incentive for shareholders to hold up their shares, which would increase the cost of takeovers and bring down activity in the market for corporate control (Goergen et al., 2005). In combination with the principle of equal treatment of shareholders and the squeeze-out right, however, these pernicious effects are cancelled out. In the Directive, the sell-out right allows residual shareholders to sell their shares to the offeror under similar conditions as the offeror is allowed to purchase this residual stake. The economic justification of the sell-out right, similar to that of the mandatory bid rule, is to protect minority shareholders by giving them exit rights following a takeover. It is therefore relevant for the promotion of investment and the development of the capital markets.

Like the squeeze-out right, the effect of the sell-out right depends on the principles used to determine the price of the residual shares and the threshold required for the exercise of these rights. In the Directive, both factors closely mirror the factors governing the squeeze-out.

Finding #4. The acquisition of full control allows the offeror more easily to align the management of the offeree company with its own interest. A high threshold for the exercise of the squeeze-out right protects the rights of incumbent shareholders, while a low threshold would stimulate the market for corporate control. There is no economic rationale to justify different squeeze-out rights for different underlying transactions. The link between squeeze-out and de-listing should be further explored.

12.6 Empirical analysis

Regressions. Using 996 observations from the above-mentioned dataset on takeover deals between 2003 and 2010 (see Box 8 on the dataset), this section on the empirical analysis briefly discusses the results of the econometric regression using different regressands. It is important to clarify that this is a

preliminary analysis to show whether the Directive has had an impact on the market for corporate control and on the economy overall. Additional analyses are needed in future to assess the overall impact of the Directive. In any case, the lack of harmonisation and the financial crisis further complicate the econometric analysis, rendering it inevitably subject to distortions. (For a detailed look at the results of the econometric regressions, see Appendix 5.)

Cumulative abnormal returns (CARs). We regressed the CARs (-41; +41) to explore the unexpected returns of a takeover transaction. We assume that CARs, calculated as the difference between the sector return and the company return in real terms (prices) around the announcement date, are a good proxy for the unexpected benefits accruing to the offeror in a takeover transaction. The higher the value of the CAR, the greater is the incentive of a potential acquirer to bid, assuming the offeror compares the market premium calculated using a theoretical model with the additional abnormal returns above this market premium for that given sector. Overall, a high CAR means that the value of the company or of the sector is currently undervalued, so an offeror can extract more than what could potentially be expected in a sector with low CAR values. CARs not only capture the market premium, but also all the other factors that cannot easily be factored in a model but which may be used by the incumbent shareholders to bargain for a higher premium. Therefore, by extension, if a variable has a positive correlation with CARs, it increases the unexpected market returns of a takeover against which the potential offeror will benchmark its premium, thereby potentially increasing the incentives to launch a bid.

Other regressions. We have also regressed the market capitalisation, the competitiveness index related to the deal (based on the Global Competitiveness Index of the World Economic Forum) and the financial development index (market capitalisation over GDP).

Outcomes. Indices of shareholder, employee and creditor protection have been added to the model, in particular to control for the other legal requirements in place that may affect the dependent variable apart from the transposition of the Takeover Directive. In all regressions but the one explaining market capitalisation, the introduction of the Directive had an observable impact. Still, coefficients suggest that the impact is very low if not negligible. In terms of relations, the results cautiously suggest that the Directive had a positive impact on cumulative abnormal returns (0.13799; $p<0.01$), a positive impact on market capitalisation (0.00215; but no significance), a positive impact on competitiveness (0.01037; $p<0.01$) and a negative impact on financial development (-0.09170; $p<0.01$). The impact is very low for deriving clear-cut conclusions. Greater shareholder and employee protection negatively influence CARs, which means fewer unexpected returns

and more entrenchment for incumbent shareholders. Reducing, as it does, the possibilities for post-bid defences, the introduction of the board neutrality rule has had a negative impact on CARs as it narrows the space for unexpected defensive actions. The breakthrough rule and the mandatory bid rule are less important in this empirical analysis, as their effect relates mainly to *ex-ante* incentives. The index of minority shareholder protection seems to be significant in all regressions, thus establishing a definite link between takeovers and the promotion of market capitalisation (in line with La Porta et al., 1998).

Overall, it is possible to conclude that the Directive has had an impact on the market for corporate control and the economy. At the same time, as could be reasonably anticipated the intensity of this impact is marginal. The introduction of the Directive appears to be positively related to CARs and thus to the volume of takeovers (increasing the weight of unexpected factors, perhaps owing to the fragmented transposition of the legal text) and negatively related to the broad index of financial development. In effect, in the most developed financial markets, price efficiency reduces CARs because investors' expectations reflect that they are already able to price in many factors, which may not feed into prices in less developed markets. Additionally, the board neutrality rule appears to have a negative impact on CARs, which is theoretically related to the prospect that, by reducing the scope for defences, incumbent shareholders will be able to extract a lower premium, thereby reducing the value of both the CARs and the benchmark employed by the potential offeror. The regression shows that the BNR had a positive impact on increasing incentives to launch a takeover in the countries where it has been fully transposed. That being stated, the impact is low, as the BNR may also raise pressures for incumbent shareholders to entrench, therefore raising the cost of acquiring control for the potential offeror (with additional effects on dispersed ownership structures).

12.7 Conclusions

Multiple impacts. Takeover regulation has multiple impacts on the economy. In particular, it affects relevant areas like investor protection, ownership and control of a company through the crucial role of capital markets, which allow the development of an efficient market for corporate control. Depending on the characteristics of the company (ownership structure) and the legal system, takeover rules can have diverse repercussions and effectiveness in reaching their original objectives. Whether the ownership structure is more concentrated (with private benefits of control) or more dispersed matters, especially for the intensity of the impact of some of the rules on the market for corporate control

and on the contestability of control. It is questionable whether private benefits of control should be addressed through takeover regulation or whether they should rather be the object of broader regulatory action in corporate law. Moreover, the legal system matters as well, particularly with regard to investor protection and setting the framework for corporate decision-making, whether shareholder- or management-oriented.

Efficiencies and discipline. Transfers of corporate control (takeovers) may result in a more efficient allocation of control if the offeror presents a higher valuation of control because it is capable of using the pool of assets in the offeree company to generate greater value than the incumbent. Takeovers may also have disciplinary effects by aligning the interests of managers with those of the company. The company's interests may not necessarily be those of the controlling shareholders, and regulation should take into account such other aspects as the protection of long-term firm-specific investments, which may not be in line with the short-term resolve of incumbent shareholders to tender their shares to the highest bid.

Trade-offs. This study of the Directive reveals three important trade-offs and conflicts among regulatory objectives (Table 34).

Table 34. Trade-offs in takeover regulation

Trade-offs		
Disciplining management (agency problem)	⇔	Preserving long-term firm-specific projects
Controlling contestability	⇔	Protecting minority shareholders
Addressing free-riding	⇔	Increasing pressure to tender

Source: Authors.

Disciplining management. First, by increasing the contestability of control, takeovers induce managers to behave in line with the interests of shareholders, reducing agency costs. On the other hand, control contestability reduces the incentives of management to carry out long-term firm-specific projects precisely because of the possibility of losing control by not performing well in the short term and thus not being able to push up share prices. This situation, especially in concentrated ownership structures, may ultimately reduce shareholder value for minorities who have invested in the firm's long-term projects. The alignment of managers' and shareholders' interests may induce short-termist behaviour on the part of management, depending on the shareholder structure. The contestability of control reduces the incentives of managers and blockholders to undertake firm-specific investments, such as investment in human capital, which generate company value over the medium to long term.

Protecting minority shareholders. Second, strengthening the protection of minority shareholders may increase takeover costs, thereby dissuading takeovers and reducing control contestability (as shown in the empirical analysis). The intensity of the trade-off critically depends on the company's shareholding structure. Protecting shareholders should be a primary concern in the case of concentrated ownership in order to limit expropriation. Conversely, in the case of diluted ownership, promoting takeovers may be more important than protecting shareholders (Enriques, 2010). Moreover, not all measures of shareholder protection necessarily increase takeover costs.

Free-riding. Furthermore, by addressing free-riding issues and reducing hold-up by shareholders, takeover rules may increase the influence of the potential offeror, thus creating pressures to tender and vice versa. Table 35 summarises these trade-offs by presenting the objectives in conflict.

Table 35. Impact of takeover regulation (± relationship and intensity, shaded areas illustrate an outcome opposed to the objectives of the Directive)

	Volume of takeovers		**Protection of (minority) shareholders**		**Disproportionality between ownership and control**	
	Concentrated ownership	Dispersed ownership	Concentrated ownership	Dispersed ownership	Concentrated ownership	Dispersed ownership
Mandatory bid rule	–	– –	+ +	+	+	+ +
Ownership transparency	+	+ +	+	+ +	–	–
	–	– –				
Squeeze-out rule	+ +	+	–	–	+	+
Sell-out rule	– –	–	+ +	+	– –	–
Break-through rule	+ +	+	+ +	+	+ +	+
Board neutrality rule	+ +	+	+	–	+	+ +

Note: The positive and negative signs indicate the direction of the effect of each of the provisions on the three variables under consideration (volume of takeovers, protection of shareholders and disproportionality between ownership and control). The shading indicates whether this effect is in line (non-shaded areas) or not in line (shaded areas) with the objectives of the Directive.

Source: Authors' elaboration.

Takeover rules. At the rule level, Table 35 reflects the impact of the main aspects of takeover regulation on key objectives of the Directive. The major components of the Directive are the mandatory bid rule, ownership

transparency, the squeeze-out and sell-out rules, the breakthrough rule and the board neutrality rule. The key objectives of the Directive are increasing control contestability and facilitating takeovers to discipline management, strengthening (minority) shareholder protection and reducing the incentives to keep ownership concentrated, through both direct incentives (such as control-enhancing mechanisms) and indirect incentives. Table 35 measures the intensity of the impact of these rules by level of ownership concentration, and uses two levels of gradation. The same signs across rules do not necessarily mean that the rules have the same level of impact on the key objectives of the Directive. The two rules that have a broader 'net' negative impact on the objectives of the Directive are the mandatory bid rule and the squeeze-out rule (see the shaded areas in Table 35). In a nutshell, the rules that have a greater net positive impact on the key objectives of the Directive are the disclosure of ownership structure, the breakthrough rule and the board neutrality rule. The negative impact of the squeeze-out rule on the protection of minority shareholders and ownership concentration is rather negligible owing to the high level of the threshold set in the Directive. The following paragraphs refer to each of the provisions in greater detail.

Mandatory bid. The mandatory bid rule has a negative impact on the volume of takeovers because it increases the cost of takeovers *ex ante*. It also has a negative impact on ownership concentration as it incentivises incumbent shareholders to increase their holdings close to the triggering threshold. The rule has a greater impact on dispersed ownership structures where control does not yet lie with only a handful of blockholders. In contrast, the mandatory bid rule enhances the protection of minority shareholders, particularly in concentrated ownership structures, by forcing the offeror to offer the control market premium to all shareholders. Such bold shareholder protection must be weighed against the potential adverse affects on the launch of new takeovers.

Transparency. Ownership transparency has a beneficial impact on all three key objectives of the Directive, and especially on the volume of takeovers and the protection of minority shareholders, since potential offerors are able to see the composition of the ownership structure and plan their bid accordingly. This positive effect may disappear when it comes to the disclosure of subsequent purchases of shares. In this respect, the disclosure of purchases above a certain threshold does not allow 'creeping-in' takeovers, which enhance shareholder value. This rule may also discourage takeovers, however, since it may be more expensive for the potential offeror to build up an initial stake before the launch of the bid if the threshold is set too low.

Squeeze-out. The squeeze-out right may have a positive impact on the volume of takeovers. The squeeze-out right protects the offeror from shareholders' free-riding, while the sell-out right has a positive impact on

strengthening the power of minority shareholders, thereby reducing the incentive to increase ownership concentration. Squeeze-out rules also carry significant economic importance given the interest of offerors in gaining full control and going private. From this perspective, facilitating squeeze-outs helps to make the market for corporate control more 'contestable'. The impact of both rules is nonetheless limited, because of the level of the thresholds set in the Directive.

Breakthrough. The breakthrough rule could have a substantial positive impact on the volume of takeovers and the protection of minority shareholders if it managed to effectively eliminate all control-enhancing mechanisms. That being stated, the rule may also create incentives to increase direct control by raising the stake in the company, leading to higher ownership concentration. Furthermore, it may be arbitraged using alternative mechanisms, such as pyramid structures. If coherently devised and consistently applied, the breakthrough rule would produce a very high impact on the ownership structure of firms, especially in those jurisdictions where ownership and governance are more concentrated. Yet, the limited transposition of the rule means that not enough information is available to extract evidence of its impact.

Board neutrality. Finally, the board neutrality rule certainly increases incentives to launch an offer, since it constrains the capacity of the board to set out impediments and protects minority shareholders, increasing the value of their shares by making control more easily contestable. At the same time, it may raise pressures for incumbent shareholders to entrench by increasing their stake in the company in order to raise the cost of acquiring control for potential offerors (with greater impact especially on dispersed ownership structures). Still, increasing the ownership stake held in the company may be very expensive for incumbent shareholders, which would mitigate the negative effect of the board neutrality rule.

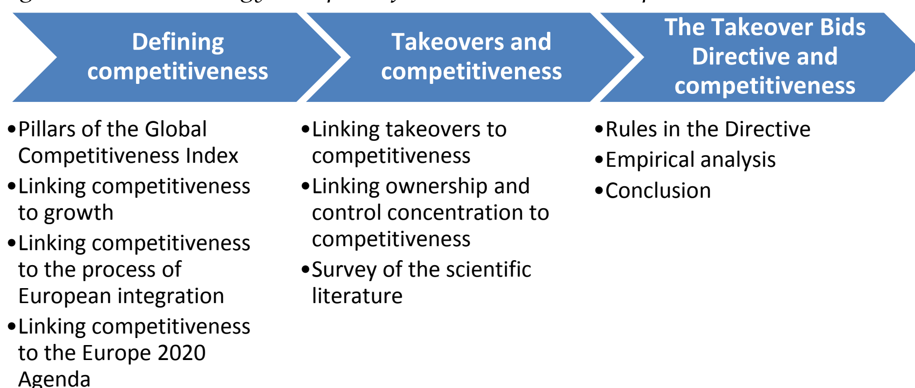
Empirical analysis. In conclusion, according to the empirical analysis, the Directive seems to have had an impact on the market for corporate control and the economy. The impact seems rather marginal, however, and may be significantly affected by the actually fragmented transposition across member states. Further analyses of the Directive in the coming years may help to strengthen the preliminary results of this study.

13. IMPACT OF THE DIRECTIVE ON COMPETITIVENESS

Europe 2020

Fostering competitiveness and growth is a primary concern of the EU in the framework of the Europe 2020 Agenda. Competitiveness is a multi-faceted concept and so are its links with the market for corporate control. The purpose of the present chapter is to shed light on the impact of the Takeover Bids Directive on the level of competitiveness and growth of the European economy. The scope of the Directive is narrow in comparison with the vast number of factors that determine competitiveness in one way or another. To best address this mismatch, this chapter follows a methodology based on three steps, as illustrated in Figure 28. In sum, this chapter a) sheds light on the links between takeovers and competitiveness and b) considers how the Takeover Bids Directive affects those links.

Figure 28. Methodology – Impact of the Directive on competitiveness



Source: Authors.

13.1 Defining competitiveness

13.1.1 Definition of competitiveness

Defining competitiveness at the level of individual countries may prove elusive given that it is a multi-faceted concept. Moreover, the number of factors that determine the level of competitiveness of an economy and the interactions among these factors very likely defies measurement. For instance, the OECD

defines competitiveness as a measure of a country's advantage or disadvantage in selling its products in international markets. Traditional competitiveness indicators are based on the differential between domestic and competitors' unit manufacturing labour costs and consumer prices. Yet these indicators seem to say little about the origin and sources of competitiveness, since they do not make explicit the contribution of such aspects as education, training, innovation, governance and company sophistication. Therefore, this study instead considers the approach followed by the World Economic Forum (WEF), which assesses multiple factors grouped into 12 pillars to compile its Global Competitiveness Index (GCI). This index places emphasis on the link between competitiveness, sustained economic growth and long-term prosperity, and therefore represents a useful tool for policy-making. Available since 2004, the index covers 139 countries, including most European economies.

13.1.2 Determinants of competitiveness

Competitiveness is defined by the WEF in the *Global Competitiveness Report 2010-2011* as "the set of institutions, policies, and factors that determine the level of productivity of a country" (Sala-i-Martin and Schwab, 2011, p. 4). It is the result of the interaction of 12 pillars, which bring together a variety of factors, surveyed and scored to compile the index. These pillars are split into basic requirements (see the first row in Table 36), innovation and sophistication factors, and efficiency enhancers (all other factors).

