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The Takeover Directive as a Protectionist Tool?

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Paul Davies
University of Oxford and ECGI
Edmund-Philipp Schuster
London School of Economics and Political Science
Emilie van de Walle de Ghelcke
Freshfields Bruckhaus Deringer LLP

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Abstract

When the European Commission first proposed a harmonised legal framework for takeovers in the EU, its aim was to facilitate takeover bids in order to create a more efficient and competitive corporate landscape and to further the single market. In the view of the Commission, a functioning market of corporate control required rebalancing the division of powers between shareholders and management in companies facing a takeover bid. Taking the UK, EU's most active takeover market, as a model, the Commission proposed to assign the sole decision-making power regarding the bid to the shareholders, with management primarily playing an advisory role.

This so-called board neutrality rule, however, caused much controversy among the member states, and it was one of the main reasons for the Takeover Directive's notoriously long adoption history. Failing to achieve consensus on this topic, the Takeover Directive was finally adopted in a "watered down" version, without a mandatory board neutrality rule. Instead, a rather complicated system of "options" was introduced, both at member state and at company level. Although it was clear that this approach would not create the same barrier-free market for corporate control the Commission originally had in mind, it was still hoped that it would be a step in this direction. At the very least, it was certainly expected that this approach would retain the status quo.

This paper examines how the implementation of the Directive changed the takeover rules applicable to European companies. To that end, we analyse the pre-implementation rules regarding management's role in takeovers in all member states, and compare them with the current legal framework. We find that, instead of facilitating the Commission's ideal of a comprehensive, mandatory board neutrality rule, the Directive has, in aggregate, likely had an opposite effect. We argue that there are signs of protectionist motives driving member states' choices regarding board neutrality, and we find that the system of company-level choices is ineffective in its current form.

We propose a simplified and more coherent board neutrality rule, solely based on shareholder decision making. Acknowledging that a system allowing management to prevent unwanted bids might have advantages over a pure board neutrality rule in certain circumstances, we argue that shareholders are in a better position to decide on the optimal rules for a particular company than legislators.

Keywords: European Takeover Directive, board neutrality rule, reciprocity in takeovers, takeover defences, poison pill, ownership structure, contestability of corporate control

JEL Classifications: K22, G34, G38

Paul Davies
Jesus College
Oxford OX1 3DW
phone: 44-1865-279731, fax: 44-1865-279687
e-mail: paul.davies@law.ox.ac.uk

Edmund-Philipp Schuster
London School of Economics and Political Science
Houghton Street
London WC2A 2AE
United Kingdom
e-mail: e.schuster@lse.ac.uk

Emilie van de Walle de Ghelcke
Freshfields Bruckhaus Deringer LLP
Place du Champ de Mars, 5
1050 Brussels, Belgium
e-mail: emilie.vandewalledeghelcke@freshfields.com

The Takeover Directive as a Protectionist Tool?[†]

Paul Davies[*], Edmund-Philipp Schuster[**] and Emilie van de Walle de Ghelcke[***]

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I. INTRODUCTION

The principal purpose behind the Takeover Directive[1] in the eyes of the European Commission was to promote the integration of the national economies constituting the "Single Market" and to enhance the competitiveness of European industry as against non-European rivals by facilitating takeover bids, especially cross-border ones. As the Commission put it in its 2002 proposal,

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[†] We wish to thank Domenico Benincasa, Jacques Buhart, Luca Enriques, Athanasios Kouloridas, Frédéric Pelèse and Luigi Verga for valuable comments. We are also indebted to various European regulatory authorities for helpful clarifications and explanations of their respective legal frameworks. Finally, we want to thank all participants of the conference on 'Company Law and Economic Protectionism', held at Christ Church, Oxford.

[*] Allen & Overy Professor of Corporate Law and Fellow of Jesus College, Oxford; Emeritus Professor of Law, London School of Economics and Political Science; Fellow of the European Corporate Governance Institute.

[**] Research Assistant, London School of Economics and Political Science.

[***] Research Assistant, London School of Economics and Political Science; Member of the Brussels Bar (Freshfields Bruckhaus Deringer LLP).

[1] Directive 2004/25/EC on takeover bids (OJ L142/12, 30.4.2004) (the '*Takeover Directive*' or the '*Directive'*).

> *"the Lisbon European Council placed this directive, which forms part of the Financial Services Action Plan, among the priorities as regards the integration of European financial markets by 2005. […] Under the circumstances, the Commission considers it essential to provide a European framework for cross-border takeover bids as part of the Financial Services Action Plan. Such transactions can contribute to the development and reorganisation of European firms, a key condition for withstanding international competition and developing a single capital market."*[2]

Although this rationale was buttressed with the familiar arguments about providing a level playing field and enhancing legal certainty, it is clear that the competitiveness and integration rationales were the dominant ones in the Commission's mind. Also, as Enriques has pointed out,[3] the level playing field rationale is, by itself, a rather uncertain guide to what, substantively, should be included in any particular Community legal instrument. Everyone would be playing by the same rules if, for example, the launching of a bid were made conditional upon the agreement of shareholders of the acquirer and of the employees of the target, but such rules would be inconsistent with the promotion of cross-border takeovers. The same point can be made about legal certainty. This is not to deny that common rules *of a particular character* and legal certainty *of a certain type* facilitate cross-border bids, but simply to point out that the substantive content of the Commission's 2002 proposal, or at least the elements of it that were to prove controversial, can be explained only on a rationale of facilitating bids and integrating the European capital market.[4]

This paper seeks to establish whether and, if so, to what extent the implementation of the Takeover Directive in the Member States has moved national laws (further) towards the position in which takeovers are available to a significant extent as a technique for 'the development and reorganisation of European firms'. For this purpose, it focuses on one of the provisions in the Directive which was aimed at facilitating takeover bids, the board neutrality rule (BNR), contained in Article 9 of the Directive. In the very long debates over the Commission's proposals for a Takeover Directive, the BNR was at the centre of the political controversy about whether the European Community should attribute a significant role to takeovers. The Commission's

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[2] Commission of the European Communities, *Proposal for a Directive of the European Parliament and of the Council on Takeover Bids*, COM (2002) 534 final, Brussels, October 2002 (hereafter 'Commission's 2002 proposal') 3.

[3] L Enriques "The Mandatory Bid Rule in the Proposed EC Takeover Directive: Harmonization As Rent-Seeking?" in G Ferrarini, KJ Hopt, J Winter and E Wymeersch (eds), *Reforming Company Law and Takeover Law in Europe* (OUP, Oxford/New York 2004) 784.

[4] The integration rationale probably played an important role in regard of the mandatory bid rule, which is widely believed to have a "chilling" effect on (domestic and cross-border) takeover activity, whilst providing minority shareholders with additional protection (and therefore arguably increasing market confidence). However, takeover bids are only the means to an end (ie a more competitive corporate landscape); consequently, the mandatory bid rule can also be seen as being in line with the "competitiveness"-rationale in so far as it prevents inefficient takeovers.

1996 proposal for a Takeover Directive contained a mandatory BNR[5] and it was primarily the European Parliament's objections to this provision, coupled with a late change of heart by the German government of the day (departing from the common position agreed by all the Member State governments), which led to the failure of this first proposal at the very final stage of the European legislative process in 2001.[6] The Commission's 2002 proposal reiterated the suggestion for a mandatory BNR but, to address one set of objections which had been made to a ban on post-bid defences, the Commission coupled it with a proposal for the mandatory 'breakthrough' of certain pre-bid defences, ie that certain departures from the principle of one share - one vote and certain restrictions on the transfer of shares, existing prior to the offer, should not apply in the context of a takeover bid. So in the 2002 proposal a mandatory BNR was supplemented with a mandatory breakthrough rule (BTR).[7] Perhaps not surprisingly, this extension of the scope of the rules against takeover defences proved no more attractive to the other participants in the Community's legislative process. Eventually, agreement was reached between the Council (representing the Member States) and the Parliament on the final text of the Directive only on the basis that member states could decide to opt out of the BNR (contained in article 9) and/or of the BTR (contained in article 11) when they came to transpose the Directive.[8] This compromise, which was proposed initially by the Portuguese government and later elaborated upon by the Italian, was bitterly opposed by the Commissioner responsible for the Commission's proposal.[9] Whatever one thinks of the compromise, it clearly made the transposition decisions of the member states more than usually significant.

This article proceeds as follows. Part II identifies the function of the BNR in facilitating takeover bids. Part III analyses the choices created by the Directive in relation to the BNR by the Directive. As we shall see, these choices exist both at the level of the member state and at the level of the individual company. Parts IV and V report the evidence about the choices which have been made at both these levels. Part VI concludes.

II. THE FUNCTION OF THE BOARD NEUTRALITY RULE

The BNR, as adopted in the Takeover Directive, prohibits the management of a target company from taking any action which may result in the frustration of a takeover bid for this company

[5] [1996] OJ C 162/5; COM (95) 655, art 8. There was an even earlier Commission proposal of 1989 (COM (1988) 823 final), which also contained a (somewhat weaker) form of mandatory BNR, negotiations on which were suspended in 1991. See V Edwards, "The Directive on Takeover Bids – Not Worth the Paper It's Written On?" (2004) 1 European Company and Financial Law Review 416.

[6] Edwards ibid at 425-427. In fact, the very last vote on the Directive (in the European Parliament) was tied, so that, by convention, the proposal failed.

[7] See Art 11.

[8] The optional provisions are contained in Art 12.

[9] Edwards, above n 6, at 430-431. The title of her article includes the phrase the responsible Commissioner used of the Directive as adopted.

without obtaining post-bid shareholder approval for the specific defensive measure.[10] The only exceptions to this strict prohibition are the search for alternative bids (ie seeking a "white knight") and the completion of measures within the company's normal course of business, if they were already started pre-bid. It might seem obvious that a rule prohibiting the board of a company from taking defensive measures against an unwelcome bid without the consent of the shareholders given after the bid has been launched would have a significant impact in facilitating bids, where the rule is present, and in constraining bids, where it is absent. However, there are two sets of arguments which can and have been made in support of the view that the BNR is less important than first impression suggests and even that it is trivial. These two sets of arguments can be termed (a) the redundancy argument (which comes in three forms) and (b) the shareholder structure argument.

(a) The redundancy argument

(i) The BNR adds nothing to national law

The first form of the redundancy argument is that a BNR adds nothing to restrictions already existing in a legal system constraining directors from acting contrary to the interests of the shareholders when deciding whether to take defensive measures in relation to a takeover bid. Those national restrictions either already require shareholder approval of defensive tactics or constrain the exercise of board discretion in the face of a bid so as to protect shareholders. This is an argument which is obviously highly contingent on the content of the corporate laws of any particular legal system to which it is being applied. Whether it is true or not in relation to any particular system requires an in-depth and sophisticated analysis of that system against the standard of the BNR.[11] It is obviously doctrinally possible for a set of corporate laws not to contain an explicit BNR but instead to contain a collection of more specific rules and standards which together produce the same overall effect. In fact, it is rather unlikely that a legal system without a BNR lacks any restraints at all on defensive measures. In most member states the core duty of loyalty, for example, requiring directors to act in the best interests of the company would be engaged in a takeover situation, but, as we argue below, this constraint is probably not very effective. However, this form of the redundancy argument is not convincing.

First, it is unlikely that the argument that the BNR adds nothing to existing restrictions holds good in relation to many member states of the Community.[12] The BNR, as articulated in Article 9, has three powerful features which the non-BNR provisions must match if this form of the redundancy argument is to be made out. First, the BNR is a general rule which covers any action the board may take which could potentially result in the frustration of the bid (subject to the two

[10] See Art 9.2.

[11] For an application of this argument to the UK see D Kershaw, "The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition" (2007) 56 International & Comparative Law Quarterly 267.

[12] Of course, the Directive's BNR may be trivial if the national system already contains a domestic BNR, but the question we address here is whether a BNR, from whatever source, is a significant rule.

exceptions just mentioned and the positive requirement of the Directive that the board publishes its views on the offer).[13] Thus, the rule is not open to evasion by the creation of new defensive measures, such as, famously, the poison pill in the United States, which were not in mind when the more specific rules were formulated.[14] As important, a general rule will catch measures with defensive qualities which, while generally available, were not anticipated as being used for this purpose when the specific rules were drawn up.[15]

Second, the BNR is a rule, not a standard, and a rule which turns on the likely *effect* of the defensive measure in frustrating the offer, not on the good faith or proper purposes of the directors. Hence it is less susceptible to qualification or softening through ex post judicial decision-making. For example, a general duty of loyalty imposed on directors, requiring them to act in what they consider to be the best interests of the company, is not likely to be significantly constraining in relation to defensive tactics, because of the element of subjectivism in the formulation of the duty, coupled with the fact that in many member states' laws the 'company' does not constitute a reference exclusively to the shareholders' interests or, at least, does not do so unambiguously. Even with more objectively formulated standards, such as the UK standard requiring directors to exercise the powers conferred upon them only for a 'proper purpose', courts are sometimes reluctant to apply the standard in such a way as to require directors to obtain shareholder authorisation for defensive measures against what the court perceives to be an abusive offer.[16] In addition, takeovers are a time-critical operation from the bidder's perspective, and thus the prospect of having to litigate against the target's management will often render a transaction substantially less attractive for the acquirer – even where the chances of prevailing

[13] See Art 9.5. The advice of the target's board to accept an offer, for instance, will often be a key factor for the bidder's success. A recent example is Kraft Foods' takeover offer for Cadbury, where the decision of Cadbury's board to agree to (and recommend) Kraft's offer ended a month-long fierce fight over the company, and financial journalists had little doubt that – with Cadbury's board "approving" the takeover – it would be successful; see J Wiggins and L Saigol, 'Cadbury and Kraft agree £11.6bn deal' Financial Times, 18 January 2010.

[14] For the reasons given below, the poison pill is a US-specific example which cannot as easily be replicated in the Community. So, in the Community the ingenuity of lawyers acting for target management would have to be exercised along different lines. The point is that scope is given for such ingenuity if the rule constraining defensive measures is not comprehensive.

[15] For example, the rulings of the British Takeover Panel bringing within the BNR decisions by targets to litigate against the bidder. See Panel Decision 1989/7, *Consolidated Gold Fields* (decision by wholly-owned subsidiary to seek to restrain in the US courts the bid for the British parent company as being a breach of US competition legislation required approval of parent's shareholders).

[16] This is true even in the UK where the dominant trend in the court decisions is to require shareholder approval under the proper purposes rule in all cases for defensive actions (see *Hogg v Cramphorn* [1967] Ch 254; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821). A minor strand in judicial thinking, nevertheless, is that a proper purpose is constituted by saving the company from an abusive takeover. See *Cayne v Global Natural Resource* (unreported, August 12, 1982, Chancery Division) (directors' purpose not to perpetuate their control over the company but to 'prevent it from being reduced to impotence and beggary' by a predatory bidder); and *Criterion Properties plc v Stratford UK Properties LLC* [2003] BCC 50. Since the adoption of a BNR in the UK City Code in 1968 there has been less need to litigate the issue under the proper purposes doctrine.

seem reasonably high. In short, the BNR is a bright-line ex-ante rule, which avoids the uncertainty of meaning and interpretation associated with a more open-ended standard.[17]

Finally, the BNR requires shareholder authorisation of defensive tactics in the face of the bid. Pre-bid shareholder authorisation is not enough. How significant is the distinction between pre-bid and post-bid authorisation? The issue is particularly important in the European Community because the issue of shares (or convertible debt or share warrants) requires shareholder authorisation under the Second Directive, which also specifies pre-emption rights for the existing shareholders if the new shares are issued for cash.[18] However, that authorisation can be given up to five years in advance of the particular exercise of the issue power by the directors.[19] Share issues constitute one of the core areas for defensive measures by target management and so the Second Directive is potentially important.[20] The poison pill, ie the shareholder rights plan, is thus not as easy to adopt in the Community as in the US, because the authority to put the plan in place does not lie exclusively with the directors, as it does in the US.[21] Nevertheless, the Second Directive does not require shareholder authorisation post-bid where the decision to issue shares is taken by the board of directors in the framework of prior shareholder authorisation. How much does the BNR add to the Second Directive?

The Takeover Directive applies the BNR from the moment the board of the target receives information about the bidder's decision to make a bid.[22] It would be staining credulity to suppose that significantly different shareholder responses would be obtained if the shareholders were asked to approve defensive measures just after that moment or just before it when rumours of a potential bid were widespread but the acquirer had not yet communicated its offer to the target board. In both situations, managers requesting authorisation for the use of additional powers will be well understood by their shareholders as, in fact, asking for permission to "defend" the company. Thus, the shareholders' decision will depend on the expected impact of the anticipated defensive measures on the share price – eg trading-off the risk of entrenchment-driven defences

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[17] For a general analysis of the distinction between rules and standards see L Kaplow, 'Rules vs Standards: an Economic Analysis' (1992) 42 Duke Law Review 557.

[18] Directive 68/151/EEC ([1968] O J L65/8), Arts. 25 and 29. Articles 25 and 29 refer to 'increases of capital.' However, it is clear that this means the issuance of shares, rather than an increase of the authorised capital (in those jurisdictions which have both concepts).

[19] Arts. 25.2 and 29.5.

[20] It is a defensive measure singled out for specific mention in Art 9.2.

[21] LA Bebchuk and A Hamdani, 'Optimal Defaults for Corporate Law Evolution' (2002) 96 Northwestern University Law Review 489, 513. It is unlikely that shareholder consent will be introduced via the US rules relating to increases in authorised capital, because US companies usually carry substantial levels of shareholder approved authorised capital. A US-style shareholder rights plan, which excludes the acquirer from the rights, is also likely to infringe the European rule requiring equal treatment of shareholders (Second Directive, art 42) but it is possible to craft an effective shareholder rights plan without infringing this principle. We discuss the recently introduced French example of this approach below in Section V(b). So, shareholder approval is the bigger obstacle.

[22] Takeover Directive, Arts 9.2 and 6.1. Member states may impose the BNR at an earlier stage 'for example, as soon as the board of the offeree company becomes aware that a bid is imminent'.

against the chances of obtaining a higher takeover premium due to the increased bargaining power of the board.

However, the powers most commonly used to "defend" the target company can typically be used for multiple purposes, many of which clearly lie in the interest of shareholders. This is certainly true for the authority to issue new shares – probably the most important corporate power used for defending a target company. Before takeover rumours appear, shareholders will often be inclined to give the board the power to move quickly to raise finance for the company and to avoid the delays inherent in obtaining shareholder permission or offering pre-emption rights.[23] Thus, management seeking permission to issue shares (and on a non-pre-emptive basis) at a time when the company is not acutely perceived to be a potential takeover target will often succeed simply because the expected value of this decision is positive from the shareholders' point of view. Consequently, in the absence of a BNR 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. Although it will be possible to make the pre-bid permission conditional in some jurisdictions (so that it does not apply once an offer has been announced), this step presupposes a sophisticated shareholder body and requires overcoming the typical collective action problems in shareholder decision making. Therefore the BNR in effect imposes a requirement for shareholder permission post-bid, when the motives of the incumbent management are suspect, without the need for shareholders to amend the management's pre-bid proposals so as to impose that qualification. In other words, the BNR enables shareholders by simple vote to accept the benefits and avoid the costs of advance approval of share issues.