Table 36. Competitiveness 'pillars' considered by the WEF Global Competitiveness Index

Index pillars			
Institutional environment	Infrastructure	Macroeconomic environment	Health and primary education
Business sophistication	Innovation	Higher education and training	Goods market efficiency
Labour market efficiency	Financial market development	Technological readiness	Market size

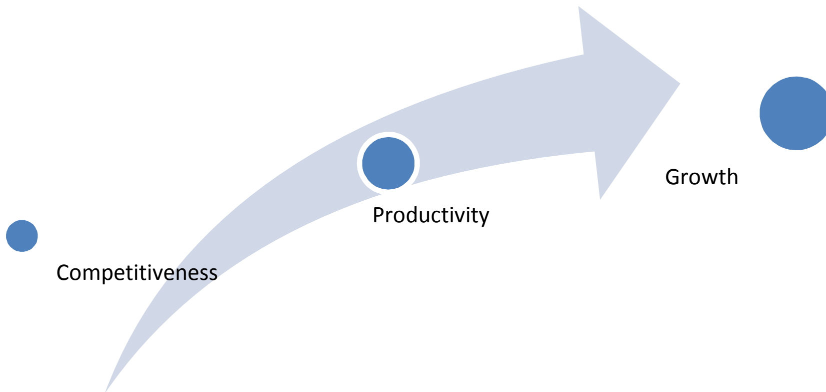
Source: Authors based on WEF GCI.

13.1.3 Economic growth

The link between competitiveness and growth is well established in economic theory, although this link is drawn differently depending on the concept of competitiveness that is chosen. Under the WEF definition followed here, competitiveness determines productivity, which in turn explains the rates of

return of the different factors employed in the economy (Figure 29). Hence, given higher rates of return, a country with higher competitiveness and productivity would be more prosperous. Competitiveness would therefore explain actual and potential economic growth. For economies at an advanced stage of development, productivity and growth depend primarily on the innovation and sophistication components of competitiveness.

Figure 29. From competitiveness to growth



Source: Authors.

13.1.4 *Europe 2020 Agenda*

It is worth noting that the pillars postulated by the WEF are in line with the vision of competitiveness in Europe embodied by the Europe 2020 Agenda. The GCI has been endorsed by the Joint Research Centre of the European Commission as a robust indicator of competitiveness. The Europe 2020 Agenda is based on three priorities:

- smart growth – developing an economy based on knowledge and innovation. Policy action is undertaken in the fields of innovation, education and digital society;
- sustainable growth – promoting a more resource-efficient, greener and more competitive economy. Action under this heading refers to industrial policy, climate change and energy efficiency; and
- inclusive growth – fostering a high-employment economy delivering economic, social and territorial cohesion. Action refers here to the labour market, training and poverty.

The 2020 Agenda also considers other actions in direct relation to the pillars of the GCI, such as the strengthening of the single market, the upgrade of the institutional setting of the monetary union and the improvement of

macroeconomic imbalances. Table 37 summarises the linkages among the pillars of the GCI and the priorities of the Europe 2020 Agenda. The next section discusses the impact of takeovers on competitiveness.

Table 37. Linking competitiveness to takeovers

Europe 2020	Global Competitiveness Index
Smart growth	Higher education
	Innovation
	Technological readiness
	Business sophistication
Sustainable growth	Infrastructure
	Goods market efficiency
Inclusive growth	Health and primary education
	Training
	Labour market efficiency
Other actions	Development of financial markets
	Market size
	Institutions
	Macroeconomic environment

Source: Authors.

13.2 Takeovers and competitiveness

13.2.1 Introduction

Takeover attributes. Research on the effect of mergers and acquisitions on company performance does not provide consistent evidence. Instead, results vary across studies depending on the country, sector and time span examined, rendering any overall conclusion precipitate. Empirical studies consider either share prices, under an assumption of market efficiency, or accounting information, under an assumption of full disclosure and materiality. With regard to offeror performance, studies do not show clear evidence of an improvement in performance in either the short or long run (Tuch and O'Sullivan, 2007). Similarly, evidence regarding the performance of acquired companies is mixed even when controlling for different parameters in the transaction (Martynova and Renneboog, 2006, see Table 38). Furthermore, these studies do not distinguish between mergers and acquisitions, which should be borne in mind given the limited scope of this study.

Table 38. Impact on long-term performance

Parameter	Expected impact on long-term performance*		Empirical evidence found in literature*
	↑	↓	
Method of payment	Cash	Stock	No impact
Deal atmosphere	Hostile	Friendly	No impact
Acquirers' financial position	Leveraged	Excess cash flow	Inconclusive
Industry relatedness	Same sector	Different sector	Inconclusive
Size of the offeree company	Big	Small	Inconclusive
Geographical focus	Cross-border	Domestic	Inconclusive

* Adapted from Martynova and Renneboog (2010).

Sources: Authors; Martynova and Renneboog (2010).

Stock market returns. Measuring takeover stock market returns is not a direct indicator of the impact of takeovers on competitiveness and growth. Shareholder gains represent a transfer of wealth from one economic agent to another. Instead, the impact of takeovers on competitiveness hinges primarily on the realisation of efficiencies and on the balance of these with the costs derived from the transaction.

Efficiencies. Takeovers may induce different kinds of efficiencies, either direct or indirect, in the form of synergies and positive externalities. On the one hand, direct efficiencies are the result of the application of the business plan of the acquirer, meaning that not all takeovers result in the realisation of all possible efficiencies. While the existence of exploitable inefficiencies is a rational motivation to launch the offer, studies have failed to show the relative poor performance of the offeror prior to the takeover (Franks and Mayer, 1996 in Maher and Andersson, 1999). This result does not in itself negate the significance of the realisation of efficiencies by the offeror, but rather puts the emphasis on corporate strategy. The acquirer will be able to introduce efficiencies into the offeree company depending on its sophistication and know-how and its business plan for the acquiree (Andrade et al., 2001; Pyykkö, 2010). On the other hand, indirect efficiencies may derive from synergies between the activities of the acquirer and the acquiree and from the realisation of positive externalities, both of which are difficult to measure. For instance, research and development may benefit from cooperation between the acquirer and the acquiree. Similarly, cooperation may result in the opening up or formation of networks and clusters, with positive effects for third parties and the economy overall. These effects are thought to be particularly relevant for transnational takeovers (Thomsen, 2007).

Costs. Takeovers come at a cost, however, including transaction costs and the premium payable to shareholders. Among the other transaction costs, financing costs and legal and advisory fees represent on average 4% of the purchase price, but may be significantly higher at the deal level (Maher and Andersson, 1999). The premium paid to shareholders also depends on the characteristics of each deal, but on average amounts to approximately 40% (Pyykkö, 2010). Under the efficient market hypothesis, the shareholder premium will be equal to or lower than the expected increase in cash flows realised by the acquisition. Other variables, such as managerial hubris, may nonetheless bring the premium paid above expected future gains. Moreover, expected gains may not ultimately materialise.

Recovery. Takeover costs being non-negligible, they may substantially affect the financial situation of the offeror. For instance, the offeror may be forced to reduce the amount spent on research and development, at least in the short term. Alternatively, it may seek to recover some of these costs by expropriating rents from other stakeholders, including employees. These disruptions stemming from the impact of takeover costs on the financial situation of the offeror are likely to be limited to the short term, but nevertheless affect competitiveness negatively.

Distribution. Redistribution concerns also affect the impact of takeovers on competitiveness. The question to be asked concerns the origin of the gains captured by the takeover premium and advisory fees. Where these gains are disproportionately realised at the expense of employees and other stakeholders, what may appear as a zero-sum game is unlikely to be economically neutral. Expropriating wealth from employees and other stakeholders may negatively impact competitiveness by reducing such parties' incentives to undertake firm-specific investments (Maher and Andersson, 1999). The foregoing assertion is not intended to discredit all forms of restructuring arising in the aftermath of a takeover bid. Restructuring can streamline procedures, incentivise performance and reduce superfluous costs and free-riding (i.e. improve operational efficiencies). It therefore has the potential to increase the productivity of the company without reducing the incentives of stakeholders to undertake firm-specific investments, thereby increasing competitiveness. Still, where the costs incurred in the transaction are high, management may face enormous pressure to recoup such costs in the short term. Clever restructuring may then turn into predatory cost-cutting to the detriment of competitiveness and growth. Redistribution concerns also have repercussions on public finances, which may be negatively affected by the socialisation of some of the losses realised by restructuring.

Time. A further complexity in determining the impact of takeovers on competitiveness concerns the time horizon. In this regard, it is worth highlighting that the costs involved in a takeover deal are, by their very nature, one-off costs, while efficiency gains have the potential to be dynamic and long-term. Addressing the long-term impact of takeovers on company performance is a difficult exercise given the challenges of isolating the effect of the takeover from other factors. As such, evidence in this regard is limited (Martynova and Renneboog, 2006).

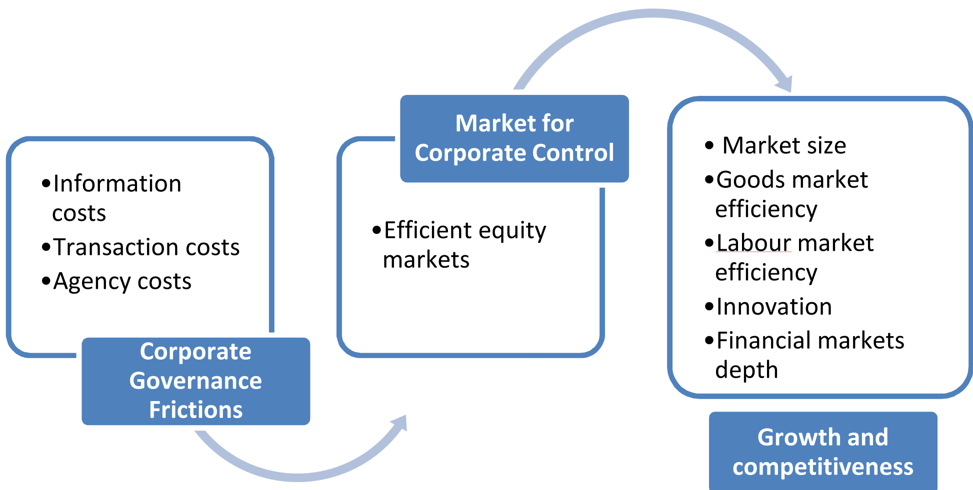
Ownership concentration. On a different note, the level of shareholder concentration resulting after a takeover is also likely to have an impact on competitiveness and growth (Maher and Andersson, 1999). The absence of stable shareholders can curtail the ability of management to pursue long-term value creation and induce it to prefer projects with short-term payoffs instead. This phenomenon may occur where there is high ownership dispersion and managers face a continuous threat of dismissal. Conversely, ownership concentration reduces the agency problems between management and shareholders, although its effects on performance are unclear given the higher risk of extraction of private benefits. National legislation strives to adapt to the level of ownership and control the concentration prevalent in the jurisdiction, while legislation also shapes it by enforcing such rules as the one share–one vote principle.

The academic literature presents mixed evidence on the link between ownership concentration and corporate performance. Distinguishing between short-term and long-term performance appears particularly difficult in this regard. In a survey of the relevant literature, Maher and Andersson (1999) conclude that the results are country- and sector-specific, but that performance tends to increase in line with concentration at low levels of concentration. At the same time, higher shareholder concentration increases the risk of extraction of private benefits, which the literature has found to be significant (Zingales, 1994; Barca, 1995 in Maher and Andersson, 1999). Private benefits exceeding the compensation for control and non-diversification are inefficient and will negatively impact competitiveness.

Stakeholders. Corporate governance is thought to affect performance at the level of the company as well as the overall competitiveness and growth of the economy (Maher and Andersson, 1999). Balancing the interests of the different stakeholders involved appears crucial in this regard. As a precondition, shareholder protection is essential to maximise the amount of resources invested in the economy. Where shareholders face the risk of expropriation by management or controlling blockholders, their willingness to invest will be reduced (La Porta et al., 1997, 1998). That being stated, shareholders are not the only agents who invest in the corporation. Other

stakeholders, such as employees and suppliers, also undertake company-specific investments that have a direct impact on company performance and competitiveness. The engagement of all stakeholders is of particular importance in activities with high asset specificity and added value (Maher and Andersson, 1999; Mayer, 1996).

Figure 30. Virtuous cycle of takeovers



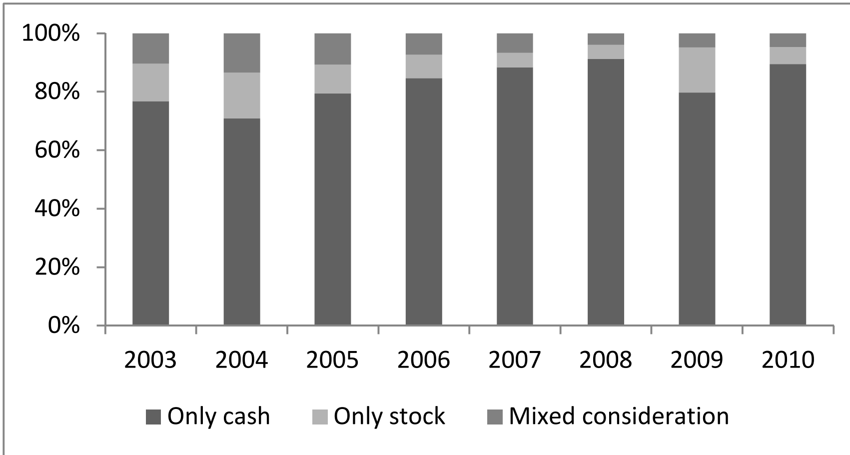
Source: Authors.

Box 10. Method of payment and consideration in takeovers

Figures B10.1 and B10.2 present the payment method and the distribution of the consideration paid by acquirers in takeovers in Europe. More than 70% of deals are settled using cash alone, which makes up most of the consideration paid overall.

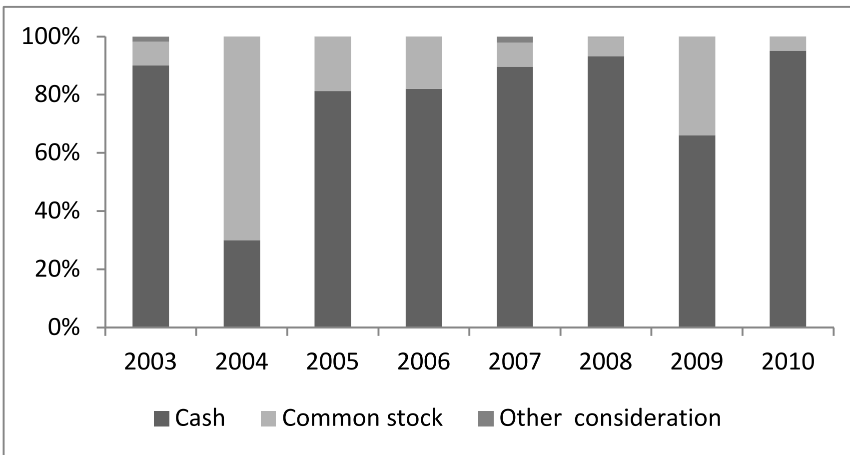
A fair amount of research has been conducted on the impact of the method of payment on the gains of the offeree company shareholders and company performance. Martynova and Renneboog (2006) conducted a review of this literature and concluded that the method of payment does not influence long-term performance.

Figure B10.1 Number of takeover deals by method of settlement



Source: Authors' elaboration based on Thomson Reuters SDC Platinum.

Figure B10.2 Consideration paid in takeover deals in Europe



Source: Authors' elaboration based on Thomson Reuters SDC Platinum.

13.2.2 Linking takeovers to the pillars in the Global Competitiveness Index

This subsection considers the potential effect of takeovers on competitiveness with reference to selected pillars of the Global Competitiveness Index that have the most direct connection to takeover activity (see Table 39; Table 47 at the end of this subsection also presents a summary).

Table 39. Linking the pillars in the Global Competitiveness Index to takeovers

Global Competitiveness Index	Impact on takeovers
Higher education	–
Innovation	Yes
Technological readiness	Yes
Business sophistication	Yes
Infrastructure	–
Goods market efficiency	Yes
Health and primary education	–
Training	–
Labour market efficiency	Yes
Market size	Yes
Development of financial markets	Yes
Institutions	–
Macroeconomic environment	–

Source: Authors.

a) Goods market efficiency. Efficient markets are those able to produce the right mix of products and services given demand and supply conditions while ensuring their effective distribution (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 40).