Whilst the Second Directive requires at least pre-bid shareholder authorisation for share issues, there is no equivalent general Community law requirement in relation to the other main category of defensive measures, ie dealings with the assets of the company, for example, the conditional sale[24] of prized assets to a third party or the acquisition of assets which make the target less attractive to the bidder.[25] Although most member states probably require shareholder approval, at least in listed companies, of sales of all or a substantial part of the company's assets, these rules still leave target management with considerable leeway in their dealings with the corporate assets – which the BNR restricts. Also, rules requiring specific shareholder approval for certain high-value transactions are typically triggered by thresholds tied to factors like asset values, profit

[23] See, for example, the vulnerability of British banks to short-selling during 2008 as they coped with the delays imposed by the need to obtain ex post shareholder approval. H M Treasury, *A Report to the Chancellor of the Exchequer by the Rights Issue Review Group*, November 2008, Ch 1.

[24] The sale is conditional on the success of the takeover offer, so that, in the ideal situation, the target loses its attraction for the acquirer and the bid is withdrawn. A conditional sale of the 'crown jewels' also helps to meet the test that the sale must be in the best interests of the company. If it is in the interests of the company that the bid fail, a sale whose purpose is to achieve that end and which will be executed only if the bid succeeds more easily meets the core loyalty test than an outright sale.

[25] An acquisition is probably more difficult to put in place in a hurry post-bid than a sale.

generation or the consideration of a transaction.[26] In terms of "defence potential", however, other factors, like synergy potential of sold assets or restrictions arising from competition law play a more important role, which will often allow management to make the target company substantially less attractive for a particular bidder without even coming close to the relevant thresholds.

We thus conclude that, certainly in the case of Community law and probably in respect of national rules, the BNR fills a regulatory gap.

(ii) Removal rights render the BNR unnecessary

The first form of the redundancy argument asserts that the BNR is unnecessary because other features of domestic law already constrain managerial discretion to an equivalent extent. Those constraints may be transaction-specific (such as the rules on share issues) or general standards for reviewing the exercise of discretion by directors (such as the core duty of loyalty). The second form of the argument proceeds on the basis that such constraints may not exist to an equivalent extent, but argues that such constraints are unnecessary provided the shareholders have effective removal rights over the directors. To put the matter another way, governance rights can replace the BNR or its equivalents. Where there are strong removal rights, shareholders can ensure that the bid discretion possessed by management will be exercised in their favour by threatening to remove the directors later, if a wealth-maximising bid fails through board opposition, or (more likely if shareholders suffer from collective action problems) an acquirer can solve the shareholders' coordination problems by mounting a takeover bid through the mechanism of a proxy fight to replace the existing directors with its own nominees. In the latter case, the absence of a BNR causes the acquirer to adopt a different acquisition technique but there is no impact on the chances of the acquisition occurring. This argument is well-known in the United States in the form that it is the poison pill together with the staggered board[27] that chills acquisitions, not the poison pill on its own.[28]

However, it is far from clear that the delay involved in the requirement to make the acquisition through a proxy fight, even when the board is not staggered, is insubstantial. If, with even a non-staggered board, the opportunity to remove the incumbent management arises only once a year at the expiry of the directors' term of office, then the delay and inflexibility as to timing imposed on the potential acquirer, as well as the advance publicity as to its goals, would be inhibiting.[29]

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[26] See eg UKLA's Listing Rule 10 for the UK.

[27] In the typical staggered board arrangement one third of the board retires each year and thus can be replaced at the annual general meeting, but the others are irremovable before the end of their terms, except for cause (see Delaware General Corporation Law § 141 (k)). A bidder will thus have to win a proxy fight in two successive years in order to be able to replace a majority of the board.

[28] LA Bebchuk, JC Coates and G Subramanian, 'The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy' (2002) 54 *Stanford Law Review* 887.

[29] Bebchuk et al (ibid) focus on the impact of the staggered board but note at p 912 that in company laws with 'effective annual terms' (EAT) for directors but without staggered boards *"because a significant delay might be*

Put more generally, the removal strategy can operate effectively as a substitute for the BNR only if an ordinary majority of the shareholders can at any time and without cause remove the directors from office and only if a small proportion of the shareholders are in a position quickly (and cheaply) to convene a meeting of the shareholders at which the removal power can be exercised. Even then it might be good policy to buttress the removal power with the equivalent of a BNR once the notice requisitioning the shareholders' meeting was communicated to the target board. Without that safeguard there would be opportunities for managerial opportunism in the intervening period, which is bound to be measured in weeks rather than days.[30] This is especially true for defensive actions which cannot easily be reversed after the bidder obtains control over the board, such as "defensive acquisitions". Additionally, the bidder will often be restricted in his ability to place his nominees on the target's board as a consequence of competition law.[31] However, the more important point is that by no means all member states provide for director removal along these lines. In many Community jurisdictions removal is not available until the end of the term of office or a supermajority for removal is required or removal is not an act which can be carried out directly by the shareholders (because that power lies with a supervisory board) or the convening of meetings against the opposition of incumbent management is difficult.

(iii) Market responses to managerial entrenchment

The third form of the redundancy argument is that the BNR is unnecessary because the same effect can be produced through contractual arrangements between the company and the incumbent management. Again, this argument is founded on US experience. The argument is that the poison pill, at least to some extent, has been countered by the development, through contracting, of performance-related payment schemes for managers, at least where these generate significant pay-outs upon a change of control.[32] These arrangements, which have become very widespread in the United States, will powerfully affect management's response to an offer, if a successful offer triggers the vesting of share options (or some other financial bonus, such as a

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required before a proxy contest can be launched, the ballot box route may not provide a sufficient safety valve against disloyal incumbents of EAT targets in some cases. Thus, incumbents of EAT targets sometimes have significant power to block offers that shareholders would support". See also JN Gordon, 'An American Perspective on Anti-Takeover Laws in the EU: The German Example' in G Ferrarini et al (eds), above n 3 at 549: "The poison pill is, on its own, formidable."

[30] Art 5.4 Directive 2007/36/EC of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies ([2007] O J L184/7) imposes a minimum period of three weeks between the notice summoning the meeting and its happening, and the directors will have some further period to check the validity of the request from the shareholders and to respond to it. The provision also contains an exception for meetings convened in order to decide on takeover defences; even in this case, the minimum notice period is two weeks (see Art 9.4 Takeover Directive).

[31] Obtaining of control over the target's board will often, in itself, already be subject to competition law approval.

[32] M Kahan and EB Rock, 'How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law' (2002) 69 University of Chicago Law Review 871. The remuneration strategy may counteract the adverse effect of the poison pill on the number of takeovers, but the division of the bid premium as between shareholders and managers, by contrast, is significantly affected by the pill. Incentivised remuneration conditioned on a change of control can be viewed *"as a buyback by shareholders of the takeover-resistance endowment that managers were able to obtain form the legislatures and the courts during the 1980s."* (Gordon, above n 29 at 555).

golden parachute) under a performance-related remuneration scheme. Whilst this is a potentially effective market response to the poison pill, its effectiveness turns on the acceptability of high-powered remuneration schemes in the jurisdiction in question. Although performance-related pay for managers of listed companies has spread quite widely through the developed economies, the extent to which it has been embraced still varies from jurisdiction to jurisdiction. Where such schemes run against national corporate culture, this market response will be lacking or muted. In such jurisdictions, it may well not be the case that a manager will be significantly better off, at least on a life-time basis, by taking a change-of-control payment rather than exercising discretionary powers so as to maintain him- or herself in office. Moreover, following the classical market for corporate control-rationale, such change-of-control payments will often be a consequence of a company's underperformance prior to the bid. The resulting "reward for failure"-character of such arrangements will further reduce their acceptability.[33] The significance of this aspect was recently evidenced by the public outcry caused by the enormous payments to unsuccessful managers in the financial sector, even in jurisdictions like the US.[34]

(iv) The Example of Germany

It might be useful to take a particular jurisdiction and see how the considerations mentioned above play out in a particular national setting. Germany, as seen above, led the last-minute opposition to the 1996 proposal for a takeover directive largely because it contained a mandatory BNR. Having secured that negative position in 2001, it then enacted at the end of that year a domestic Securities Acquisition and Takeover Act.[35] That Act starts from a board neutrality principle but then creates three exceptions to it. Most important, it provides that the management of German targets may take defensive measures if the supervisory board approves post-bid.[36] The section also authorises 'actions which a diligent and conscientious manager not subject to a

[33] Such considerations played an important role in Germany's 2009 regulation of executive remuneration ('*Gesetz zur Angemessenheit der Vorstandsvergütung*', 'VorstAG'), which gives the supervisory board the power to alter the contractual remuneration arrangements in case of a deterioration of the company's situation. See the press release of the German Ministry of Justice (available at http://www.bmj.de/managergehaelter), which states that such a deterioration would, for example, exist where 'the company needs to lay-off employees and cannot pay dividends'. § 87 (2) AktG now allows an adjustment of the remuneration, where the continued payment of the contractually agreed remuneration would be "inequitable" (*"unbillig"*) for the company.

[34] Even in the US, CEOs of (quasi-)failed financial institutions came under substantial criticism (and political pressure) over the enormous "golden parachutes" they received; see eg New York Times, 'Chiefs' Pay Under Fire at Capitol', 8 March 2008, available at: http://www.nytimes.com/2008/03/08/business/08pay.html.

[35] Wertpapierwerbs- und Übernahmegesetz – WpÜG. For an brief overview of the WpÜG's history see eg A Zinser, 'Das neue Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und von Unternehmensübernahmen vom 1. Januar 2002' (2002) 56 WM - Zeitschrift für Wirtschafts- und Bankrecht 15.