Table 40. The determinants of goods market efficiency in the GCI

Determinants			
Supply responsiveness	Efficient distribution	Healthy market competition	Minimum red tape
Moderate and neutral taxation	Openness to foreign direct investment	Trade openness	Customer orientation and sophistication

Source: WEF GCI.

Scale and scope. Takeovers have the potential to increase the efficiency and productivity of a company in supplying the goods and services demanded by the economy (Thomsen, 2007; Maher and Andersson, 1999). The realisation of economies of scale and scope are particularly apt to generate efficiency gains that affect not only production, but also research, marketing and distribution, with a positive impact on the economy as a whole (OECD, 2001). These effects are assumed to be more significant where takeovers are transnational, given the increase in market size and trade (OECD, 2001). Company restructuring following a takeover also has the potential to streamline procedures,

incentivise performance and reduce superfluous costs. Supply responsiveness and the efficiency of distribution can therefore be positively transformed as a result of takeover activity.

Competition. The effect of takeovers on competition remains unclear and depends on the circumstances of each deal. By increasing concentration, takeovers alter the structure of the marketplace and may therefore negatively impact competitive dynamics. This is why takeovers are frequently subject to screening by competition authorities, as in the EU Merger Regulation (139/2004) (Art. 3.1(b)). Takeovers may result in the accumulation of dominant positions, which may later be abused, but may also disrupt market structures, rendering the latter unable to deliver the benefits that follow from competition (Whish, 2009). There is evidence that takeovers may lead to a reduction in competition and increased prices, although this evidence does not in any way establish a general rule (Thomsen, 2007). For instance, it is important to differentiate between horizontal takeovers, involving companies that compete at the same level of the production chain, and vertical takeovers, which involve companies at different levels and are therefore less likely to reduce competition. Moreover, in sectors engaged in transnational consolidation, the geographical focus of the marketplace will shift to the international level without necessarily reducing competition. Overall, therefore, the impact of takeovers on competition is difficult to anticipate.

b) Market size. Market size allows companies to reach economies of scale, thereby increasing productivity (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 41).

Table 41. The determinants of market size considered in the GCI

Determinants			
Domestic market size	Trade openness	Economic integration	Legislative integration

Source: WEF GCI.

Efficient scale. Takeovers have the potential to help business gain an efficient scale, thereby increasing both business size and productivity (Martynova and Renneboog, 2006). In the context of the EU, market size is realised through the legislative and economic integration of the national markets of member states, which come together to form the single market (see Box 11). Transnational takeovers of a European dimension are therefore instrumental to the constitution of the single market. An open market for corporate control is a useful tool to develop an international production base (Maher and Andersson, 1999) and to secure the potential for economies of scale

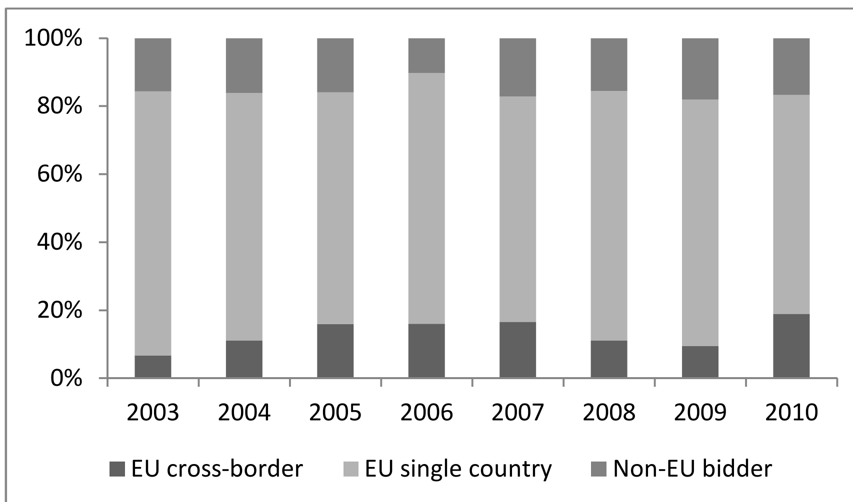
and scope within the single market. In addition, transnational takeovers tend to increase trade integration for both the final product and intermediate supplies (Thomsen, 2007). Furthermore, by facilitating trade integration, transnational takeovers can play a role in fostering political stability (Thomsen, 2007). A larger market size is expected to increase the mobility of resources and boost competition for these resources, thereby directing them towards more productive utilisation (OECD, 2001).

Box 11. Integration of the European market for corporate control

The number of cross-border takeovers in the EU has increased since 2003, although relatively speaking, it was more strongly affected by the financial crisis in 2008 and 2009 than takeovers taking place within the same EU country and deals involving a non-EU offeror (Figure B11.1).

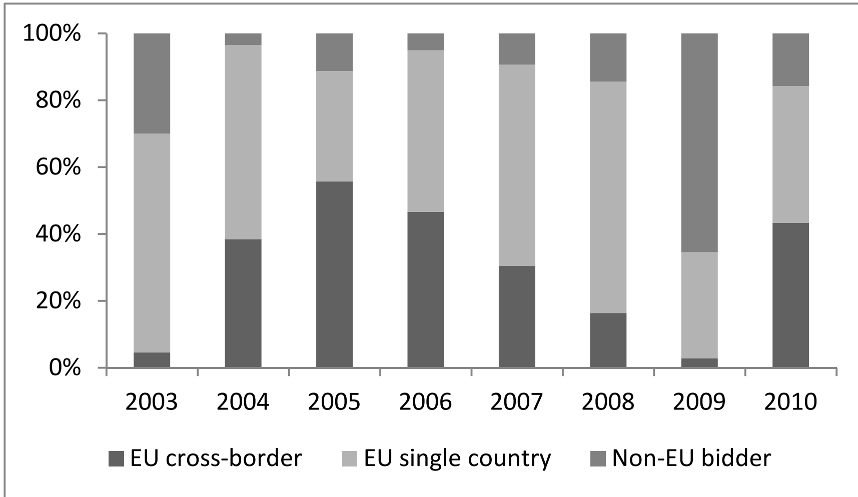
In terms of value, the share of EU cross-border deals is very significant but has varied widely over time. In 2005, EU cross-border deals accounted for more than 50% of the total value of takeovers. This share decreased considerably in the following years but recovered in 2010 (see Figure B11.2).

Figure B11.1 Number of takeovers by location of the parties



Source: Authors' elaboration from Thomson Reuters SDC Platinum.

Figure B11.2 Value of takeovers by geographical location of the parties



Source: Authors' elaboration from Thomson Reuters SDC Platinum.

c) Labour market efficiency. Efficient labour markets are those where human resources are best allocated and are appraised by their performance (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 42).

Table 42. The determinants of labour market efficiency in the GCI

Determinants			
Allocation flexibility	Wage flexibility	Incentives based on performance	Gender equality

Source: WEF GCI.

Human resources. Takeovers have the potential to further the efficient management of human resources at the company level, thus increasing competitiveness (the effect of takeovers on employment and labour market efficiency is the object of a separate chapter in this study). Three main factors are involved: i) the presence of exploitable inefficiencies in the offeree company and any restructuring plans of the offeror devised to capture the benefits available; ii) the business plan of the offeror and the success of the deal, which may result in business expansion over the medium term and an increase in workforce numbers; and iii) the engagement of employee representatives and management to mitigate the effects of restructuring on individual employees. There is evidence that acquisitions are used by some European companies to reach their optimal employment levels, which they

cannot otherwise reach given strict employment protection legislation (Gugler and Yurtoglu, 2004).

d) Technological readiness. Technological readiness is a measure of the capacity of the economy to best dispose of technology to enhance productivity (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 43).

Table 43. The determinants of business sophistication considered in the GCI

Determinants			
ICT penetration	Technological availability	Readiness for adoption	Customisation

Source: WEF GCI.

Information and communication technology (ICT). Takeovers may boost the development and application of ICT, given that it is instrumental in managing bigger or more diversified organisations. ICT allows for more flexible business practices, swifter communication and better customisation of products and services. It is therefore crucial for the integration of regional and national markets, helping to reap economies of scale and scope (OECD, 2001). At the same time, organisations with a multi-product or multi-market base are more likely to invest in ICT to satisfy their increased need for technology, which springs precisely from their presence in different markets.

e) Innovation. Innovation is measured by the ability to further the frontiers of knowledge, beyond the integration and adaptation of exogenous technologies (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 44).

Table 44. The determinants of innovation considered in the GCI

Determinants			
Research and development	Public sector support	Quality research institutions	Networks and clusters
Protection of intellectual property	–	–	–

Source: WEF GCI.

Transfer of technology. Takeovers are thought to foster the transfer of technology between offeror and offeree companies, both internally and by enabling access to third-party providers and networks. Transnational takeovers are particularly useful in this regard, since they bring together providers and experts operating in different markets and jurisdictions (OECD,

2001; Sachwald, 2000). Learning effects may have a positive impact in increasing the innovative capabilities of actors and economies on both sides. Countries at an intermediate stage of development, such as member states that have acceded to the EU more recently, are expected to benefit the most from technological transfers. Countries at a further stage of development, closer to the technological frontier, benefit less from transfers themselves and more from positive externalities arising from the formation and consolidation of networks (Thomsen, 2007; OECD, 2001; Al Azzawi, 2004). On a different note, the distribution of the benefits arising from technological transfers depends to a large extent on the location of research and development (R&D) facilities, which may be relocated, thus disadvantaging one of the parties involved in the takeover.

Volume of research. Alongside technology transfers, takeovers are also likely to affect the volume of research undertaken by both the offeror and offeree companies. The amount of resources dedicated to R&D may decrease owing to rationalisation and the pooling of programmes and competencies following the takeover. Still, such a reduction is unlikely to weaken R&D outcomes and may instead strengthen them. It is not possible to advance a general rule; rather, it is the business plan of the acquirer that will determine the amount of resources that the acquiree allocates to research and development. Nevertheless, as previously discussed, the costs incurred through the takeover deal may result in a reduction of the financial ability of both the offeror and the offeree company to invest in R&D, at least over the short to medium term.

Market for corporate control. The level of activity in the market for corporate control also has an impact on research and innovation. The evidence, however, is mixed. An inactive market for corporate control may incite management to stifle innovation in order to avoid stimulating product competition and thus "creative self-destruction" (Morck, 2000; Morck and Yeung, 2004). On the other hand, it may encourage company-specific investments and long-term internal innovation by reducing pressures on management and employees to perform in the short term (Hitt et al., 1996). In practice, companies that are the object of a continual takeover threat are likely to invest less in internal innovation and rely more on external sources (Hitt et al., 1996). Furthermore, stimulating product competition may offset any reduction in innovation because of the lack of activity in the market for corporate control. It is well established that strong monitoring of dominant behaviour and anti-competitive practices is necessary to avoid takeovers having pervasive effects on the economy, in terms of both higher prices and reduced innovation.

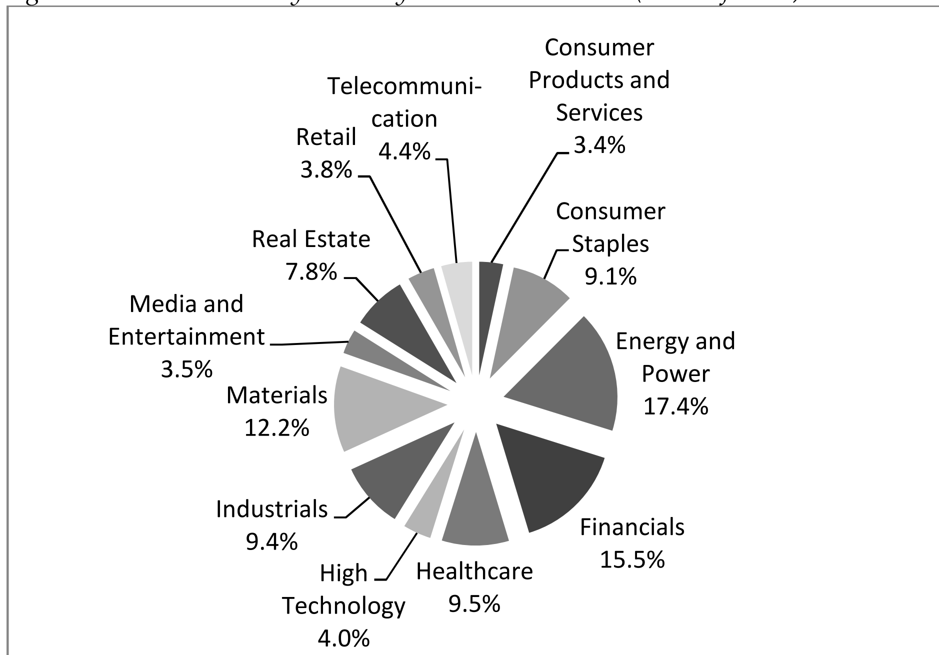
Ownership concentration. The level of ownership and control concentration arising after the bid is not neutral to innovation either. Concentrated control of corporate assets may distort capital allocation and reduce the rate of innovation (Morck and Yeung, 2004). Yet dispersed ownership and control, if coupled with a lack of stable shareholders, may induce short-termism in managerial behaviour and also reduce the rate of innovation. Balanced ownership structures are likely to avoid the misallocation of resources and maximise innovation.

Box 12. Takeovers by industry subsector

Figures B12.1 and B12.2 present the distribution of takeover deals and value per industry subsector in the sample considered in this study.

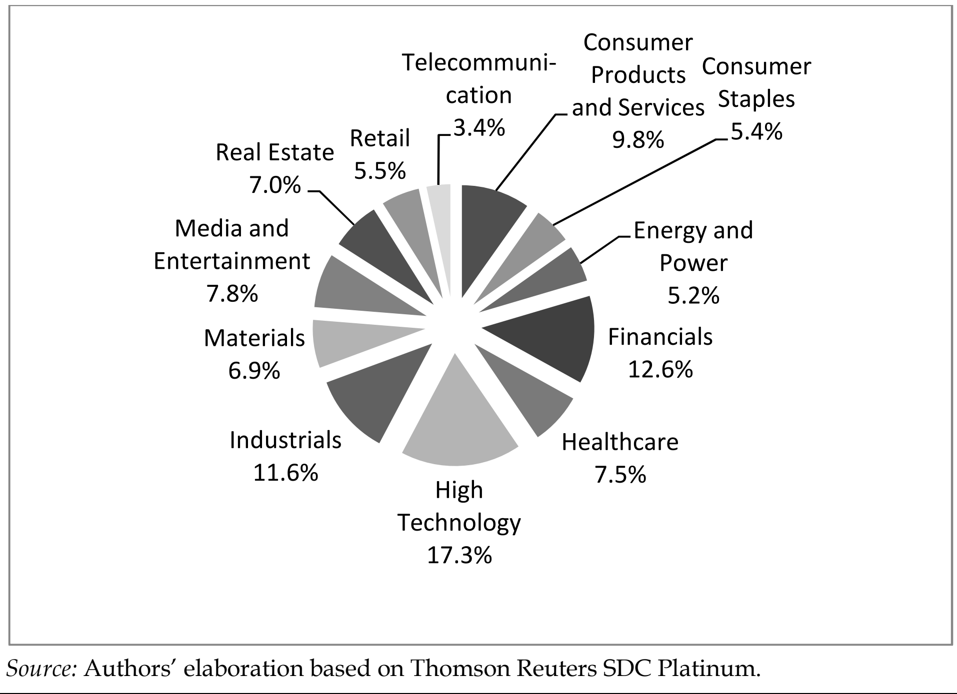
Takeovers occur in all sectors but more frequently in the energy and power, financial and materials sectors. The distribution of value follows a different pattern, however. Most notably, while the high technology subsector attracts only 4% of the deals, these deals are worth 17% of the total value across sectors.

Figure B12.1 Takeovers by industry subsector 2003–10 (value of deals)



Source: Authors’ elaboration based on Thomson Reuters SDC Platinum.

Figure B12.2 Takeovers by industry subsector 2003–10 (number of deals)



Source: Authors' elaboration based on Thomson Reuters SDC Platinum.

f) Business sophistication. Business sophistication measures the quality of business networks and clusters within an economy (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 45).

Table 45. The determinants of business sophistication considered in the GCI

Determinants			
Quantity and quality of local suppliers	Business networks	Business clusters	Position in value chain

Source: WEF GCI.

Networks and clusters. Takeovers have the potential to result in the formation and consolidation of both business networks and clusters. For instance, this potential is particularly high in the case of transnational takeovers, where there is scope for the creation of networks across markets that would otherwise be difficult to achieve. The effect of takeovers on the creation of networks and business sophistication is not restricted to the acquirer and acquiree, but frequently extends to resource providers that did not previously interact. In the context of the EU, establishing business networks across

different member states allows actors to reap the potential of the single market for competitiveness and growth.

Vertical spillover. Where takeovers connect companies working at different levels of the value chain, they also have the potential to strengthen the position of both companies. They may, for instance, allow for more efficient sourcing or distribution, resulting in more efficient production processes and the better targeting of consumers. At the same time, takeovers result in the transfer of know-how and skills that have the potential to raise the level of sophistication of the companies involved, together with that of their suppliers and distributors.

g) Development of financial markets. Efficient financial markets channel resources to the soundest economic activities (Sala-i-Martin and Schwab, 2011, pp. 5-8; see also Table 46).

Table 46. Determinants for the development of financial markets considered in the GCI

Determinants			
Depth	Access to capital	Prudential regulation	Transparency and investor protection

Source: WEF GCI.

Equity markets. An active market for corporate control is linked to the existence of functioning equity markets. It simultaneously increases the efficiency of these markets by providing opportunities for the valuation and transfer of control, allowing investors to acquire such control and channel their capital towards value-creating investments (Rajan and Zingales, 2003). Where ownership and control are dissociated, the protection of investors is essential to foster their participation in capital markets. In any case, corporate governance (and takeover regulation) affects the development of capital markets and therefore resource allocation (capital mobility), ultimately affecting competitiveness and growth.[70]

Capital markets. Despite criticism stemming from the recent financial crisis concerning resiliency in distressed times, financial markets unquestionably tend to solve problems related to information asymmetries and transaction frictions (Levine, 1997). Moreover, they represent the most efficient

[70] Certain authors, such as Lucas (1988), argue that the impact of the financial system on economic growth is limited and reject the notion of a strong link between finance and growth.

tool available in promoting the contestability of control, even at the cross-border level. Following Levine (1997), financial markets address transaction costs, which may impede an efficient allocation of resources, by (among other things) exerting control over companies' performance and management. It follows that this situation is most likely to favour growth through capital accumulation and technological innovation.

Long-term investments. It is nonetheless crucial to design a financial system that creates liquidity around long-term investments, which ultimately produce high returns, through the proper mix of financial contracts, markets and institutions (Boyd and Smith, 1996). A financial system that is designed around the need to increase returns in the short term due to widespread short-term funding needs may not generate sufficient liquidity for long-term investments. This in turn stunts the development of technological changes and innovation, and consequently greater competitiveness and growth. This will impinge on growth and will potentially push the entire financial system to the brink of a broader collapse. A financial system that lowers the monitoring costs over the efficiency of investments increases company performance and competitiveness. If markets are able to price and provide liquidity for long-term projects, they will also reduce incentives to increase ownership concentration to protect long-term projects.

Table 47. Competitiveness indicators affected by takeover activity

Country/ economy	Avg. index	Goods market efficiency	Market size	Labour market efficiency	Technological readiness	Innovation	Business sophistication	Development of financial markets
Greece	**3.78**	3.91	4.52	3.71	4.06	3.00	3.41	3.88
Romania	**3.83**	4.08	4.41	4.32	3.82	2.94	3.24	4.01
Slovakia	**4.08**	4.34	3.97	4.66	4.48	2.95	3.54	4.61
Hungary	**4.10**	4.16	4.27	4.46	4.41	3.55	3.71	4.16
Italy	**4.13**	4.16	5.63	3.81	4.12	3.40	4.11	3.70
Portugal	**4.16**	4.32	4.34	3.85	4.63	3.77	3.98	4.26
Estonia	**4.22**	4.71	2.89	4.91	4.94	3.68	3.90	4.50
Cyprus	**4.22**	4.97	2.82	4.64	4.4	3.66	4.07	5.01
Poland	**4.26**	4.38	5.08	4.58	4.02	3.31	3.76	4.66
Spain	**4.27**	4.20	5.47	3.88	4.64	3.47	3.96	4.28
Czech Rep.	**4.42**	4.58	4.47	4.75	4.55	3.92	4.19	4.49
Ireland	**4.53**	5.09	4.20	4.87	4.99	4.25	4.55	3.79
Austria	**4.80**	5.00	4.59	4.75	5.09	4.48	4.97	4.74
Belgium	**4.84**	5.08	4.77	4.64	5.22	4.59	4.91	4.64
Luxembourg	**4.87**	5.49	3.16	4.71	6.11	4.53	4.76	5.35

Table 47. cont'd

Country/ economy	Avg. index	Goods market efficiency	Market size	Labour market efficiency	Technological readiness	Innovation	Business sophistication	Development of financial markets
France	**4.92**	4.69	5.76	4.47	5.28	4.48	4.83	4.96
Denmark	**5.06**	5.10	4.25	5.47	5.62	4.89	5.15	4.94
Finland	**5.07**	4.92	4.15	4.85	5.17	5.56	5.43	5.38
Netherlands	**5.10**	5.17	5.10	4.83	5.99	4.77	5.16	4.71
UK	**5.14**	4.96	5.80	5.29	5.58	4.65	4.98	4.73
Germany	**5.15**	4.97	6.01	4.40	5.36	5.19	5.51	4.62
Sweden	**5.31**	5.30	4.58	4.89	6.12	5.45	5.67	5.15

Source: WEF (2011).

13.3 The Directive and competitiveness

Regulatory environment

The impact of takeovers on competitiveness is strongly influenced by the regulatory environment in each jurisdiction. For instance, dysfunctional factor and product markets may limit the forecasted efficiency gains, while discrimination against foreign companies, as in public procurement, will hamper transnational deals and reduce their potential for generating efficiency gains. Conversely, well-grounded national policies in the areas of research, education and skills will boost the positive effects of takeovers, while at the same time diminishing the chances of relocation (Thomsen, 2007).

Corporate governance

Takeover regulation needs to be understood as part of the broader system of corporate governance, which impacts on productivity and competitiveness. To foster productivity and competitiveness, corporate governance must achieve a complex balance. It needs to be capable of attracting long-term capital by privileging the interests of shareholders, while at the same time taking into account the interests of employees and other stakeholders, whose performance determines productivity and competitiveness (OECD, 2001).

Economic integration

Takeover regulation also needs to effectively take into consideration the increasingly international nature of deals, given the growing importance of cross-border mergers and acquisitions (OECD, 2001). In the case of the single European market, harmonising takeover regulation appears to be a necessary element for the proper governance of deals and the reduction of arbitrage. A common set of rules is expected to increase the efficiency of the market for

corporate control and have a positive impact on competitiveness. The crucial questions, however, are what level of legislative integration is most adequate and whether such regulation should be based on full or partial harmonisation. As stated in every discussion on the Directive, there is no full harmonisation of takeover regulation in Europe. Partial harmonisation is combined with the introduction of a number of optional provisions that member states may or may not transpose into national law. Notably, the board neutrality rule and the breakthrough rule are optional provisions of this kind.

Harmonisation

There is a lack of consensus as to the desirable level of harmonisation. Homogenous rules can have widely different effects in practice depending on the ownership structure prevalent in each country (Ventoruzzo, 2008; Goergen et al., 2005). Optional provisions would therefore be a useful approach to account for national diversities in the governance structure (McCahery et al., 2010). Even so, optionality comes at the expense of lower legal certainty and higher transaction costs (Humphery-Jenner, 2010; Davies et al., 2010; Clarke, 2009; Enriques, 2004). Partial harmonisation may even result in a race to the bottom in connection with regulatory standards. In this regard, the Commission concluded in 2007 that the "number of member states implementing the Directive in a seemingly protectionist way is unexpectedly large" (European Commission, 2007a).

Mandatory bid rule

The level of concentration of ownership and control in the offeree company appears to be a main determinant of the impact of the Directive's provisions. In the case of a dispersed ownership structure, the mandatory bid rule protects minority shareholders from the entrance of a large blockholder (see Table 48). Meanwhile, in the case of concentrated ownership, it also protects the incumbent blockholder by making the acquisition more costly due to the fair price rule. But if the takeover goes forward, the mandatory bid rule will protect minority shareholders in concentrated ownership structures the most, by forcing the acquirer to offer the control premium to all shareholders. Higher transaction costs are likely to have a negative impact on competitiveness at both the company level and throughout the economy as a whole. For instance, costs may disrupt research and development in the short term or be passed on disproportionately to employees, reducing the incentives to commit to firm-specific investments.

Table 48. Impact of key Directive provisions according to ownership structure

	Concentrated ownership/control		**Dispersed ownership/control**	
	Positive impact	**Negative impact**	**Positive impact**	**Negative impact**
Mandatory bid rule	☺ Protects minority shareholders	☹ Raises costs of takeover	☺ Protects minority shareholders	☹ Raises costs of takeover
Board neutrality rule	😐 None	😐 None	☺ Protects shareholders	☹ Does not allow the interests of other stakeholders to be taken into account
Breakthrough rule	☺ ? May reduce extraction of private benefits	☹ ? Does not allow the interests of other stakeholders to be taken into account	😐 None	😐 None

Source: Authors' elaboration.

Board neutrality rule

Ownership and control concentration also determine the effect of the board neutrality rule. In the case of dispersed ownership, this rule addresses the agency problem between management and ownership and thus protects shareholders. Yet in the case of concentrated ownership, the rule becomes irrelevant for the protection of minority shareholders given the alignment of interests between blockholders and management. At the same time, the board neutrality rule is non-neutral for competitiveness. On the one hand, by protecting shareholders, the rule maximises their incentives to invest, therefore contributing to the development of capital markets, the links of which with competitiveness and growth are well established (La Porta et al., 1997, 1998). On the other hand, by removing all power of decision from the board, the rule may not allow for the proper consideration of the interests of other stakeholders, including employees, whose contribution to competitiveness and growth is also of great importance.

Breakthrough rule

The breakthrough rule likewise affects competitiveness. The rule is tantamount to the introduction of the one share–one vote principle on an *ex-post* basis. It

facilitates changes in corporate control where concentration of ownership and control diverge owing to the use of control-enhancing mechanisms, notably dual shares. By facilitating changes of control where dual-class shares are present, the breakthrough rule is likely to deter the use of such shares, which is to some extent associated with the exploitation of private benefits of control. If rights are altered on an *ex-post* basis, however, it introduces legal uncertainty and can therefore negatively affect the development of financial markets. In contrast, the rule is ineffective where pyramid holdings are used, rendering its effects less clear. Moreover, it has not been transposed in any member state except Estonia. Like the mandatory bid rule, the breakthrough rule may reduce the scope for the interests of stakeholders to be factored into the takeover process due to the enforcement of the one share–one vote principle.

Squeeze-out rule

The squeeze-out right also affects competitiveness by reducing the hold-up problem and facilitating changes in control. Most importantly, the squeeze-out right affords the offeror the possibility to gain full control of the offeree company by excluding residual shareholders, de-listing the offeree company and making it a private company. Hence, the impact of the squeeze-out right on competitiveness depends on the trade-off between remaining public or going private. The strengths and drawbacks of public versus private companies is a broad question beyond the scope of takeover regulation and hence this study.

Summary

Table 49 summarises the discussion above with reference to each of the pillars in the Global Competitiveness Index for the mandatory bid rule and the board neutrality rule. The former, by protecting minority shareholders, has a positive impact on the development of capital markets, in particular where ownership is concentrated – by forcing the acquirer to offer the control premium to all shareholders. At the same time, by raising the cost of acquiring control, the mandatory bid rule may negatively affect the other determinants of competitiveness. For instance, it may deter some takeovers with a potential to generate efficiencies and increase the geographical scope of good markets. This higher cost may also result in a reduction of the funds invested in human resources or research and development, at least over the short to medium term. As to the board neutrality rule, it is only relevant where the interests of managers and owners are not aligned, that is, where ownership is dispersed. By granting shareholders full decisional power, board neutrality promotes the development of financial markets. Furthermore, since it does not allow management to adopt defensive measures, the rule facilitates takeovers,

including those with a potential to generate efficiencies and increase the geographical scope of good markets. Still, board neutrality limits the extent to which stakeholders' interests are taken into account in the takeover process, reducing their incentives to undertake company-specific investments.

Table 49. Impact of key provisions of the Directive on competitiveness

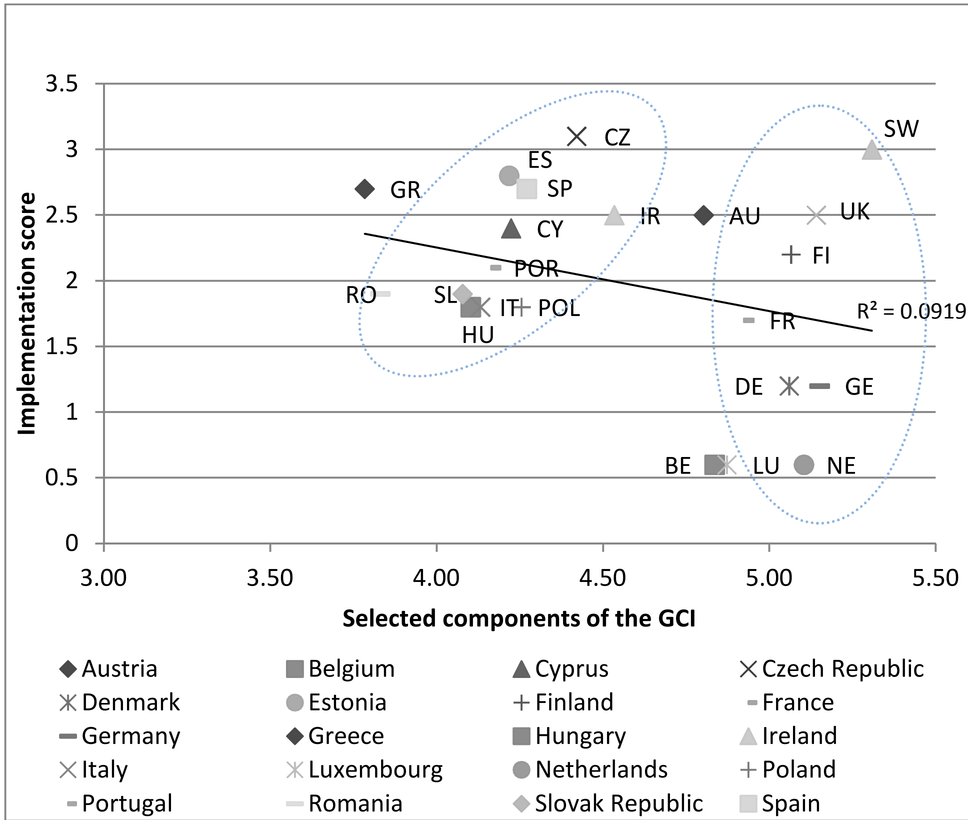
	Concentrated ownership		Dispersed ownership	
Global Competitiveness Index	**Mandatory bid rule**	**Board neutrality rule**	**Mandatory bid rule**	**Board neutrality rule**
Goods market efficiency	☹	😐	☹	☺
Market size	☹	😐	☹	☺
Labour market efficiency	☹	😐	☹	☹
Technological readiness	☹	😐	☹	😐
Innovation	☹	😐	☹	😐
Business sophistication	😐	😐	😐	😐
Development of financial markets	☺	😐	😐	☺

Source: Authors' elaboration based on WEF GCI.

13.4 Empirical analysis

Application. The link between the Directive and competitiveness is difficult to establish empirically. An indication may be obtained by mapping member states' transposition and their respective positions in terms of competitiveness. Figure 31 compares the scores for implementation of the Directive with an indicator of competitiveness based on the average scores for the selected pillars of the GCI. There appears to be a positive link between better transposition and higher competitiveness for those countries with low to medium GCI scores. Notably, however, countries with high GCI scores have transposed the Directive in dissimilar ways, achieving both high and low implementation scores rather than median ones. Mapping of this kind is illustrative and does not allow general conclusions to be drawn. It shows that the impact of the Directive on competitiveness and growth is limited. That notwithstanding, it provides some indication that transposition close to the mean tends to be associated with relatively poor competitiveness. It also shows that poor transposition is not necessarily linked to low competitiveness.