[36] §33(1) WpÜG. Under §33(2) WpÜG the management board may also obtain pre-bid shareholder approval for defensive measures (effective for 18 months at a time). This is the second exception to the domestic BNR. However, since shareholder-approved defensive measures also need supervisory board approval post-bid, little is gained (and something is potentially lost) by seeking shareholder authorisation in advance, and so this particular provision seems to have been largely a dead letter. See T Stohlmeier, *German Public Takeover Law* (Kluwer, The Hague 2nd edn 2007) 112 (its "practical relevance […] is, in any event, very minor").

takeover offer would have also taken'[37] – without imposing the requirement of supervisory board approval. Indeed, prior to the enactment of the 2001-act, there existed an ongoing debate on whether or not German general company law contained an implicit BNR, which lost much of its force through the enactment of the WpÜG, which can be seen as the legislator's answer to the negative.[38] This certainly underlines the importance of a bright-line rule, as any degree of legal uncertainty allows management to use, or credibly threaten to use, corporate powers to defend the company at a much smaller cost.[39] When the second version of the Directive was adopted with an optional BNR, Germany chose to opt out of it, in order to preserve its domestic provisions.[40] Thus, on two occasions in recent history Germany has chosen to avoid a mandatory BNR in order to preserve its freedom to enact and maintain domestically what it sees as a less demanding takeover regime.

Why did Germany expend precious political capital in resisting EU legislative efforts to introduce a mandatory BNR? Can it be argued that the apparent freedom the WpÜG gives to management through the exceptions to the neutrality principle is illusory because other parts of German law, including those implementing the Second Directive, restore the shareholder primacy which the BNR espouses? The answer appears to be in the negative, i.e. the adoption of a mandatory BNR in Germany would have been a significant departure from the existing law for the following reasons.

- Prior shareholder approval for share issues (including share issues on a non pre-emptive basis) can be given up to five years in advance.[41]
- Acquisition of assets is subject only to the general core duty of loyalty, which views the company through a stakeholder rather than a shareholder lens.[42]

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[37] This does not give the managing board powers it would not otherwise have (eg to issue shares without shareholder authorisation) but it does at least permit the managing board to perform the balancing act among stakeholder interests which the German duty of loyalty requires without taking account of the fact that shareholder interests might indicate that the bid should be facilitated. Thus, a company already pursuing an acquisition strategy could continue (and even accelerate?) it in the face of a bid, even if fully aware that the acquisition would render the company a less attractive target.

[38] See A Wolf, 'Der Mythos "Neutralitätspflicht" nach dem Übernahmerichtlinie-Umsetzungsgesetz', (2008) ZIP – Zeitschrift für Wirtschaftsrecht 300 for an overview of the discussion.

[39] First, a credible threat to block the transaction will often result in hostile takeovers not being attempted. Second, even where they are, managers will not only take into consideration their chance of prevailing with their arguments in litigation, but they often will also enjoy a certain kind of liability privilege where they take decisions in an area of legal ambiguity (even where no statutory liability privilege applies, the ambiguity of the situation might have consequences in terms of insurance cover).

[40] §33a WpÜG provides the company level opt-in to the Community's BNR. See section IV below.

[41] §§ 202-204 Aktiengesetz (AktG). This is 'probably the most common defence': Stohlmeier, above n 35, 114. The par value of the new shares may not exceed one half of the value of the share capital existing at the date of the authorisation and the authorisation of the supervisory board is needed for the issuance. There are no equivalents to the pre-emption or share issuance guidelines from institutional investors which cut down on the statutory freedom to give advance approval, as is the case in the UK. Contrast ABI, *Directors' Powers to Allot Share Capital and Disapply Shareholders' Pre-emption Rights*, December 2008 and Pre-emption Group, *Disapplying Pre-Emption Rights: A Statement of Principles*, 2006.

- Disposal of assets is subject only to the general duty of loyalty.[43]
- Removal rights for shareholders are constrained. During their term of office (typically around 5 years), members of the management board may be removed only by the supervisory board and only where good cause can be shown. Good cause may include a vote of no confidence by the shareholders, but such a vote only empowers (not requires) the supervisory board to act.[44] Thus, the shareholders may be forced to proceed indirectly by removing the members of the supervisory board as a first step. Within the term of office (again usually around five years)[45] three quarters of the votes cast are necessary for such a removal.[46] Of course, in codetermined companies this applies only to the shareholder representatives on the board. A shareholders' meeting may be convened by 5% of the shareholders.[47]
- High-powered incentivised remuneration, especially where it involves pay-outs dependent on a change of control, is treated with caution in Germany. The Act has recently been further tightened so as to allow for downward revision of contractual pay arrangements in case of financial distress.[48] It also requires the supervisory board, which fixes the remuneration of the members of the management board, to ensure that such remuneration "bears a reasonable relationship to the duties of such member and the condition of the company."[49] The German Corporate Governance Code states more precisely: "payments promised in the event of premature termination of a Management Board member's contract due to a change of control shall not exceed" 3 years' remuneration.[50]

(b) The shareholder structure argument

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[42] W Underhill and A Austmann, 'Defensive Tactics' in J Payne (ed), *Takeovers in English and German Law* (Hart Publishing, Oxford 2002) at 96: *"In a takeover situation, management may take action frustrating the bid if this appears justified in balancing the different interests involved."*

[43] The *Holzmüller* doctrine may limit disposals (and possibly acquisitions) when they are very large, but on the latest authority it only applies in cases comparable to the original decision where the disposals reached 80% of the company's total assets: M Löbbe, 'Corporate Groups' (2004) 5 German Law Journal 1057, 1078-1079. The AktG requires shareholder approval only for the transfer of the entire assets of the company: §179a AktG.

[44] § 84 AktG.

[45] § 102 AktG.

[46] § 103 AktG, which contains a default rule to this end; the articles can provide for a removal by simple majority.

[47] § 122 AktG.

[48] See n 33 above.

[49] § 87(1) AktG.

[50] 2009 edition, 4.2.3. See generally Gordon, above n 29, arguing that cultural opposition to golden parachutes and the accelerated vesting of stock options on a change of control casts the discretion conferred on boards by takeover defences in an entirely different light, because the market reaction to the defences is not available or is significantly limited. The infamous recent criminal prosecution for corporate waste of former Mannesmann board members for the payment of post-takeover bonuses has no doubt also chilled pay-outs conditional on a change of control, though it should be noted that the payment in that case was gratuitous, not contractual. See BGH 21 December 2005, NJW 2006, 522 and C Milhaupt and K Pistor, *Law and Capitalism* (University of Chicago Press, Chicago/London 2008) ch 4.

The second main argument against the BNR is that it has no significance in concentrated shareholder jurisdictions and that these jurisdictions predominate in the European Community. The argument can be elaborated as follows. It is commonplace in the relevant literature to assign a *corporate governance* or *disciplining function*[51] as well as an *efficiency function*[52] to the market for corporate control, or, in other words, to identify two types of desirable control shifts. We need to consider the dispersed/concentrated distinction in relation to each function.

First, in companies with widely-dispersed ownership structures ("Berle-Means companies"), even significant underperformance by the managers will often not lead to shareholder action, due to rational apathy and collective action problems. Managers, therefore, have little to fear from their unorganised and apathetic investors. Being theoretically empowered, but practically unable, to 'fire' their managers, the market for corporate control here fulfils its disciplining function by providing an alternative mechanism to bring assets to more efficient use.[53] Shares trading below the fair value of the same assets under efficient management invite bidders to make a tender offer for the company's shares. The bidder, holding all or the majority of the shares after the offer, can now exercise the formerly unused powers to oust the current managers and run the company more efficiently. The effect is not limited to *actual* (observable) control transfers, however. In the face of a (realistic) takeover threat, managers have an *ex ante* incentive to do their best, as a hostile takeover will normally lead to them losing their job. From a policy perspective, employing this effect, in principle, clearly makes sense, as more efficient corporate structures may be expected as a result, fitting in smoothly with the mentioned rationale of the Takeover Directive.

Second, and distinct from this corporate governance function, which primarily addresses problems of managerial agency costs, transferability of corporate control also serves a more general efficiency goal. In that sense, takeovers can be explained by what are normally referred to as "synergies", where the target company's assets are of unique value for the acquirer.[54] Combining two firms' assets can create value – eg due to economies of scale or scope – which even the most talented and diligent managers could not achieve for the target company's shareholders. Here, the issue turns away from corporate governance and agency costs; rather,

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[51] On the market for corporate control, see the classical contribution by Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110; see also e.g. JC Coffee, 'Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145.

[52] See JC Coffee, ibid, at 1166, describing the synergy hypothesis.

[53] See eg R Gilson, "A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers" (1981) 33 Stanford Law Review 819, 841.