Figure 31. Competitiveness and transposition of the Directive

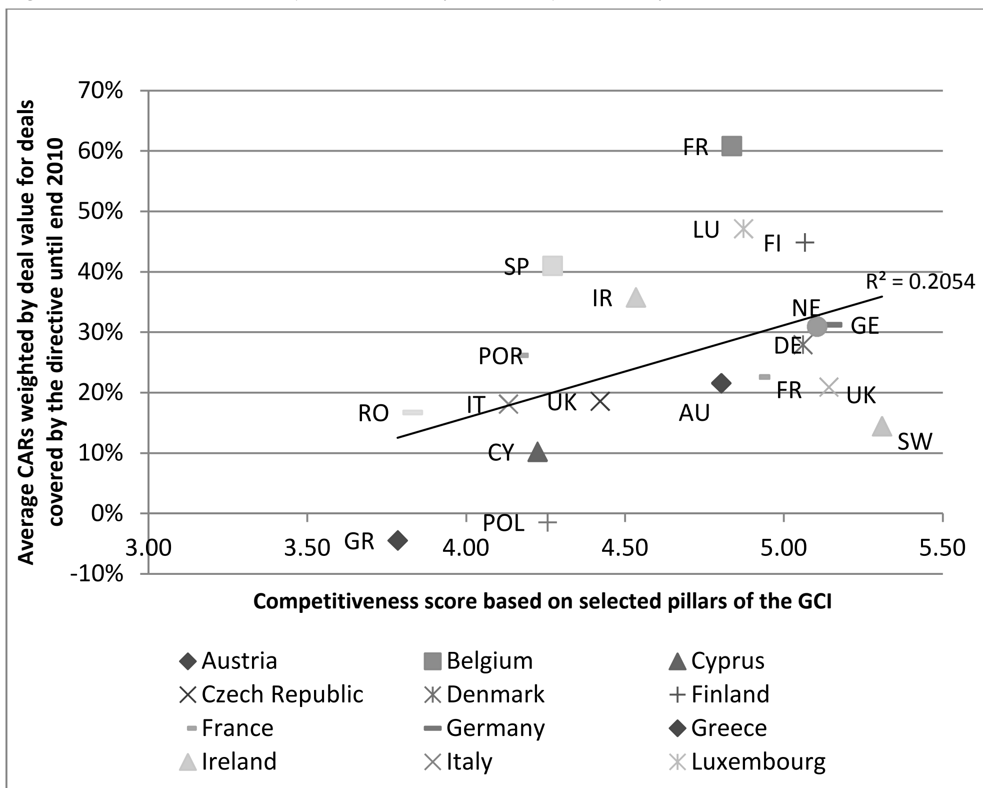


Source: Authors' elaboration.

Abnormal returns. Cumulative abnormal returns for offeree company shareholders appear to be positively correlated to competitiveness. While this result does not reflect the impact of the Directive itself, it shows a link between shareholder returns and the level of competitiveness in the country of the offeree company. This evidence is consistent with the relevance attributed by the academic literature to country-specific variables in the performance of mergers and acquisitions (Maher and Andersson, 1999; Pyykkö, 2010). Figure 32 features the average CARs accruing 41 trading days before and after the announcement of a takeover. It considers over 500 takeover deals that took place after the transposition of the Directive in each member state until 2011, where such takeovers aimed at acquiring control of an offeree company based

in the EU.[71] Data was kindly provided by Thomson Reuters for the purpose of this study from its SDC Platinum and DataStream databases. Cumulative returns take as a benchmark the STOXX Europe 600 Index corresponding to the sector or industry of the offeree company. A positive trend appears where CARs are mapped at the country level and the indicator of competitiveness is based on selected pillars of the GCI. Yet given the many caveats discussed in the previous sections, the use of stock market returns as an indicator of takeover performance needs to be treated with caution. The econometric analysis (see Appendix 5) confirms this relationship with significance and relevant impact.

Figure 32. CARs and competitiveness after transposition of the Directive



Source: Authors' elaboration based on Thomson Reuters SDC Platinum, Datastream and STOXX sector indices.

71 Takeovers are filtered according to the stake held by the acquirer before announcement. The goal of takeovers is deemed to be acquiring control where the acquirer held less than 51% of the shares before announcement.

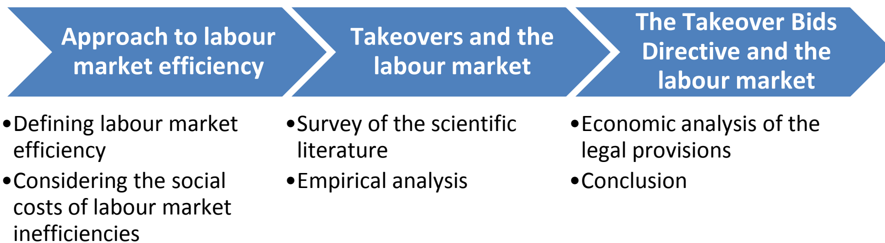
The evidence highlights the link between stock market returns for the shareholders of the offeree company and the level of competitiveness of the target member state. It does not, however, directly address the question of the impact of takeovers on competitiveness. Given the almost infinite number of factors that explain the level of competitiveness and growth in an economy, it is not possible to isolate the impact of takeovers in an econometric regression. Nonetheless, the mapping above represents a valuable indication of the relevance of takeover activity to country-wide competitiveness and growth.

14. IMPACT OF THE DIRECTIVE ON EMPLOYMENT AND EMPLOYEES

Introduction

Takeover deals result in a transfer of control that is likely to affect employees in diverse ways depending on the business plan of the acquirer. Where a takeover is followed by restructuring, collective lay-offs may occur, which worries both employees and public authorities. To address the impact of takeovers on employment and employees, this chapter follows a methodology based on three steps: 1) defining labour market efficiency with reference to the flexicurity approach, 2) considering the links between takeovers and employment, and 3) referring to the rules in the Takeover Bids Directive (see Figure 33).

Figure 33. Methodology – Impact of the Directive on employment and employees



Source: Authors.

14.1 Approach to labour market efficiency

Approach

Given the many different approaches to employment protection and labour market efficiency, considering the effects of the Directive on employment is by no means straightforward. Exploiting any inefficiency in the management of human resources in the offeree company may constitute part of the economic rationale of a takeover. In this regard, the offeror may wish to apply changes in employment conditions – such as salary, working schedules or training – that will directly affect employees. Similarly, employment levels may be reduced or increased depending on the business plan of the offeror and the existence of expansion opportunities. Before discussing these effects, it is important to clarify the approach to employment protection and labour market efficiency that will be followed.

Flexicurity

Modern labour market policy in the EU is built upon the 'flexicurity' approach, which recognises the need for a flexible workforce given global competition and rapidly changing economic conditions. It therefore acknowledges that restructuring, such as that which might follow a takeover bid, can have a positive effect on productivity and competitiveness within the company and the economy as a whole. On the other hand, flexicurity gives equal importance to the individual and social costs of changes in employment levels and working conditions. To address these costs, the emphasis is placed on the effectiveness of active labour market policies and comprehensive, lifelong learning strategies, along with modern social security systems. The goal is to ensure that human resources are efficiently reallocated so workers do not face long periods of unemployment, thereby reducing the risks associated with social exclusion and budgetary burdens on the state.[72]

14.2 Effects of takeovers on employment

Available evidence

Empirical evidence on the effects of takeovers on the labour market is scarce owing to insufficient data collection and dissemination. Where data exist, they are anecdotal and while indicative, cannot be taken as fully representative. In addition, empirical studies face a number of methodological constraints that have so far not been overcome:

- finding control groups of comparable companies where no takeover has taken place;
- disentangling organic job growth from acquisitions and divestitures;
- taking into account jobs created elsewhere, through outsourcing;
- measuring efficiency and productivity gains; and
- accounting for the distributional effects of efficiency and productivity gains obtained through collective dismissals and early retirement schemes.

[72] See European Commission (2007b); see also Council of the European Union, Towards Common Principles of Flexicurity – Draft Council Conclusions, 15497/07, Brussels, 23 November 2007.

European Monitoring Centre on Change database

The most useful pan-European database for assessing the overall effects on employment levels is compiled by the European Monitoring Centre on Change (EMCC), which considers planned job creation and reductions according to the type of restructuring: bankruptcies and closures, business expansions, mergers and acquisitions, off-shoring and delocalisation, outsourcing, relocation and other internal restructuring. The database, however, relies solely on information available in public media.[73]

Mergers

The EMCC database considers takeovers not as a separate category, but within the category of mergers and acquisitions. In this category, average net job creation was negative from 2002 to 2010, except for 2007 where exceptional planned creation was registered (see the data summarised in Table 50 and the complete table in Appendix 2). To best interpret data for this category, it should be noted that the arguably major cause of layoffs in mergers – avoiding the duplication of tasks – is by its very nature not present in acquisitions. Net job creation is in any case explained by the business plans of the acquirer. It is therefore probable that net job creation in takeovers and other acquisitions is higher than in the case of mergers.

Table 50. Planned job creation by year in M&A deals in the EU-27 and Norway

Year	Cases	Job creation	Job reduction	Net job creation	Average net job creation
2002	21	0	-12,163	-12,163	-579
2003	17	160	-4,535	-4,375	-257
2004	35	360	-15,203	-14,843	-424
2005	55	2,315	-25,303	-22,988	-418
2006	51	3,170	-27,763	-24,593	-482
2007	49	69,183	-16,988	52,195	1,065
2008	38	1,840	-25,772	-23,932	-630
2009	23	480	-13,229	-12,749	-554
2010	18	3,950	-10,973	-7,023	-390
Total	307	81,458	-151,929	-70,471	-230

Source: EMCC.

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[73] Media reports have a bias towards reporting restructuring announcements, but rarely follow up on the actual measures taken. In addition, there is a national bias towards reporting.

Abnormal observations

Average net job creation for mergers and acquisitions is higher than for most other restructuring categories considered in the EMCC database for the period 2002–10. This assertion only holds partially if observations are excluded for 2007, when abnormal data for planned job creation were recorded. Tables 51 and 52 make this comparison across headings in the EMCC database for both time intervals.

Table 51. Planned job creation by type of restructuring in the EU-27 and Norway (2002–10)

Type of restructuring	**Cases**	**Job creation**	**% Job creation**	**Job reduction**	**% Job red.**	**Net job creation**	**% Net job creation**	**Avg. net job creation**
Bankruptcy/ closure	7,260	71,863	3.17	-3,826,888	52.81	-3,755,025	75	-517
Business expansion	3,809	2,029,834	90	-1,175	0.02	2,028,659	-41	533
Internal restructuring	4,774	69,757	3	-2,964,728	40.91	-2,894,971	58	-606
Merger/ acquisition	307	81,458	4	-151,929	2.10	-70,471	1	-230
Off-shoring/ delocalisation	558	331	0.01	-180,404	2.49	-180,073	4	-323
Other restructuring	47	3,605	0.16	-30,880	0.43	-27,275	1	-580
Outsourcing	61	395	0.02	-33,356	0.46	-32,961	1	-540
Relocation	231	6,850	0.30	-56,836	0.78	-49,986	1	-216
Total	17,047	2,264,093	100	-7,246,196	100	-4,982,103	100	-292

Source: EMCC.

Table 52. Planned job creation by type of restructuring in the EU-27 and Norway (2002–10 excluding 2007)

Type of restructuring	**Cases**	**Job creation**	**% Job creation**	**Job reduction**	**% Job red.**	**Net job creation**	**% Net job creation**	**Avg. net job creation**
Bankruptcy/ closure	1,666	1,495	0	-580,537	17	-579,042	33	-348
Business expansion	3,038	1,601,320	95	-1,175	0	1,600,145	-91	527
Internal restructuring	4,165	58,945	4	-2,499,994	72	-2,441,049	138	-586
Merger/ acquisition	237	12,275	1	-122,778	4	-110,503	6	-466
Off-shoring/ delocalisation	484	291	0.02	-157,444	5	-157,153	9	-325
Other restructuring	45	3,605	0.21	-30,560	1	-26,955	2	-599
Outsourcing	51	300	0.02	-18,153	1	-17,853	1	-350
Relocation	175	5,590	0	-41,291	1	-35,701	2	-204
Total	9,861	1,683,821	100	-3,451,932	100	-1,768,111	100	-179

Source: EMCC.

Employment levels

The tables above show that planned job reductions were higher than planned job creation for all restructuring types, except for business expansion. Net job creation for mergers and acquisitions was persistently negative except for 2007, and still lower than for internal restructuring and other restructuring. In consideration of all observations from 2002, average net job creation for mergers and takeovers is situated in the lower range of the scale.

Academic studies

Besides the EMCC database, there are several scientific studies that consider the effects of takeover bids on employment. These studies are based on small samples and while they do not arrive at general conclusions, they do find evidence that takeovers do not have a straightforward effect on employment. Accordingly, the effect on employment may be either positive or negative, depending on the business plans of the acquirer.

Business plans

A survey of over 26 recent deals conducted in 2007 by Eurofound emphasises the link between business plans and employment outcomes. It finds instances of both increases and reductions in employment. Nevertheless, the survey, which considers mostly acquisitions, finds more examples of employment contraction than expansion (Eurofound, 2009a). A summary table of these case studies is presented in Appendix 1.

US

Gugler and Yurtoglu (2004) consider a large number of mergers and acquisitions in the US and Europe between 1981 and 1998. Using empirical techniques, the authors find that average demand for labour did not significantly diminish in the US while it diminished by almost 10% in Europe. They attribute this difference to rigid employment protection legislation in Europe. According to the authors, European companies use mergers and acquisitions to attain their optimal employment levels, which they cannot reach otherwise given the strictness of legislation. In view of labour reforms in many EU member states in recent years, these results should be interpreted with caution.

Greece

Other studies have taken place at the national level. The Greek General Confederation of Labour surveyed all mergers and acquisitions considered by

the Hellenic Competition Commission between 1995 and 2005, before the introduction of the Directive. While most of the deals in the sample are takeovers, the results of the study once again need to be interpreted with caution given that they include mergers. The study finds that the effects on employment of mergers and acquisitions depend on the time horizon considered. As a general rule, the number of employees decreases in the short term but picks up in the medium term. The study finds a strong correlation with employment trends in the overall economy (Kouzis et al., 2008).

France

Margolis (2006) uses data from the French National Institute for Statistics and Economic Studies from the 1990s, referring once more to both mergers and takeovers. The author finds that acquired companies are likely to lay off more workers than their acquirers in the first three years following the deal. It also finds that the characteristics of the workers who are laid off are not associated with long-term unemployment. This latter finding is probably significant only for France and the period surveyed.

Spain

A study by Fradejas and Aguilar (2007) supports the idea that the situation in a company before acquisition is a main determinant of the depth of any restructuring undertaken by the acquirer. The study surveyed 67 Spanish non-financial companies that were the object of a takeover bid between 1990 and 2000, and found that job losses were more frequent in those offeree companies having the lowest productivity and return as shown by O'Shaughnessy and Flanagan (1998). Fradejas and Aguilar suggest that in countries where labour legislation is relatively stricter, takeovers are more likely to involve collective dismissals.

Working conditions

Besides employment levels, a takeover may also affect employment conditions. The existence of inefficiencies in human resource management in the offeree company may constitute part of the gains expected by the offeror. In this respect, it is likely that changes in working conditions will be directed at saving costs and increasing productivity. The list below presents the changes most frequently considered by commentators:

- changes in productivity through the substitution of relatively underperforming employees;
- changes in remuneration through, for instance, the early retirement of relatively aged and well-paid employees, who are later substituted by relatively younger and lower-paid workers;

- changes affecting collective bargaining, such as the individualisation of employment relations for new entrants;
- changes affecting job security, such as the use of temporary contracts for new entrants;
- other changes in the internal management of human resources affecting such aspects as working schedule, remuneration mix, training or performance evaluation; and
- changes derived from outsourcing and relocation.

Social costs

The social costs of restructuring may be very significant, but lie outside the objective of this study. They consist of costs for the individuals involved, local communities and society at large. In this regard, the cost of early retirement and unemployment benefits may fall disproportionately on public budgets, while the benefits of restructuring may be captured privately. These structural issues, while relevant to the effects of takeovers on employment, do not directly pertain to the realm of takeover regulation and are for the largest part better addressed using horizontal legislation.

Summary

To summarise, the effects of takeover on employment are not necessarily pervasive and need to be considered over the medium rather than the short term. Three main factors are at stake:

i) the presence of exploitable inefficiencies in the offeree company and any restructuring plans by the offeror devised to reduce such inefficiencies and capture the benefits;

ii) the business plan of the offeror and the success of the deal, which may result in business expansion over the medium term, possibly with the recruitment of new employees; and

iii) the commitment of employee representatives and management to mitigate the effects of restructuring on individual employees.

The Directive intervenes only at the level of information and consultation rights for employee representatives, promoting negotiation to alleviate the effects of any restructuring planned by the offeror.