[54] See Coffee, above n 51, 1166. See also R Romano, 'A Guide to Takeovers: Theory, Evidence, and Regulation' (1992) 9 Yale Journal of Regulation 119, 125-129.

takeovers are here explained as an operation of Coasian mechanisms, "bringing together what belongs together".[55]

Clearly, both motivations can give rise to takeovers, and both forms of control shifts are socially desirable and therefore compatible with the Directive's aims. However, it should be noted that the disciplining effect of takeovers is basically a remedy against shareholder apathy; it is the unsatisfied investors who choose to sell their shares, rather than to oust or more closely monitor the management, and – by leaving the share price languishing – trigger the functioning of the market for corporate control.[56]

In blockholder[57] companies, in contrast, the controller of the company *does* have sufficient incentives to closely monitor the managers' performance and, where necessary, let better qualified people run the company.[58] Equally, managers in controlled companies are always confronted with a realistic threat of being ousted in case they underperform, as they face a vigilant "principal" watching them permanently. This is to say that the market for corporate control (and contestability of control) is simply not needed in blockholder companies, as far as disciplining takeovers are concerned. To put it slightly differently: a blockholder will not normally sell his shares to a person whose only source of gains from the transaction is the replacement of the current inefficient management team; he would rather effect the change himself and keep all the value generated for himself (and free-riding fellow shareholders). Knowing that, we should not expect a potential bidder to actually propose such a transaction, as the research on its part is likely to constitute sunk costs. Therefore, there is neither demand nor supply on the market for corporate control in blockholder companies as far as disciplining

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[55] There are, of course, other possible motives behind or explanations for corporate control transactions. Especially worth mentioning is the empire building explanation, asserting that bidders actually overpay in takeovers, which can be founded in self-interest (eg higher managerial compensation) or simply in hubris. As Easterbrook and Fischel ('Corporate Control Transactions' (1982) 91 Yale Law Journal 698, 707) point out, corporate law can ignore overpayment due to the self-deterring nature of wasting money (this is to say, it can ignore that when dealing with control transactions, not in general). This view was also implicitly embraced in the Directive, which does not try to address issues related to bidder overpayment (eg by means of obligatory approval by bidder shareholders). Moreover, as an expression of the agency costs of shareholders, empire building is itself constrained by the threat of a takeover of a company run by managers who destroy shareholder wealth through ill-advised acquisitions.
Another explanation of premiums paid by the bidder is the exploitation rationale, based on dispersed shareholders' inability to coordinate their actions when facing an inadequate bid (see eg LA Bebchuk, 'The Pressure to Tender: An Analysis and a Proposed Remedy' (1987) 12 Delaware Journal of Corporate Law 911); this cannot be further analysed here, as the problems are mostly addressed by the mandatory bid and the sell-out rules; see PL Davies, 'The Notion of Equality in European Takeover Regulation' in J Payne (ed), above n 41, 14-15. Exploitation of other stakeholders – another possible driver for takeover activity – is better dealt with by separate regulation; see also the *Report of the High Level Group on Issues Relating to Takeover Bids*, Brussels, January 2002, ch 4.2.

[56] See Manne, above n 50, 113.

[57] The term "blockholders" is used here to describe a shareholder of the company who, at least under normal circumstances, can exercise effective control over the company due to his shareholding.

[58] See PL Davies and KJ Hopt, "Control Transactions" in R Kraakman et al, *The Anatomy of Corporate Law* (OUP, Oxford 2nd edn, 2009) 233, explaining the shift of the agency conflict away from the management-shareholder relationship in controlled companies.

takeovers are concerned; this seems to make questions about the contestability of control close to meaningless in this context and to leave no room for a BNR to operate.

Regarding the efficiency function of the market for corporate control, the situation is different. Obviously, even the most vigilant watchdog cannot easily cause the managers to create value that depends on a shift of corporate control.[59] However, the existence of blockholders by itself should not reduce the contestability (or, rather, transferability) of corporate control regarding such takeovers "of the second kind". Where the potential bidder has something to offer to the incumbent controller which the latter cannot achieve (a purchase price exceeding the value of the shares in the hands of the incumbent controller, even with the best available managers), the blockholder will have ample economic incentives to effectuate the transaction. Arguably, the acquirer will find it easier to convince the blockholder to sell than to secure agreement in a widely-held company (where the acquirer has to deal with the managers or dispersed shareholders).[60]

However, the blockholder's response to restructuring offers is complicated by the potential for private benefits of control (PBCs). Although the blockholder, as rational economic actor, can be expected to accept mutually beneficial offers,[61] this somewhat depends on an equal (or rather: unchangeable) distribution among the shareholders of the cash-flows generated by the company. PBCs, on the other hand, are benefits enjoyed by the blockholder (controller) of a company due to the controlling position, which are not shared with the outside (ie non-controlling) investors, and are typically associated with concentrated share ownership.[62]

The existence of PBCs naturally increases the per share value of the blockholder's shares as opposed to the valuation of those held by the outside investors. This, in turn, potentially diminishes the transferability of a controlling position. Where the incumbent controller derives

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[59] Unless it is in a position to effect that shift by acting as acquirer, rather than as a target.

[60] This, of course, is over-simplifying the complex relationships between managerial ability and the potential for synergy gains. It can probably be expected that good managers (irrespective of whether the company has a dispersed shareholding or not) are likely to create more efficient company structures by employing all means available to them before being taken over (eg buying smaller competitors, entering complementary businesses where this creates value, and the like). This, however, only strengthens the point made: blockholder structures, it could be argued, are likely to render disciplining takeovers unnecessary *and* leave less scope for synergy-based takeovers (as managers make use of all options to create economies of scale/scope available without changing the current control structure). Simple measures, like the sheer level of public M&A activity, are therefore unsuitable for assessing the efficient functioning of the market for corporate control.

[61] This is to say, he will accept the bargain where the potential acquirer is willing to pay a purchase price above the controller's current (or otherwise achievable) per share value.

[62] See eg CG Holderness, "A Survey of Blockholders and Corporate Control" 2003 Economic Policy Review 51; A Dyck and L Zingales, "Private Benefits of Control: An International Comparison" (2004) 59 Journal of Finance 537. The latter show that the size of PBCs varies from jurisdiction to jurisdiction. In some jurisdictions they are probably no greater than is appropriate for compensating blockholders for their monitoring efforts. In that situation PBCs do not constitute a barrier to control shifts since the incumbent controller will be relieved of the monitoring costs after a sale.

much of the value of his shareholding from the enjoyment of PBCs,[63] socially desirable control shifts can be prevented by the fact that the potential acquirer, while creating a higher overall value, does so in a way which requires it to share the gains equally among all shareholders. In this case, it might not be able to meet the blockholder's (rational) price expectations.[64] This potential for decreasing the transferability of control in blockholder-companies, which depends on differences in PBCs between the bidders,[65] can therefore impede the Directive's efficiency goal.

A good regulatory response to this problem of private benefits of control where there is blockholder control is hard to design.[66] Whatever the best solution, it is clear that the BNR is of only limited[67] relevance to it. The Directive attempts to tackle part of the free-rider problem by allowing the successful bidder to "squeeze-out" the remaining shareholders.[68] However, this right comes coupled with another core-provision of the Directive which effectively exaggerates the PBC problem, the mandatory bid rule (MBR). This rule requires an offer at the same price to be made to the outside shareholders where there is a transfer of control shares from blockholder to bidder, thus preventing the bidder from compensating the blockholder for its additional (ie PBC-) "loss" arising out of the sale.[69]

Does this mean that the BNR is relevant only in jurisdictions where blockholding is unusual? Within the European Community, there are only two such jurisdiction, namely, the United Kingdom and Ireland.[70] However, since the UK has long imposed a BNR – indeed its BNR provided the model for the Directive – and Ireland similarly has enacted an equivalent rule long

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[63] Although often associated with "tunnelling" or outright theft, PBCs can come in different forms, including synergies; eg Holderness, ibid, at 55.

[64] This is mainly due to free-rider problems on the part of the remaining shareholders, who will be reluctant to sell below the post-takeover share value; see LA Bebchuk 'Efficient and Inefficient Sales of Corporate Control' (1994) 109 Quarterly Journal of Economics 957, at 966-967. See also Easterbrook and Fischel, above n 55, at 705-706.

[65] See Bebchuk, ibid 961.

[66] One suggestion made by Easterbrook and Fischel (above n 55) is to allow an acquirer to squeeze-out the remaining shareholders at the pre-transaction value (ie the current share price), which allows shifts of corporate control to take place even where the acquirer produces most of his efficiency gains in the form of increasing future dividends (as opposed to retaining or increasing the PBC-level of the incumbent controller). The Directive (Art 15), on the other hand, requires far stricter requirements to be met in order to squeeze-out minority shareholders, namely a 90% threshold and payment of the same price as in the block-trade/bid.

[67] Arguably, the presence of a BNR allows *de facto* controlling shareholders with (substantially) less than 50% of the voting rights to prevent the success of a bid which offers a premium over the market price of the shares (thus being attractive to the outside investors), but leaves the incumbent worse off because he is not compensated for a loss of his current PBCs.

[68] See Art 15, allowing the bidder to acquire the remaining shares where he obtains 90% or 95% of the target's shares. For the rather complicated calculation of the threshold and the respective member state options see eg C van der Elst and L van den Steen, 'Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-out and Sell-out Rights' (2009) 6 European Company and Financial Law Review 391

[69] For this argument in more detail, see Davies and Hopt, above n 58 at 257-260 Adding the MBR also means that PBCs can prevent efficient takeovers even where the acquirer and the seller have the identical PBC-levels.

[70] M Faccio and LH Lang, 'The Ultimate Ownership of Western European Corporations' (2002) 65 Journal of Financial Economics 365 at 379.

before the Directive's enactment, the debate over the Directive's BNR might be thought to be a storm in a tea-cup.

Whilst we accept that shareholder structure can render the BNR irrelevant, we argue that the view that the BNR has importance only in the UK is misplaced. We have three reasons for our view. First, the issue is not whether companies in a particular jurisdiction typically have dispersed shareholding or blockholder control but which category a particular target company falls into. In the UK there are some companies under blockholder control, even if that arrangement is far from typical. Equally, in jurisdictions where blockholder control is typical, companies with dispersed shareholding can be found. Whilst stressing the importance of controlling shareholders in Continental Europe, Berglöf and Burkart have remarked that:

> *"most publicly traded firms in Europe are either widely held or family controlled. There is, however, a marked difference in the relative importance of these two categories across Europe. In Continental Europe, as in most other countries of the world, family controlled firms are in the majority."*[71]

This is far from a claim that widely controlled companies are non-existent in Continental Europe. The existence, but atypicality, of widely held companies in Continental Europe may explain the willingness of many European Community states to adopt a BNR in advance of the Directive.[72] The BNR was relevant in these jurisdictions but the atypicality of the widely-held company reduced managerial opposition to the adoption of the rule.[73]

Second, the evidence suggests that the pressures of globalisation and the expansion of the Single Market within the European Community have generated a discernible trend towards an increase in the proportion of companies not subject to blockholder control. In a study of Germany, France Italy and the UK, Franks and colleagues used a test of no shareholder with more than 25% of the voting shares as the (relatively generous) test for that company being widely held.[74] On that basis there had been significant increases in the number of widely held companies in all three continental jurisdictions between 1996 and 2006, with the UK remaining steady at over 90%. In France the percentage of widely held companies increased from 21% to 37%, in Germany from 26% to 48% and in Italy from 3% to 22%.[75]

Third, our analysis above assumed a binary division between dispersed shareholding and secure blockholder control (ie a blockholder holding at least 50% of the votes in a company). An

[71] M Burkart and E Berglöf, 'European Takeover Regulation' (2003) 18 Economic Policy 171, 181.
[72] Ibid, Table 1 (referring to the then twelve members of the EU).
[73] See the similar argument by A Ferrell, 'Why Continental European Takeover Law Matters' in G Ferrarini et al (eds), above n 3, 571-572.
[74] J Franks, C Mayer, P Volpin and H Wagner, 'Evolution of Family Capitalism: A Comparative Study of France, Germany, Italy and the UK' EFA 2009 Bergen Meetings Paper, available at http://ssrn.com/abstract=1102475.
[75] Ibid Table 2, Panel B.

intermediate situation is one where a group of large shareholders have control of the company, so long as they act together, but the defection of one or more of them, together with the support of the majority of the non-controlling shareholders would be enough to transfer to an acquirer control over the company. One might term this situation 'insecure' blockholder control. The empirical evidence suggests that such control arrangements are quite common in Europe. Thus, Laeven and Levine report on a sample of 1657 publicly traded firms across Europe in the late 1990s. Here, 34% by number and 18% by market capitalisation had multiple large shareholders (a large shareholder being one holding 10% or more of the voting rights), as opposed to having one controlling shareholder (50% by number and 46% by capitalisation) or no controlling shareholder (16% and 36%).[76] In such a situation an acquirer is not without hope of effecting a control shift against the opposition of at least some of the leading shareholders.[77] In that context, restrictions on the power of the management[78] to prevent or discourage the bid being put to the shareholders as a whole fulfil a function in facilitating bids even in companies one would not characterise as having dispersed shareholding. Of course, leading shareholders can seek to counteract the risk of defection by contract, for example, shareholder agreements binding the signatories in some way to adopt a common policy towards acquirers. Thus, it may be that in the insecure blockholder situation the value of the BNR depends in part on other rules putting shareholder agreements in question where there is a bid. It is not the purpose of this paper to discuss the BTR but we note below (in Section V(b)) in our discussion of France the increased significance of the BNR in a national jurisdiction which has adopted a 'mini' BTR directed at shareholder agreements.

Equivalently, a blockholder often does not have *de jure* control of the target (ie more than 50% of the voting rights), but nevertheless is still able to exercise the majority of the voting rights in a typical general meeting. The practical relevance of this is evidenced by the 30% threshold most European jurisdictions use as a trigger for the mandatory bid rule. This second type of insecure blockholders will typically be in control of the company's board at the time of the offer announcement. As we will argue below,[79] the BNR can significantly impede the ability of such blockholders to prevent unwanted offers from succeeding.

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[76] L Laeven and R Levine, 'Complex Ownership Structures and Corporate Valuations' (2008) 21 Review of Financial Studies 579, Table 2. In none of the countries studied did the proportion of listed firms with multiple large shareholders fall below 20% by number. These figures also suggest that the largest companies were more likely to have no controlling shareholder and that multiple (ie more than one) large shareholders were disproportionately to be found in smaller listed companies. Table 2 also supports our first point for it reports the existence of listed companies with no controlling shareholder in all jurisdictions, even if the proportion in some is very small (<5% in Italy, Austria, Portugal, and France).

[77] Precisely what level of support the acquirer needs to obtain to be successful will vary from case to case. In some instances acquisition of shares carrying a majority of the voting rights may be enough to give effective control; in other cases, where decisions important to the acquirer require supermajority approval of the shareholders, the acquirer may need to be certain that no hostile shareholder holds a blocking minority position.

[78] The management will have been appointed by the leading shareholders before defection and probably see their loyalty as lying with the non-defecting members of the group of leading shareholders.

[79] Section III(c).

Taking these points together, it would be wrong to conclude that hostile takeovers (and more generally, the BNR) are a phenomenon confined to the UK. Whilst Martynova and Renneboog report that 80 of 130 hostile bids launched in Europe in the period 1993 to 2001 concerned UK or Irish targets, the remaining 50 by definition occurred elsewhere, with France (13) and Sweden (11) being particularly active markets.[80] Overall, the above analysis suggests that a Community-level prohibition on post-bid defensive measures by target management without shareholder approval could have a potentially significant impact. The argument can be made that a 'no frustration' or 'board neutrality' rule (BNR)[81] promotes the corporate governance benefits of takeovers in widely dispersed companies, whilst not impinging on the operation of companies controlled by secure blockholders. Where the blockholder or controlling coalition is insecure, a ban on post-bid defences encourages challenges by acquirers and thus promotes transfers of control to acquirers who can offer the benefits of economies of scale or scope.[82]

However, although the analysis suggests that a mandatory BNR encourages value increasing control shifts, it does not follow that the BNR is *necessarily desirable* in terms of creating value for shareholders *overall*. It is possible that the advantages of "shareholder primacy" (ie increased chances of value increasing takeovers) are set-off or outweighed by forgone benefits found in systems vesting discretion over control transactions in management. For instance, a shareholder-focussed system can discourage employees from investing in firm-specific skills, as no credible promises of long-term employment are available.[83] 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. We return to this point in our concluding policy proposal.

(c) Evasion through pre-bid defences

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[80] M Martynova and L Renneboog, *Mergers and Acquisitions in Europe*, ECGI Finance Working Paper 114/2006, Table 4 (also in L Renneboog (ed), *Advances in Corporate Finance and Asset Pricing* (Elsevier, Amsterdam 2006) On the other hand, 17 of 29 countries studied had experienced no hostile bids in the period.

[81] These terms are generally used interchangeably, but 'no frustration' can be argued to be the better term, since the Article 9 of the Directive does not require the board to take a neutral stance on the bid. Inaction (eg refusing the bidder access to the target's books), seeking a 'white knight' and recommending against the bid are all examples of non-neutrality which the Article allows. However, board neutrality seems to have become the accepted term and it has the advantage that its acronym (BNR) resonates with that for the breakthrough rule (BTR).

[82] There remains room to argue, however, that transfers against the will of insecure blockholders or parts of a controlling coalition do not *per se* pass the efficiency test. Losses of PBCs on the part of the blockholder or coalition are not necessarily completely set-off by equivalent efficiency gains caused by the control shift. In other words, transactions could impose negative external effects on blockholders. Contrary to what is sometimes asserted, PBCs are not necessarily illegal, and there are good reasons for legislators to take into account such efficiency losses; see EP Schuster, 'Efficiency in Private Control Sales - The Case for Mandatory Bids' (2010) LSE Law, Society and Economy Working Paper 8/2010, available at http://ssrn.com/abstract=1610259.

[83] This is a central theme in the 'varieties of capitalism' literature; see P Hall and D Soskice, 'Introduction to Varieties of Capitalism' in P Hall and D Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (OUP, Oxford/New York 2001) 30.

The strongest criticism of the BNR is probably none of the above, but rather the argument that an effective BNR simply generates a strong incentive for incumbents to put in place defensive measures in advance of the bid.[84] A BNR simply does not bite on such measures. As we have noted,[85] the Commission's 2002 proposal sought to address this concern by adopting a BTR, whereby certain pre-bid steps with defensive qualities would cease to be effective post-bid, namely certain departures from the one share - one vote principle and certain restrictions on the transfer of shares. As with the BNR, the BTR ended up in the Directive as an optional rule.[86] We do not report systematically in this paper on the BTR. We simply note the following: (a) A mandatory and comprehensive BTR was known in no member state before the Directive was adopted, with the possible exception of Italy, even though the mandatory BNR had been adopted by a large proportion of the member states. However, a number of member states has 'mini BTRs' ie rules restricting the adoption of certain pre-bid defences. (b) Very few member states adopted the BTR on transposition of the Directive.[87] (c) Apparently, no company has opted into the BTR. We do, however, consider the relevance of the absence of a mandatory and comprehensive BTR for member state and company choices in relation to the BNR.

III. THE CHOICES CREATED BY THE DIRECTIVE

(a) Introduction

The aim of this paper is to investigate the choices made by the member states in the course of the transposition of Article 9 of the Takeover Directive and by companies thereafter. The first step in such an exercise is to identify the choices created by the Directive. In any case where the Community's legal instrument takes the form of a Directive some choices are created for member states. Unlike a Regulation, a Directive does not automatically become part of the member state's legal order upon enactment through the Community's legal process, but rather it needs transposition into national law by an act of each member state's legislative process. Further, a Directive "shall be binding, as to the result to be achieved [...] but shall leave to the national authorities the choice of form and methods".[88] In the case of the Takeover Directive, however, member state level choices were given a particular significance because of the default status ultimately accorded at Community level to the BNR. Agreement was reached between the Council (representing the Member States) and the Parliament on the final text of the Directive only on the basis that member states could decide to opt out of the BNR (contained in article 9) when they came to transpose the Directive.[89]

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[84] J Arlen and E Talley, 'Unregulable Defences and the Perils of Shareholder Choice' (2003) 152 University of Pennsylvania Law Review 577,
[85] Above Section I.
[86] Arts 11 and 12. The options created track those for the BNR.
[87] Bulgaria, Estonia, Latvia and Lithuania have opted into the BTR.
[88] Article 288 EC [formerly art. 249 EC].
[89] Art. 12. A similar provision was made in relation to the BTR, which we do not discuss in detail in this paper.