14.3 Employment provisions in the Directive

Trade-offs

The regulation of takeovers faces several trade-offs as highlighted previously in this study. Some of these trade-offs relate to balancing the interests of the different stakeholders involved, including employees and shareholders. These interests are usually presumed to be contradictory, although this assumption may not always be accurate in practice. The Directive includes a number of provisions in favour of employees' interests, mainly concerning information rights (Arts. 6 and 9 of the Directive). At the same time, the Directive does not affect national rules relating to the information and consultation of employee representatives (Art. 14 of the Directive). In the latter regard, three legislative texts are of particular relevance at the EU level:

- Directive 2002/14/EC establishing a general framework relating to information and consultation of workers,
- Directive 2001/23/EC on transfers of undertakings, and
- Directive 98/59/EC on collective redundancies.

Legislative recast

The European Commission started to revise this legislation in 2010 and is due to introduce new proposals in 2012.[74] It follows that the future revision of related provisions in the Directive should take into account any changes introduced in the overall framework of the Directives above. In this regard, it may be desirable to consolidate all legislative provisions referring to employee information and consultation in a single instrument. As highlighted in a 2006 impact assessment commissioned by the European Parliament, consolidation would allow European co-legislators to conduct an in-depth cost-benefit analysis. Furthermore, consolidation would help clarify workers' rights and enhance legal certainty by unifying the legal base (European Parliament, 2006).

Board neutrality rule

In addition to information and consultation, the discussion on the protection of employees in the Directive also relates to the latter's core provisions. In this respect, the academic literature is particularly wary of the board neutrality rule (Sjåfjell, 2010a). It argues that imposing passivity at the board level significantly reduces the extent to which employees' interests may influence

[74] See "'Fitness check' on EU acts in the area of Information and Consultation of Workers", Information Note, European Commission, Brussels, 2010.

the outcome of the bid. The relevant authors point out what they consider to be a fundamental incoherence in the Directive: on the one hand, at the level of principles, the board is required to act in the interests of the company as a whole, following a stakeholder approach, and therefore encompassing the interests of employees (Art. 3.1(c) of the Directive). On the other hand, at the rule level, the neutrality rule withdraws from the board the power to decide on the deal, granting such power solely to shareholders. As a consequence, the interests of employees are likely to have little influence on the process of the deal and any subsequent restructuring despite the information and consultation procedures in the Directive.

Stakeholder interests

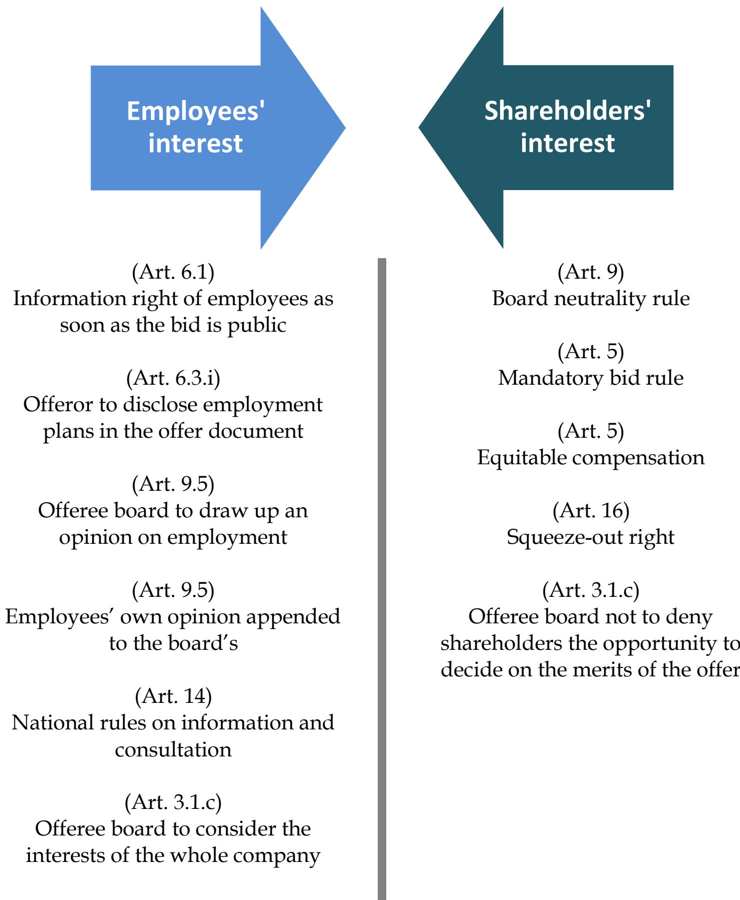
Several authors highlight that given the premium and liquidity offered by the offeror, shareholders are likely to pay little attention to firm-specific investments by employees when confronted with a takeover. Some commentators use the expression 'blind voting' to refer to shareholder behaviour during a takeover and consider that board neutrality exacerbates short-termism in management. The tension between stakeholder and shareholder interests and its link with long-term value creation and firm-specific investments is thus of the utmost relevance in takeover regulation. This tension affects corporate governance legislation as a whole, not just the Directive. Piecemeal solutions are likely to have unintended effects and hence a structured approach running through the entire legislative body is preferable.

In Figure 34, the provisions of the Directive are organised according to which interest they are intended to further. As explained in the discussion above, the reader will find that the core provisions uphold shareholder interest rather than employee interest.

Board participation

The distribution of voice and voting rights between shareholders and employees determines how these interests are balanced in the event of a deal. The board neutrality rule confers decisional rights solely to shareholders. Nevertheless, the balancing of rights in a takeover bid cannot be fully understood without considering the broader framework of corporate governance law. In this regard, employees participate in board decisions through codetermination procedures in a minority of cases, while in most jurisdictions they are only accorded information or consultation rights.

Figure 34. Employees' interest vs. shareholders' interest



Cooperative culture

The degree of workers' participation in managerial decisions may explain, at least partially, the attitude of employees and their representatives in the case of restructuring. Consultation and codetermination procedures are expected to encourage cooperative behaviour and mitigate discrepancies between shareholders and employees. Conversely, the lack of information or negotiation may lead to hostility and industrial action, exacerbating any divergences between the two stakeholder groups.[75] A European Company

[75] See the Eurofound website, "Industrial relations aspects of mergers and takeovers", Eurofound, Dublin, last updated 27 June 2002 (http://www.eurofound.europa.eu/eiro/2001/02/study/tn0102401s.htm).

Survey conducted by Eurofound (2009b) concluded that a majority of both employee representatives and management believe that there is a rather good cooperative culture between them, and that social dialogue is positive for the workplace. These results probably signal the existence of a balanced approach to workers' participation in the EU as a whole. Yet, in light of the methodological constraints of this survey, its results should be interpreted with caution.

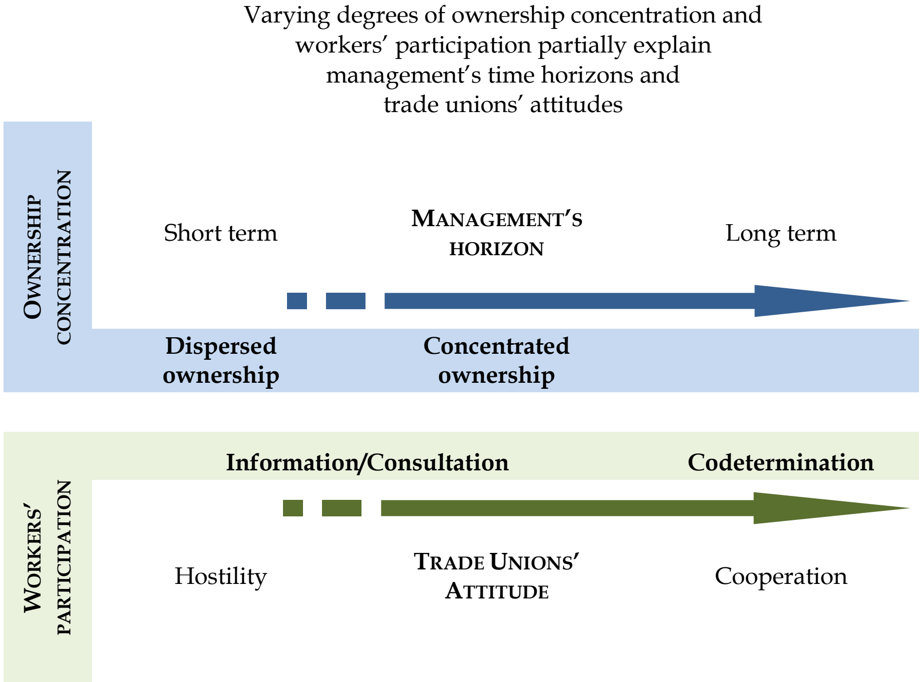
Planning horizons

Given the impact of the shareholding structure on management's horizons, the degree of shareholder and control concentration also explains industrial relations. Dispersed ownership may reduce planning horizons and force management to focus excessively on short-term performance, disregarding firm-specific investments through human capital. On the other hand, the presence of stable and larger shareholders allows managers to focus more on generating value over the medium to long term, encouraging firm-specific investments in the workforce. As found by Fehn and Meier (2000), the institutional structures of capital and labour markets are not independent of one another, but rather are strongly intertwined. Fehn and Meier's empirical research shows a negative correlation between labour protection and shareholders' rights.

Bridging the gap

Together, the degree of workers' participation in decision-making and the level of concentration of ownership and control explain the nexus between cooperative industrial relations and the long-term performance of the company, in both the ordinary course of business and the case of restructuring or takeover. As represented in Figure 35, stable shareholders and employee decision-making favour firm-specific investments in human capital for the benefit of the company's long-term performance. At the same time, the cooperation of employees and their representatives in the case of restructuring, including collective lay-offs, increases the chances of restoring the viability and profitability of a troubled company. Cooperation in restructuring will probably be more effective if employee participation has existed throughout the ordinary course of business than if regulation only requires it in the case of restructuring.

Figure 35. Ownership concentration and workers' participation



As such, the link between corporate governance and firm-specific investments in human capital should not be underestimated. The information and consultation provisions in the Directive do further these investments by promoting workers' cooperation in the event of a deal. Nonetheless, as highlighted, these provisions play a relatively minor role in the overall legislative framework on employee participation. Their impact therefore remains limited, even where the board neutrality rule is not enforced.

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APPENDIX 1. EFFECTS OF TAKEOVERS ON EMPLOYMENT: CASE STUDIES

Table A1.1 Effects of takeovers on employment: Case studies

Year/country/ type of deal	Companies involved	Reason for deal	Involvement of trade unions	Effects on employment	Outcome for the company
2006 Belgium Acquisition	Mittal Steel acquired Arcelor	To expand market share	Yes (information rights)	Reduction	Mittal's position strengthened
2007 Bulgaria Merger	HVB Bank Biochim and Hebros Bank merged with Bulbank	To rationalise activities and expand market share	Yes (information rights)	Reduction	Increase in equity value
2005 Czech Republic Acquisition	Kooperativa Pojišťovna acquired ČPP	To increase competitive-ness and rationalise activities	No	Creation	Increase in turnover
2008 Germany Acquisition	Bayer acquired Shering	To expand market share	Yes (voting rights)	Reduction	Increase in profits
2005 Estonia Acquisition	Sorbes AG acquired Repo Vabrikud	To expand market share	No	Reduction	Repo became the biggest producer in the Baltic region
2001 Ireland Acquisition	Trustee Saving Banks was acquired by Irish Life and Permanent	Market expansion	Yes (collective negotiation rights)	Creation	Unclear
2005 Greece Acquisition	Mytilineo Group acquired Aluminium de Grèce	To strengthen market position	Yes (information rights)	Unchanged	Turnover rose
2004 France Merger	Neuf Telecom merged with Cegetel	To improve market position	Yes (information rights)	Reduction	New company became the biggest French operator

Table A1.1 cont'd

Italy Acquisition	ABB acquired Elasag Bailey	To expand market share	Yes (information rights)	Creation	ABB position strengthened
2006 Cyprus Acquisition	Laiki Bank acquired Egnatia bank and Marfin Financial Group	To increase size	No	Creation	Group became stronger
2006 Latvia Merger	Tapeks acquired Aile	To rationalise activities and expand market share	No	Creation (expected)	Larger market share
2006 Lithuania Acquisition	PKN Orlen acquired Mažeikių Naftą	To strengthen market position	Yes (collective negotiation rights)	Unchanged	PKN became the largest oil refiner in Central and Eastern Europe
2005 Luxembourg Acquisition	IVC acquired Tarkett	To expand market share geographically	No	Creation	Geographical expansion
2005 Hungary Acquisition	BAA acquired Budapest airport Handling (BAH); after 18 months Celebi acquired BAH	Unclear concerning BAA; to enter the European market concerning Celebi	Yes (collective negotiation rights)	Unclear	Business expansion
2006 Malta Acquisition	Emirate International Telecommuni-cations Malta Ltd acquired 60% stake in Maltacom PLC	To expand market share	No	Reduction	Modern-isation, profitability and expansion
2007 Netherlands Acquisition	Royal Bank of Scotland, Bank Fortis and Banco Santander took over the ABN AMRO	To expand market share	Yes (collective negotiation rights)	Reduction	Decline in the financial position
2005 Austria Acquisition	Frenzel acquired Frost	To expand market share	No	Unclear	Frost avoided closure risks

Table A1.1 cont'd

2008 Poland Acquisition	Bauer Publishing acquired Interia.pl	To expand market share	No	Creation	Revenues increased
2007 Portugal Acquisition	Sonae Distribuição acquired Carrefour in Portugal	To expand market share	Yes (information rights)	Unchanged	Expansion and decrease in overall costs
1999 Romania Acquisition	Renault acquired Automobile Dacia	To expand market share	Yes (information rights)	Reduction	Expansion
1997 Slovenia Acquisitions	Saturnus Avtooprema acquired Hella	To find a strategic partner and to expand operations	Yes (information rights)	Creation	Increase in turnover and employment
2005 Slovakia Acquisition	Enel acquired 66% of the shares of Slovenské Elektrárne (SE)	To strengthen SE's position in the domestic electrical market	Yes (information rights)	Reduction	Increase in competitive-ness
2006 Finland Merger	Tallink Finland Oy acquired Silja Oy Ab	To expand market share	Yes (collective negotiation rights)	Reduction	Reduction in costs
2005 Sweden Acquisition	Ericsson and Marconi	To expand market share	Yes (information rights)	Reduction	Ericsson strengthened its competitive position
2006 UK Merger	Boots and Alliance UniChem merged in Alliance Santé	Economies of scale and scope	Yes (information rights)	Reduction	Rationalisa-tion of the operations and international expansion
2006 Norway Acquisition	Statoil acquired Norsk Hydro	To gain competitive-ness and rationalise activities	Yes (collective negotiation rights)	Unchanged	Expansion and rationalis-ation

Source: Eurofound (2009a).