(b) Member state choices

(i) Opting out or not?

Article 12 of the Directive provides that member states "may reserve the right not to require companies [...] which have their registered offices within their territories" to observe the BNR. Although the member states' choice is untrammelled, the language used to express the option (as an opt out) signals the implementation favoured by the drafters (or, rather, shows its history).[90] More important, if a member state chooses to opt out of the BNR, it must provide a counter-option for any particular company to opt "back" into it, on a reversible basis.[91] The corporate-level decision to opt back in (or reverse this decision at a later date) is to be taken by the shareholders in accordance with the rules applicable in that jurisdiction for adopting changes to companies' articles of association.[92] Such corporate decisions are to be communicated to the national authorities of the state of incorporation and of any other state where its securities are admitted to trading on a regulated market.[93] Thus, decisions on the corporate level become important as well and are discussed below.

(ii) Reciprocity or not?

There is a further refinement to the default status of the BNR. Article 12 uses the concept of 'reciprocity' to introduce a further option – or rather another potential double option: one for the member state and – depending on this member state choice – one for the company. Reciprocity, a novel concept in takeover regulation, refers to the question of whether the acquirer is subject to the BNR. The member state may give companies subject to the BNR, if they receive a bid from an acquirer not subject to the same restrictions, the power in relation to that bid to escape from the BNR which would otherwise be applicable to them. If the member state chooses not to make this option available, that is an end of the matter. However, if the member state chooses the opposite course, then the company through its shareholders can authorise the management to take defensive action which would otherwise be caught by the BNR, if subject to a bid from a company "which does not apply the same Articles"[94] as it does. The crucial point about this authorisation is that it can be given in advance of the offer, provided the shareholders do so within the eighteen month period before the launch of the bid in question. Article 12 does not specify any particular procedure for the giving of general meeting authorisation to take up the

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[90] J Winter, 'The Need for a Regulatory Framework – EU Company Law at the Cross-Roads' in Ferrarini et al above n 3, 18.

[91] Art 12.2. The set of companies to which the Directive applies are those whose securities are admitted to trading on a regulated market within the EU: art 1.1.

[92] To use the UK term. In other jurisdictions the document is often referred to as the company's "statutes" or sometimes as its "charter".

[93] Art 12.2.

[94] Art 12.3; "Articles" here refers to Art 9 and/or Art 11.

reciprocity exception, nor does it require such decisions to be communicated to the authorities, though they must be disclosed.[95]

The reciprocity exception in its current form is probably one of the oddest results of the compromise that finally led to the adoption of the Directive. As mentioned above, the 2001 proposal was turned down primarily because of disagreement over the BNR. One of the member states' concerns[96] was that the BNR would lead to a general disadvantage of European companies as against their US rivals, because the latter typically can employ powerful defensive tactics, which would no longer be possible for their EU counterparts. The High Level Group, although clearly unconvinced by the argument, consequently suggested that the *mandatory* BNR be confined to bids by European listed companies for other European companies.[97] Instead, the reciprocity exception has finally been adopted in addition to an *optional* BNR. This substantially complicates the whole framework of the Directive and directly counteracts the aim of harmonising national takeover rules.[98]

Perhaps because it was drafted at such a late and contentious stage in the Directive's adoption process, there are also many unsolved questions about the scope of the reciprocity exception. A central one concerns the point at which the option arises. There is no doubt that a member state may choose to make the reciprocity exception available to companies when they are considering opting back into the BNR in situations where the member state has decided to opt out of the rule. It is much less clear whether a member state can decide to qualify its decision *not* to opt out of the BNR by making the mandatory BNR subject to the reciprocity exception.[99] However, a number of states on transposition took the view that they were free to apply the BNR on a mandatory basis, but subject to the reciprocity exception, and implemented such a regime in their national laws.[100] As we shall see below, the functions of the reciprocity exception are different when it operates as a qualification (a) to an otherwise mandatory BNR imposed by the member state or (b) to a corporate decision to opt back into the BNR – as are the incentives for the member state to make it available in the two cases.

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[95] Art 12.3 to 12.5. However, a convenient way of complying with the disclosure requirement may be for the member state to add reciprocity decisions to opt in decisions as needing disclosure to the national authorities.

[96] The point was primarily raised by Germany; see Becht, 'Reciprocity in Takeovers' in G Ferrarini et al, above n 3, at 648.

[97] See *Report of the High Level Group on Issues Related to Takeover Bids*, above n 54, 42.

[98] Considering exclusively the member state choices regarding BNR, BTR, and the reciprocity exception, there are *16* different possible regulatory outcomes. Note that at the time of the Directive's adoption, the EC had 15 member states.

[99] The wording of art 12.3 suggests rather strongly that the reciprocity exception is available only in the former case since it refers to 'companies, which apply' Articles 9 or 11. For arguments that the reciprocity exception is available in both cases see J Rickford, "The Emerging European Takeover Law from a British Perspective" (2004) 15 *European Business Law Review* 1379, 1397-1398 and for arguments against A Maréchal and A Pietrancosta, "Transposition de la directive OPA: des incertitudes entourant le recours à la clause de réciprocité" *Bull. Joly Bourse*, 2005, No. 203, 797.

[100] The following made this choice in relation to the BNR: France, Greece, Portugal, Slovenia and Spain. The opt-out version of the BNR ultimately adopted by Italy is also subject to reciprocity.

A second important interpretative uncertainty about the reciprocity rule arises where a target, subject to the BNR but with the reciprocity exception, receives offers from two or more bidders, one or more of which is subject to the BNR and one or more which is not. Can the target apply the reciprocity exception against all the bidders or only against the ones not subject to the BNR? The French legislator has taken the view that defensive measures can be adopted by the target in relation to all the bidders in such a case.[101] Other national legislation is ambiguous on the point. If the French view is incorrect, then target management is presumably able to take defensive measures only if these are targeted at particular offerors, for example, the issuance of warrants[102] which become effective only if a particular offeror or offerors, not subject to the BNR, obtain control. It would be improper for the warrants to be triggered by an offeror subject to the BNR obtaining control. By extension, it could be argued that warrants issued when only one bidder, not subject to the BNR, is in the field would equally have to be designed in this way, lest a bidder subject to the BNR later enters the field or be discouraged from doing so. Irreversible or non-conditional defensive measures would not be permitted because they might deter a bidder subject to the BNR from making a bid.

(iii) The function of the reciprocity exception

Why would a member state seek to make the reciprocity option available and why would the shareholders of the target seek to take it up? Where the member state does not opt out of the BNR (and assuming the reciprocity option is indeed available in this situation), it is not obvious why the principle of shareholder decision-making should be departed from in the case where the bidder is not subject to the BNR.[103] The anti-entrenchment gains for the target do not depend on whether the bidder is subject to a BNR. However, on a longer term perspective there may be something to be said for the member state's adopting the reciprocity exception. Suppose the world consists of only two states, one (A) with and one (B) without a mandatory BNR. Other things being equal,[104] over time the proportion of businesses in the two states together not subject to the BNR will increase. This is because it will be easier for state B companies to acquire state A companies than vice versa, but state A companies, once acquired by state B companies, will no longer be subject to the BNR – or rather their holding companies will not. If state A takes the view that the BNR is an important element in securing efficient management of companies,[105] it may make sense for state A to give state B or its companies an incentive to become subject to the

[101] Commercial Code, Article L233-33.
[102] See below Section V(b)
[103] J McCahery, L Renneboog, P Ritter, and S Haller, 'The Economics of the Proposed European Takeover Directive' in G Ferrarini et al, above n 3, at 645; J Rickford, above n 99, 1402, suggesting the reciprocity option is inconsistent with Treaty provisions.
[104] Which, of course, they will not be. Suppose, for example, state A generates new businesses rapidly whilst state B does so hardly at all. Furthermore, we put aside possible consequences from the product markets, which could give country A-companies, who are successful, an edge over country B-companies, which may survive in an inefficient state purely due to entrenchment (as control is not contestable in such companies, where they are widely-held).
[105] The corporate governance rationale for the BNR is discussed briefly above in Section II(b).

BNR by adopting some version of the reciprocity rule.[106] On this analysis state A has to trade off the reduced impact now of the BNR (as a result of the adoption of the reciprocity exception) against the increased impact of the BNR in the future.

However, it is doubtful whether the reciprocity option contained in the Directive is apt to secure this longer-term goal. It requires reciprocity on the part of the bidder only at the time of the acquisition and not the subsequent maintenance of the BNR after the acquisition has been effectuated. Within the EU, therefore, it is doubtful whether the reciprocity qualification to the mandatory BNR fosters the overall adoption of that rule, because companies in jurisdictions where the BNR is not mandatory can make opportunistic use of the opting in facility – opting in as potential acquirers but not opting in or opting out, after having previously opted in, as potential targets.[107] With regard to acquirers from outside the EU, the impact of the reciprocity exception is even less clear. Article 12.3 allows reciprocity where a company is subject to an offer from a company 'which does not apply the same Articles as they do' (or is controlled by such a company). Since a non-EU company, even if it is subject to the equivalent of a BNR, will not be in that position as a result of applying Article 9, it can be said that reciprocity will always be available against a non-EU company.[108] If the non-EU company is in fact subject to a BNR, this seems an indefensible result. There will exist no incentive to non-EU companies or countries to adopt the BNR because the reciprocity option will still be open to EU targets faced with bids from such companies. Perhaps for this reason the French transposing legislation makes the reciprocity exception available if the bidder does not apply the BNR 'or equivalent measures'.[109] Similarly, the Italian implementation also employs the wider concept of 'equivalency'.[110] Even if a non-EU bidder can take advantage of being subject to the equivalent of the BNR, the bidder is still required to be in this state only at the date of the bid and not to maintain that rule thereafter, so that the incentive for non-EU jurisdictions, as well, is to provide only an opt-in to/opt-out from the BNR for companies within their jurisdiction.[111]

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[106] State A will have an interest in state B companies being subject to the BNR so long as state B companies carry on operations in state A.