APPENDIX 2. PLANNED JOB CREATION IN M&A DEALS IN THE EU-27 AND NORWAY

Table A2.1 Planned job creation in M&A deals in the EU-27 and Norway

Year	Country	No. of planned job reductions	% Planned job reductions	No. of planned job creations	% Planned job creations	No. of cases	% Cases
2002	France	4,708	38.71	0	0	9	42.86
	UK	2,480	20.39	0	0	4	19.05
	Belgium	3,175	26.10	0	0	4	19.05
	Germany	1,100	9.04	0	0	1	4.76
	Sweden	150	1.23	0	0	1	4.76
	Netherlands	250	2.06	0	0	1	4.76
	Ireland	300	2.47	0	0	1	4.76
	Total 2002	12,163	100.00	0	100	21	100.00
	Country	**No. of planned job reductions**	**% Planned job reductions**	**No. of planned job creations**	**% Planned job creations**	**No. of cases**	**% Cases**
2003	UK	1,925	42.45	0	0	5	29.41
	Italy	1,010	22.27	0	0	4	23.53
	Finland	60	1.32	160	100	2	11.76
	Netherlands	125	2.76	0	0	2	11.76
	Spain	390	8.60	0	0	1	5.88
	Portugal	305	6.73	0	0	1	5.88
	Germany	470	10.36	0	0	1	5.88
	Denmark	250	5.51	0	0	1	5.88
	Total 2003	4,535	100.00	160	100	17	100.00
	Country	**No. of planned job reductions**	**% Planned job reductions**	**No. of planned job creations**	**% Planned job creations**	**No. of cases**	**% Cases**
2004	UK	7,535	49.56	250	69.44	14	40.00
	France	3,159	20.78	0	0.00	8	22.86
	Germany	2,234	14.69	110	30.56	7	20.00
	Netherlands	340	2.24	0	0.00	2	5.71
	Finland	685	4.51	0	0.00	2	5.71
	Austria	1,000	6.58	0	0.00	1	2.86
	Sweden	250	1.64	0	0.00	1	2.86
	Total 2004	15,203	100.00	360	100.00	35	100.00

Table A2.1 cont'd

	Country	No. of planned job reductions	% Planned job reductions	No. of planned job creations	% Planned job creations	No. of cases	% Cases
2005	Germany	6,329	25.01	0	0.00	13	23.64
	UK	6,822	26.96	0	0.00	11	20.00
	France	2,584	10.21	100	4.32	8	14.55
	Poland	6,568	25.96	1,000	43.20	5	9.09
	Netherlands	1,125	4.45	0	0.00	4	7.27
	Romania	100	0.40	370	15.98	3	5.45
	Austria	370	1.46	0	0.00	2	3.64
	Sweden	800	3.16	–	0.00	2	3.64
	Slovenia	175	0.69	–	0.00	2	3.64
	Czech Rep.	0	0.00	250	10.80	1	1.82
	Denmark	230	0.91	–	0.00	1	1.82
	Estonia	0	0.00	295	12.74	1	1.82
	Italy	200	0.79	–	0.00	1	1.82
	Slovakia	–	0.00	300	12.96	1	1.82
	Total 2005	25,303	100.00	2,315	100.00	55	100.00
	Country	**No. of planned job reductions**	**% Planned job reductions**	**No. of planned job creations**	**% Planned job creations**	**No. of cases**	**% Cases**
2006	Germany	7,375	26.56	700	22.08	12	23.53
	France	1,139	4.10	0	0.00	6	11.76
	UK	3,266	11.76	450	14.20	6	11.76
	Italy	8,150	29.36	0	0.00	4	7.84
	Spain	2,637	9.50	0	0.00	4	7.84
	Czech Rep.	1,190	4.29	470	14.83	3	5.88
	Austria	904	3.26	0	0.00	3	5.88
	Belgium	408	1.47	–	0.00	2	3.92
	Finland	728	2.62	–	0.00	2	3.92
	Romania	1,300	4.68	0	0.00	2	3.92
	Poland	100	0.36	470	14.83	2	3.92
	Greece	–	0.00	1,000	31.55	1	1.96
	Sweden	100	0.36	80	2.52	1	1.96
	Norway	200	0.72	–	0.00	1	1.96
	Ireland	106	0.38	–	0.00	1	1.96
	Slovakia	160	0.58	–	0.00	1	1.96
	Total 2006	27,763	100.00	3,170	100.00	51	100.00

Table A2.1 cont'd

	Country	No. of planned job reductions	% Planned job reductions	No. of planned job creations	% Planned job creations	No. of cases	% Cases
2007	France	1,987	11.70	62,388	90.18	8	16.33
	Germany	4,130	24.31	150	0.22	7	14.29
	Austria	544	3.20	275	0.40	4	8.16
	Spain	610	3.59	150	0.22	3	6.12
	Czech Rep.	450	2.65	630	0.91	3	6.12
	Italy	2,700	15.89	–	0.00	3	6.12
	UK	920	5.42	–	0.00	3	6.12
	Romania	–	0.00	5,200	7.52	2	4.08
	Sweden	100	0.59	190	0.27	2	4.08
	Portugal	141	0.83	200	0.29	2	4.08
	Belgium	303	1.78	–	0.00	2	4.08
	Hungary	500	2.94	–	0.00	2	4.08
	Ireland	970	5.71	–	0.00	2	4.08
	Netherlands	1,500	8.83	–	0.00	1	2.04
	Finland	115	0.68	–	0.00	1	2.04
	Poland	200	1.18	–	0.00	1	2.04
	Norway	1,500	8.83	–	0.00	1	2.04
	Denmark	118	0.69	–	0.00	1	2.04
	Greece	200	1.18	–	0.00	1	2.04
	Total 2007	16,988	100.00	69,183	100.00	49	100.00
	Country	**No. of planned job reductions**	**% Planned job reductions**	**No. of planned job creations**	**% Planned job creations**	**No. of cases**	**% Cases**
2008	France	2,429	9.42	515	27.99	8	21.05
	UK	5,772	22.40	625	33.97	7	18.42
	Germany	7,928	30.76	0	0.00	5	13.16
	Netherlands	2,045	7.93	0	0.00	5	13.16
	Austria	220	0.85	0	0.00	2	5.26
	Italy	6,136	23.81	0	0.00	2	5.26
	Poland	170	0.66	0	0.00	1	2.63
	Norway	352	1.37	0	0.00	1	2.63
	Lithuania	340	1.32	0	0.00	1	2.63
	Ireland	0	0.00	100	5.43	1	2.63
	Slovenia	0	0.00	120	6.52	1	2.63
	Sweden	80	0.31	0	0.00	1	2.63
	Portugal	0	0.00	100	5.43	1	2.63
	Belgium	300	1.16	0	0.00	1	2.63
	Greece	0	0.00	380	20.65	1	2.63
	Total 2008	25,772	100.00	1,840	100.00	38	100.00

Table A2.1 cont'd

	Country	No. of planned job reductions	% Planned job reductions	No. of planned job creations	% Planned job creations	No. of cases	% Cases
2009	UK	6,200	46.87	0	0.00	6	26.09
	France	1,019	7.70	0	0.00	5	21.74
	Czech Rep.	350	2.65	480	100.00	4	17.39
	Spain	420	3.17	0	0.00	2	8.70
	Estonia	166	1.25	0	0.00	1	4.35
	Belgium	104	0.79	0	0.00	1	4.35
	Denmark	100	0.76	0	0.00	1	4.35
	Austria	1,000	7.56	0	0.00	1	4.35
	Germany	220	1.66	0	0.00	1	4.35
	Italy	3,650	27.59	0	0.00	1	4.35
	Total 2009	13,229	100.00	480	100.00	23	100.00
	Country	**No. of planned job reductions**	**% Planned job reductions**	**No. of planned job creations**	**% Planned job creations**	**No. of cases**	**% Cases**
2010	France	596	5.43	1,800	45.57	5	27.78
	Spain	3,030	27.61	0	0.00	3	16.67
	Germany	1,750	15.95	150	3.80	3	16.67
	Austria	100	0.91	0	0.00	1	5.56
	UK	150	1.37	0	0.00	1	5.56
	Poland	0	0.00	2,000	50.63	1	5.56
	Latvia	100	0.91	0	0.00	1	5.56
	Netherlands	5,000	45.57	0	0.00	1	5.56
	Belgium	122	1.11	0	0.00	1	5.56
	Italy	125	1.14	0	0.00	1	5.56
	Total 2010	10,973	100.00	3,950	100.00	18	100.00

Source: European Monitoring Centre on Change.

Appendix 3. Methodology for Implementation Scores

The scores below have been elaborated by CEPS on the basis of the legal review in Marccus Partners and CEPS (2012).

1) Board neutrality rule (BNR)

a) *Basic criteria*

0 points: BNR is optional
2 points: BNR is the default rule
3 points: BNR is mandatory

b) *Additional criteria*

1 point: reciprocity is not available

2) Breakthrough rule (BTR)

a) *Basic criteria*

0 points: BTR is optional
1 point: BTR is mandatory but partially transposed
3 points: BTR is mandatory and fully transposed

b) *Additional criteria*

1 point: reciprocity is not available

3) Squeeze-out right (SqOR)

a) *Basic criteria*

3 points: a threshold of 90%
1 point: a threshold of 95%

b) *Additional criteria*

1 point: a dual test (ownership/acceptance tests are alternatives)
1 point: the threshold only refers to voting rights/capital

4) Mandatory bid rule (MBR)

a) *Basic criteria: points are awarded given the definition of control*

2 points: a one-third or 33% threshold or lower
1 point: consideration of working control

b) *Additional criteria: points are added where the national implementation effectively considers*

2 points: creeping-in
1 point: a second threshold
1 point: acting in concert does not require acquisition

c) *Negative criteria: points are subtracted where national provisions in the following area are found to undermine the MBR*

1 point: derogatory discretion granted to supervisory authorities

Table A3.1 Implementation scores

Country	BNR	BTR	SqOR	MBR	Country	BNR	BTR	SqOR	MBR
Austria	4	1	3	4	Ireland	4	1	3	3
Belgium	0	0	1	3	Italy	2	0	2	4
Cyprus	4	0	3	2	Luxembourg	0	0	1	2
Czech Rep.	4	1	4	2	Netherlands	0	0	1	2
Denmark	0	0	3	1	Poland	0	0	4	4
Estonia	4	4	3	1	Portugal	3	0	3	4
Finland	3	1	3	3	Romania	2	1	2	3
France	3	2	1	4	Slovakia	4	1	1	2
Germany	0	0	2	2	Spain	3	0	4	4
Greece	3	0	4	4	Sweden	4	1	4	2
Hungary	0	0	4	3	UK	4	1	3	3

Source: Authors.

Table A3.2 Board neutrality rule

Country	Score	Description
Austria	4	Yes; no reciprocity
Belgium	0	No; reciprocity
Cyprus	4	Yes; no reciprocity
Czech Rep.	4	Yes; no reciprocity
Denmark	0	No; reciprocity
Estonia	4	Yes; no reciprocity
Finland	3	Yes; no reciprocity
France	3	Yes; reciprocity
Germany	0	No (modified passivity rule); reciprocity
Greece	3	Yes; reciprocity
Hungary	0	No; reciprocity
Ireland	4	Yes; no reciprocity
Italy	2	Yes (subject to opt-out in the bylaws); reciprocity (subject to bylaws)
Luxembourg	0	No; reciprocity
Netherlands	0	No; reciprocity
Poland	0	No; reciprocity
Portugal	3	Yes; reciprocity
Romania	2	Yes (for voluntary bids only, not for mandatory bids); no reciprocity
Slovakia	4	Yes; no reciprocity
Spain	3	Yes (clarified); reciprocity
Sweden	4	Yes; no reciprocity
UK	4	Yes (slightly strengthened); no reciprocity

Source: Authors.

Table A3.3 Breakthrough rule

Country	Score	Description
Austria	1	No; no reciprocity
Belgium	0	No; reciprocity
Cyprus	0	No; reciprocity
Czech Rep.	1	No; no reciprocity

Table A3.3 cont'd

Denmark	0	No (optional only, subject to a grandfather clause for agreements concluded before 31.03.2004); reciprocity
Estonia	4	Yes; no reciprocity
Finland	1	No; no reciprocity
France	2	No (exception: voting caps are suspended at the first GM following a successful bid, that is, two-thirds post-bid holding); no reciprocity
Germany	0	No; reciprocity
Greece	0	No; reciprocity
Hungary	0	No; reciprocity
Ireland	1	No; no reciprocity
Italy	0	No; reciprocity (subject to bylaws)
Luxembourg	0	No; reciprocity
Netherlands	0	No; reciprocity
Poland	0	No; reciprocity
Portugal	0	No; reciprocity
Romania	1	No; no reciprocity
Slovakia	1	No; no reciprocity
Spain	0	No; reciprocity
Sweden	1	No; no reciprocity
UK	1	No; no reciprocity

Source: Authors.

Table A3.4 Squeeze-out right

Country	Basic score	Additional score	Description (C=capital; VR=voting rights)	Total score
Austria	3	–	90% C & VR ownership test	3
Belgium	1	–	95% C & VR ownership (a dual test after a voluntary bid, also 90% C acceptance, no dual test for a mandatory bid)	1
Cyprus	3	–	90% C & VR ownership test	3
Czech Rep.	3	1	90% C or 90% VR ownership test	4
Denmark	3	–	90% C &VR ownership test	3
Estonia	3	–	90% C & VR to request GM; 90% approval ownership test	3
Finland	3	–	90% C & VR ownership test	3
France	1	–	95% C & VR ownership test	1
Germany	1	1	95% VR ownership test	2
Greece	3	1	90% VR ownership test	4
Hungary	3	1	90% VR ownership test	4
Ireland	3	–	90% C & VR ownership test	3
Italy	1	1	95% C ownership test	2
Luxembourg	1	–	95% C & VR ownership test	1
Netherlands	1	–	95% C & VR ownership test	1
Poland	3	1	90% VR ownership test	4
Portugal	3	–	90% VR and 90% of acceptance	3
Romania	1	1	95% VR or 90% C (acceptance)	2
Slovakia	1	–	95% C & VR ownership test	1
Spain	3	1	Dual test: 90% VR, 90% acceptance test	4
Sweden	3	1	90% C ownership test	4
UK	3	–	90% C & VR (acceptance)	3

Source: Authors.

Table A3.5 Mandatory bid rule

	Basic threshold		Consideration of actual control		Second threshold		Consideration of creeping-in		Acting in concert		Derogatory discretion granted to supervisory authorities		
Country	**Brief description 1**	**Score**	**Brief description 2**	**Score**	**Brief description 3**	**Score**	**Brief description 4**	**Score**	**Brief description 5**	**Score**	**Brief description 6**	**Score**	**Total score**
Austria	30%	2	–	0	–	0	2% increase between 30% and 50% within 12 mos.	2	Takeover Directive	0	–	0	4
Belgium	30%	2	–	0	–	0	–	0	Both	1	–	0	3
Cyprus	30%	2	–	0	–	0	–	0	Takeover Directive	0	–	0	2
Czech Republic	30%	2	–	0	–	0	–	0	Intermediary Takeover Directive/ Transparency Directive	0	–	0	2
Denmark	50%	0	Or a majority of members of the board or controlling influence	1	–	0	–	0	Takeover Directive	0	–	0	1
Estonia	50% voting rights	0	Or a majority of members of the board	1	–	0	–	0	Intermediary Takeover Directive/ Transparency Directive	0	–	0	1
Finland	30%	2	–	0	50%	1	–	0	Both	1	General discretion	-1	3

Table A3.5 cont'd

	Basic threshold		**Consideration of actual control**		**Second threshold**		**Consideration of creeping-in**		**Acting in concert**		**Derogatory discretion granted to supervisory authorities**		
Country	**Brief description 1**	**Score**	**Brief description 2**	**Score**	**Brief description 3**	**Score**	**Brief description 4**	**Score**	**Brief description 5**	**Score**	**Brief description 6**	**Score**	**Total score**
France	30% (capital and voting rights)	2	–	0	–	0	2% increase between 30% and 50% within 12 mos.	2	Both	1	Self-granted discretion but approved by a Court of Appeal	-1	4
Germany	30%	2	–	0	–	0	–	0	Both	1	Limited discretion	-1	2
Greece	33%	2	–	0	–	0	3% increase between 33% and 50% within 12 mos.	2	Intermediary Takeover Directive/ Transparency Directive	0	–	0	4
Hungary	33%	2	–	0	25% if no other shareholder above 10%	1	–	0	Takeover Directive	0	–	0	3
Ireland	30%	2	–	0	–	0	0.05% increase between 30% and 50% within 12 mos.	2	Takeover Directive	0	General discretion	-1	3
Italy	30%	2	–	0	–	0	3% increase of 30-50% within 12 mos.	2	Takeover Directive	0	–	0	4
Luxembourg	33%	2	–	0	–	0	–	0	Takeover Directive	0	–	0	2
Netherlands	30%	2	–	0	–	0	–	0	Takeover Directive	0	–	0	2

Table A3.5 cont'd

	Basic threshold		**Consideration of actual control**		**Second threshold**		**Consideration of creeping-in**		**Acting in concert**		**Derogatory discretion granted to supervisory authorities**		
Country	**Brief description 1**	**Score**	**Brief description 2**	**Score**	**Brief description 3**	**Score**	**Brief description 4**	**Score**	**Brief description 5**	**Score**	**Brief description 6**	**Score**	**Total score**
Poland	33%	2	–	0	66%	1	10% increase by a shareholder holding less than 33% within 60 days or 5% increase by a share-holder holding more than 33% within 12 mos.	0	Both	1	–	0	4
Portugal	33%	2	–	0	50%	1	–	0	Both	1	–	0	4
Romania	33%	2	–	0	–	0	–	0	Both	1	–	0	3
Slovakia	33%	2	–	0	–	0	–	0	Takeover Directive	0	–	0	2
Spain	30%	2	Or a majority of members of the board within 24 mos.	1	–	0	5% increase between 30% and 50% within 12 mos.	0	Both	1	–	0	4
Sweden	30%	2	–	–	–	–	–		Both	1	General discretion	-1	2
UK	30%	2	–	0	–	0	Any increase between 30% and 50%	2	Takeover Directive	0	General discretion	-1	3

Source: Authors.

APPENDIX 4. STAKEHOLDER PROTECTION INDICES

Adapted by CEPS from La Porta et al. (1998) and Martynova and Renneboog (2010) with the support of Marccus Partners.

Shareholder rights protection index

Maximum 23 points. The higher the score, the higher is the protection for shareholders. The index does not take into account rules transposed under the Takeover Bids Directive.

1) Proxy voting by mail:
   - 2 if allowed
   - 0 if not allowed
2) Requirement to deposit/register bearer/nominal shares prior to a general meeting:
   - 0 if deposit required
   - 1 if only registration
   - 2 if deposit and registration are forbidden
3) Requirement for related-party transactions to be approved by shareholders:
   - 2 if required
   - 0 if not required
4) Percentage needed to convene an extraordinary meeting:
   - 2 if 5% or less
   - 1 if 20% to 6%
   - 0 if 20% or more (or no right to convene a meeting is specified)
5) Voting caps that would hold in the event of a takeover bid:
   - 0 if allowed
   - 3 if not allowed
6) Two-tier boards – nomination of the board by shareholders:
   - 2 if required
   - 0 if not required
7) Two-tier boards – overlap between the management and supervisory board is forbidden:
   - 0 if allowed
   - 2 if not allowed

8) One-tier boards – the CEO can be the chairman of the board of directors:
   - 0 if allowed
   - 2 if not allowed
9) Separate board of auditors:
   - 2 if an independent body separate from the board
   - 1 if a specific committee set up within the board
   - 0 otherwise
10) Requirement to disclose top managerial compensation:
   - 2 if required on an individual basis
   - 1 if required on an aggregate basis
   - 0 if not required
11) Requirement to disclose any transactions between management and company:
   - 2 if required
   - 0 if not required

Minority shareholder rights protection index

Maximum 21 points. The higher the score, the higher is the protection for minority shareholders. The index does not take into account rules transposed under the Takeover Bids Directive. Issue numbers 4–7 above are shared with the general shareholder protection index.

1) Minority representation on the board:
   - 2 if required
   - 0 if not required
2) Voting caps limiting the power of large shareholders:
   - 2 if allowed
   - 0 if not allowed
3) Multiple voting rights and non-voting shares:
   - 0 if both allowed
   - 1 if one allowed
   - 2 if none allowed
4) Percentage needed to convene an extraordinary meeting:
   - 2 if 5% or less
   - 1 if 20% to 6%
   - 0 if 20% or more (or no percentage is specified)
5) Two-tier boards – nomination of the board by shareholders:
   - 2 if required
   - 0 if not required

6) Two-tier boards – overlap between the management and supervisory board is forbidden:
   - 0 if allowed
   - 2 if not allowed
7) One-tier boards – the CEO can be the chairman of the board of directors:
   - 0 if allowed
   - 2 if not allowed
8) Principle of equal treatment among all shareholders:
   - 1 if mandated
   - 0 if not mandated
9) Percentage for mandatory disclosure of large ownership stakes:
   - 3 if 5% or less
   - 2 if 6% to 10%
   - 1 if 11% to 24%
   - 0 if 25% or more (or no mandatory disclosure is specified)
10) Percentage for minority claim against the board:
   - 3 if 5% or less
   - 2 if 6% to 10%
   - 1 if 11% or more
   - 0 if 25% or more (or no minority claims are allowed)

Creditor rights protection index

Maximum 10 points. The higher the score, the higher is the protection for creditors. The index does not take into account rules transposed under the Takeover Bids Directive.

1) Reorganisation is allowed by insolvency legislation:
   - 0 if allowed
   - 2 if not allowed (the legislation only provides for liquidation)
2) Automatic stay on the assets in case of reorganisation:
   - 0 if compulsory
   - 2 if not compulsory
3) Ranking of creditors in a liquidation procedure:
   - 3 if secured creditors are ranked first
   - 0 if government and/or employees are ranked first
4) Creditor approval of bankruptcy to initiate reorganisation or liquidation:
   - 2 if required
   - 0 if not required

5) Appointment of an independent third party to manage the reorganisation/liquidation procedure:
   - 1 if required
   - 0 if not required

Employee rights protection index

1) Employee voice in the board:
   - 2 if required
   - 0 if not required
2) Employee voting rights in the board:
   - 2 if required
   - 0 if not required

Table A4.1 Stakeholder protection indices

Country	Shareholder rights protection index	Minority shareholder rights protection index (full)	Minority shareholder rights protection index (excl. issues in common with shareholder rights protection index)	Creditor rights protection index	Employee rights protection index
Austria	13	11	4	6	2
Belgium	8	7	7	4	0
Cyprus	9	9	6	3	2
Czech Republic	17	14	8	6	2
Denmark	9	10	6	1	2
Estonia	14	11	6	4	0
Finland	12	11	6	4	0
France	16	13	9	1	1
Germany	14	13	8	4	2
Greece	10	10	8	4	0
Hungary	12	10	4	4	0
Ireland	10	8	7	4	0
Italy	13	14	10	3	0
Luxembourg	16	8	4	1	2
Netherlands	15	11	6	8	0
Poland	18	16	10	4	0
Portugal	11	11	5	5	0
Romania	13	11	8	4	0
Slovakia	9	12	6	1	2
Spain	11	10	8	3	0
Sweden	14	7	4	6	2
UK	16	11	7	6	0

Source: Marccus Partners and CEPS (2012), based on a survey of national legal systems through local partner law firms.

APPENDIX 5. ECONOMETRIC ANALYSIS

Variables

Sub-indices d = deals c = country t = time

Dependent variable

$CARl_d$ — Cumulative Abnormal Returns (-41, 41) event window

Independent variables

VAL_d — Rank value (size indicator)

$Dhostile_d$ — Hostile bid =1

$Dcashonly_d$ — Cash only =1

$Ddebt_d$ — Debt proceeding =1

CAP_c — Stock market capitalisation per deal, per country, per year (market size indicator)

$CAPGDP_c$ — Stock market capitalisation over GDP per deal, per country, per year (indicator development financial sector)

GDP_t – EU GDP growth (economic cycle indicator)

$CRE_{c,t}$ – Credit to non-financial institutions (financial cycle indicator)

$sharND_{dc}$ — Shareholder protection index (offeree company country)

$sharNDr_c$ — Shareholder protection index (offeree company country) – restricted (to avoid overlapping with the minority shareholder index)

$minoNDr_c$ — Minority shareholder protection index (offeree company country) – restricted

$credND_c$ — Creditors protection index (offeree company country)

epi_c — Employee protection index (offeree company country)

$compND_c$ — Competitiveness indicator (based on the GCI of the WEF)

$bnrDDC_c$ — Board neutrality rule implementation score, 2003-2010[76]

$btrDDC_c$ — Breakthrough rule implementation score, 2003-2010

$mbrDDC_c$ — Mandatory bid rule implementation score, 2003-2010

$sqrDDC_c$ — Squeeze-out right implementation score, 2003-2010

$Dcov_d$ – Deal covered by Takeover Bids Directive (deal occurring after the transposition of the Directive in each member state) =1

[76] We have calculated a score for the implementation of the rule from 2003 because some of the countries were already using some of the rules imposed by the Directive.

Regression specifications

Regression 1. Consideration of the effect of introducing the European Takeover Bids Directive

This regression considers deals occurring from the beginning of 2003 up until the end of 2010.

$$CARl_d = \alpha + \beta_1\, Dhostile_d + \beta_2\, Dcashonly_d + \beta_3\, Ddebt_d + \beta_4 \ln CAP_{dc} + \beta_5 GDP_{dc} + \beta_6\, sharNDr_{dc} + \beta_7\, minoNDr_{dc} + \beta_8\, epi_{dc} + \beta_9\, bnrDDC_{dc} + \beta_{10}\, btrDDC_{dc} + \beta_{11}\, sorDDC_{dc} + \beta_{12}\, mbrDDC_{dc} + \varepsilon$$

Source	SS	df	MS
Model	8.98740423	12	.748950353
Residual	134.016311	953	.14062572
Total	143.003715	965	.148190379

Number of obs =	966
F(12, 953) =	5.33
Prob > F =	0.0000
R-squared =	0.0628
Adj R-squared =	0.0510
Root MSE =	.375

carl	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
dhostile	-.053032	.0444654	-1.19	0.233	-.1402934	.0342293
dcashonly	.0862943	.0302792	2.85	0.004	.0268727	.1457159
ddebt	.0603525	.0833701	0.72	0.469	-.1032576	.2239626
lncap	.024881	.0191879	1.30	0.195	-.0127744	.0625363
gdp	-.0109961	.003476	-3.16	0.002	-.0178177	-.0041746
sharndr	-.0174085	.0121541	-1.43	0.152	-.0412605	.0064435
minndr	-.0377507	.0139076	-2.71	0.007	-.0650438	-.0104576
epi	-.1885781	.0898895	-2.10	0.036	-.3649824	-.0121739
bnrddc	-.0550158	.019015	-2.89	0.004	-.0923318	-.0176997
btrddc	.188681	.0441171	4.28	0.000	.1021032	.2752588
sorddc	.0346918	.0232928	1.49	0.137	-.0110192	.0804029
mbrddc	.0079896	.0280169	0.29	0.776	-.0469924	.0629716
_cons	.5407503	.2049186	2.64	0.008	.1386066	.9428941

Variable	active
dhostile	-.05303204
dcashonly	.08629429***
ddebt	.06035254
lncap	.02488096
gdp	-.01099615***
sharndr	-.01740847
minndr	-.03775073***
epi	-.18857814**
bnrddc	-.05501576***
btrddc	.18868102***
sorddc	.03469185
mbrddc	.00798955
_cons	.54075034***

legend: * p<.1; ** p<.05; *** p<.01

By adding the competitiveness index (WEF) and removing growth and market capitalisation:

Variable	active
dhostile	-.0510077
dcashonly	.08767323***
ddebt	.07882606
lncre	-.01152841
lncompnd	.87463729**
sharndr	-.02372061**
minndr	-.00585663
epi	-.148435*
bnrddc	-.02970031
btrddc	.13161581**
sorddc	.0222711
mbrddc	.03096075
_cons	-.89592349

legend: * p<.1; ** p<.05; *** p<.01

Regression 2. Consideration of the implementation scores for those deals occurring after the transposition of the Takeover Bids Directive in each member state

This regression considers the deals occurring until the end of 2010.

$$CARl_d = \alpha + \beta_1\, Dhostile_d + \beta_2\, Dcashonly_d + \beta_3\, Ddebt_d + \beta_4 \ln CAP_{dc} + \beta_5 GDP_{dc} + \beta_6\, sharND_{dc} + \beta_7\, minoNDr_{dc} + \beta_8\, epi_{dc} + \beta_9\, dCOV_d + \varepsilon$$

Source	SS	df	MS
Model	9.18657624	9	1.02073069
Residual	133.817139	956	.139976087
Total	143.003715	965	.148190379

Number of obs =	966
F(9, 956) =	7.29
Prob > F =	0.0000
R-squared =	0.0642
Adj R-squared =	0.0554
Root MSE =	.37413

carl	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
dhostile	-.0615823	.0441667	-1.39	0.164	-.1482571	.0250926
dcashonly	.0786355	.0301352	2.61	0.009	.0194967	.1377742
ddebt	.0487042	.0829768	0.59	0.557	-.1141335	.2115418
lncap	.0192989	.0180782	1.07	0.286	-.0161787	.0547765
gdp	-.0094561	.0034698	-2.73	0.007	-.0162654	-.0026467
sharnd	-.0013022	.0085072	-0.15	0.878	-.0179971	.0153926
minndr	-.0221778	.0102336	-2.17	0.030	-.0422607	-.0020948
epi	-.0455088	.0701355	-0.65	0.517	-.1831461	.0921285
dcov	.1378499	.0254476	5.42	0.000	.0879104	.1877895
_cons	.2113868	.1604251	1.32	0.188	-.1034392	.5262128

Variable	active
dhostile	-.06158226
dcashonly	.07863548***
ddebt	.04870417
lncap	.01929888
gdp	-.00945607***
sharnd	-.0013022
minndr	-.02217779**
epi	-.04550882
dcov	.13784992***
_cons	.21138682

legend: * p<.1; ** p<.05; *** p<.01

Regression 3. Consideration of the implications of protection indices, growth and the Directive on market capitalisation

$$lnCAP_{dc} = \alpha + \beta_1 GDP_{dc} + \beta_2 minoND_{dc} + \beta_3 credND_{dc} + \beta_4 epi_{dc} + \beta_5 dCOV_d + \varepsilon$$

Source	SS	df	MS
Model	485.500545	5	97.1001091
Residual	605.493868	960	.630722779
Total	1090.99441	965	1.13056416

Number of obs =	966
F(5, 960) =	153.95
Prob > F =	0.0000
R-squared =	0.4450
Adj R-squared =	0.4421
Root MSE =	.79418

lncap	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
gdp	.0151995	.0073414	2.07	0.039	.0007924	.0296066
minond	.0930652	.0172516	5.39	0.000	.05921	.1269204
crednd	.1201413	.0182373	6.59	0.000	.0843518	.1559308
epi	-2.305047	.126282	-18.25	0.000	-2.552868	-2.057227
dcov	.0021518	.0534014	0.04	0.968	-.102645	.1069487
_cons	6.142555	.2728565	22.51	0.000	5.607091	6.67802

Variable	active
gdp	.01519952**
minond	.0930652***
crednd	.12014134***
epi	-2.3050473***
dcov	.00215182
_cons	6.1425555***

legend: * p<.1; ** p<.05; *** p<.01

Regression 4. Consideration of the implications of protection indices, cumulative abnormal returns and the Directive on the financial development index

$$lnCAPGDP_d = \alpha + \beta_1 CARl_d + \beta_2 minNDr_{dc} + \beta_3 credND_{dc} + \beta_4 epi_{dc} + \beta_5 dCOV_c + \varepsilon$$

Source	SS	df	MS
Model	80.3392784	5	16.0678557
Residual	131.863072	960	.137357367
Total	212.202351	965	.219898809

Number of obs =	966
F(5, 960) =	116.98
Prob > F =	0.0000
R-squared =	0.3786
Adj R-squared =	0.3754
Root MSE =	.37062

lncapgdp	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
lnval	-.0111157	.0055343	-2.01	0.045	-.0219763	-.000255
minond	-.1075782	.0080355	-13.39	0.000	-.1233474	-.0918091
crednd	.0782006	.0085105	9.19	0.000	.0614992	.094902
epi	-.5598668	.0589069	-9.50	0.000	-.675468	-.4442655
dcov	-.0917051	.024172	-3.79	0.000	-.139141	-.0442691
_cons	1.042224	.1288166	8.09	0.000	.7894299	1.295019

Variable	active
lnval	-.01111568**
minond	-.10757822***
crednd	.07820061***
epi	-.55986675***
dcov	-.09170506***
_cons	1.0422244***

legend: * p<.1; ** p<.05; *** p<.01

Table A5.1 Summary table (betas, standard error, p-value)

Variable	CARru~s	CARdir	CAPd	CAPGDPd
dhostile	-0.053	-0.061		
	0.044	0.044		
	0.2333	0.1642		
dcashonly	0.086	0.078		
	0.030	0.030		
	0.0045	0.0098		
ddebt	0.060	0.048		
	0.083	0.083		
	0.4693	0.5649		
lncap	0.025	0.023		
	0.019	0.018		
	0.1950	0.2133		
gdp	-0.011	-0.009	0.015	
	0.003	0.003	0.007	
	0.0016	0.0065	0.0387	
sharndr	-0.017	-0.005		
	0.012	0.011		
	0.1524	0.6371		
minndr	-0.038	-0.023		
	0.014	0.010		
	0.0068	0.0272		
epi	-0.189	-0.055	-2.305	-0.560
	0.090	0.073	0.126	0.059
	0.0362	0.4545	0.0000	0.0000
bnrddc	-0.055			
	0.019			
	0.0039			
btrddc	0.189			
	0.044			
	0.0000			
sorddc	0.035			
	0.023			
	0.1367			
mbrddc	0.008			
	0.028			
	0.7756			
dcov		0.138	0.002	-0.092
		0.025	0.053	0.024
		0.0000	0.9679	0.0002
minond			0.093	-0.108
			0.017	0.008
			0.0000	0.0000
crednd			0.120	0.078
			0.018	0.009
			0.0000	0.0000
lnval				-0.011
				0.006
				0.0449
_cons	0.541	0.235	6.143	1.042
	0.205	0.164	0.273	0.129
	0.0085	0.1517	0.0000	0.0000
N	966	966	966	966
df_r	953.000	956.000	960.000	960.000
df_m	12.000	9.000	5.000	5.000
r2	0.063	0.064	0.445	0.379
r2_a	0.051	0.056	0.442	0.375
rmse	0.375	0.374	0.794	0.371
F	5.326	7.316	153.951	116.978

legend: b/se/p