[107] Of course, this overstates the ease with which companies can game the system. Member states may impose constraints on the speed with which companies can reverse an opting-in decision, and companies may misjudge whether they are potential acquirers or potential targets.

[108] At least to the extent this is not barred by international agreements; see *Report of the High Level Group on Issues Related to Takeover Bids*, above n 54, and recital 21 of the Directive. Denmark, for instance, seems to embrace this view, by applying the reciprocity exception to all non-EEA bidders; see § 81c (5) of the Danish Public Companies Act.

[109] Commercial Code Article L233-33. On the other hand, the French provision appears to make the reciprocity option available whenever there is a bid from any 'entity' which does not apply the BNR or its equivalent, whereas the Directive suggests that reciprocity is available only in the case of non-BNR companies. Thus, it is doubtful whether the Directive allows reciprocity against a bid from an individual or a non-corporate entity, whether the bidder is within or without the EU.

[110] Art. 104-ter comma 1 Legislative Decree 1998 no 58.

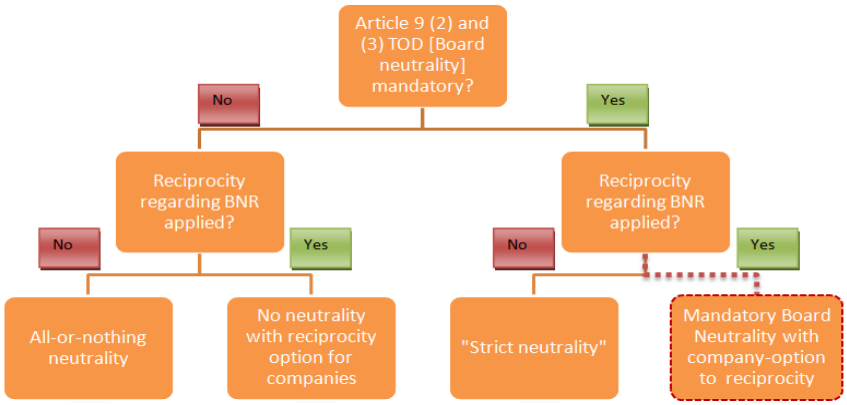
[111] There is an entirely contrary argument, based on para 21 of the recitals, to the effect that targets can invoke the reciprocity exception only against bidders which have chosen not to opt into the BNR, in which case all non-EU companies would be outside the range of the reciprocity exception, even if they are not subject to the equivalent of the BNR – an equally odd result. The argument is somewhat weakened by the reference to international agreements

It seems more likely, therefore, that the drafting of the Directive in relation to reciprocity, and decisions by member states whether to invoke it, are driven more by economic nationalism, ie a desire to ensure that in the process of global consolidation companies headquartered in their jurisdictions should more often be acquirers than targets. We return to this point below in Section IV(c).

Where the member state chooses not to make the BNR mandatory, its decision whether to allow opting in by companies subject to reciprocity raises a different set of considerations. The member state's aim, presumably, is to alter the incentives which operate upon the company when deciding whether to opt in or not. It is thought that opting in on the basis of reciprocity will be more attractive to shareholders in some cases than opting in without it.[112] Whether and in what circumstances this is a convincing analysis of the company-level incentives is discussed below.

Overall, in relation to the BNR the choices which the Directive gives the member states can be set out as follows.

DIAGRAM 1[113]



(c) Company level choices

The company may have no choices to make at all. If the member state chooses to impose a mandatory BNR and not to make reciprocity available as a qualification to the mandatory rule, then the company has nothing to decide. If, however, the member state chooses to make

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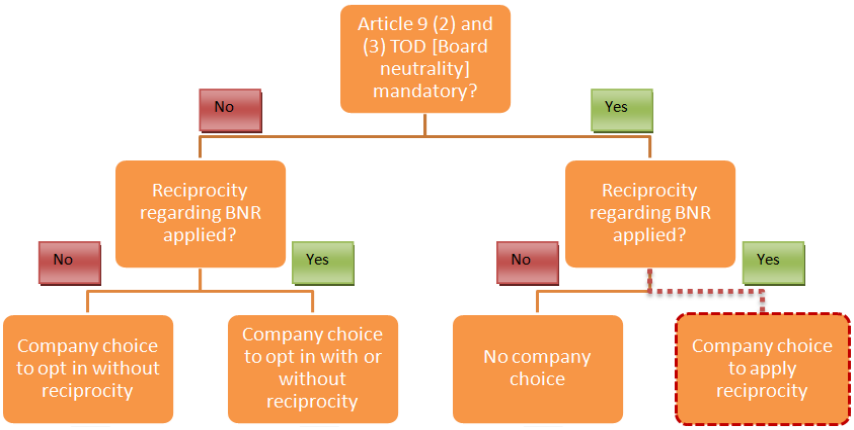
to which the EC is a party in the same sentence, which rather strongly suggests that third countries are to be included.

[112] KJ Hopt, 'Obstacles to corporate restructuring: observations from a European and German perspective' in M Tilson et al (eds), *Perspectives in Company Law and Financial Regulation* (CUP, Cambridge 2005) 380.

[113] As pointed out above (see text to n 98), it is unclear whether the reciprocity exception is in fact available in combination with a mandatory BNR under the Directive. This choice is marked by the dotted lines in Diagrams 1 and 2.

reciprocity available as a qualification to the mandatory BNR, the company, by way of shareholder decision, has to decide whether to take it up.[114] Further, if the member state chooses not to make the BNR mandatory, it must give the company the right to opt back into the BNR (by shareholder decision) and may choose to allow it to do so on the basis of reciprocity. In this case the company has two choices to make. The position can be put as in the following diagram.

DIAGRAM 2



What is the incentive structure of the shareholders if faced with any of these options? Let us look first at the company's decision to opt back into the BNR, where reciprocity is not available (i e, the far left-hand box on the bottom line of Diagram 2). All these optional decisions are to be taken by the shareholders, in the case of this decision typically by supermajority vote because the Directive mandates that the shareholders should take the opting back in decision "in accordance with the rules applicable to amendment of the articles of association".[115] The shareholders' decision to opt in to the BNR will presumably be motivated by a desire to maximise the market value of the shares, by capturing both the disciplinary and restructuring benefits of the takeover or the threat of it. However, the Directive does not significantly help the shareholders to put their preference into operation. In the absence of management initiative, the shareholders must take the initiative to secure the opt in and the Directive does nothing to help them overcome their coordination problems, which are likely to be severe in a dispersed shareholding company. To the contrary, by insisting on a supermajority vote, the Directive accentuates the shareholders' difficulties. Where shareholding is concentrated and the controlling shareholders wish to preserve their PBCs, there is probably not much the Directive could have done to facilitate a shareholder opt-in decision, other than mandating the BNR as the default rule in national law, and thereby reversing the direction of the opt-in/opt-out mechanism.[116] By insisting on a

[114] But see the Portuguese and Danish implementation, below section IV.
[115] Art 12.2.
[116] In this case, insecure blockholders would have reason to fear opposition in case they try to opt-out of the BNR. This reverse opt in-mechanism was enacted by Italy in a recent change of its takeover law; see Section IV(b) below.

supermajority vote, the Directive makes it even easier for large shareholders in insecure blockholder companies to stymie a resolution to opt back in.

Overall, the Directive's provisions on opting back in go against the modern theory that default rules should be constructed so as to be counteract shareholders' coordination problems and thus give the management or controlling shareholders the burden of securing an opt out from default.[117] It is perhaps not surprising that we found no case to date in which the shareholders of a company had opted back into the BNR where the member state had chosen not to make it mandatory.

Moving on to the next box in the bottom row of Diagram 2, we consider the case where the shareholders may opt back in either with or without reciprocity. If we have correctly identified the motives for shareholders to wish to opt back into the BNR, then the addition of a reciprocity qualification would not seem attractive to them.[118] If the reciprocity option is adopted, it will reduce the chances of an offer being made for the shares or of a competitive bidding situation arising if an offer is made. Moreover, the management of an acquirer not subject to a BNR is likely to be less strongly accountable to its shareholders than one that is subject to a BNR and so is more likely to contemplating overpaying for a target (for empire-building reasons, for example) than one that is so subject. Thus, by applying the reciprocity rule the shareholders of the target are potentially excluding offers from the most attractive acquirers. At the same time, such offerors are likely to be the favoured choices for the target's management, as a less accountable bidder will typically have more leeway offering them to keep their jobs or giving "golden handshakes". Thus, the management may use their bargaining power to divert a higher proportion of the bid premium to themselves than would be the case in the absence of the reciprocity rule.[119] Consequently, if shareholder-initiated opt-ins to the BNR by companies were to be made, we would not expect them to be accompanied by decisions in favour of reciprocity.

Where the member state has imposed a mandatory BNR but has allowed the companies to qualify the mandatory rule by opting for reciprocity by shareholder decision (ie the far right-hand box), the burden of initiating action is placed on the management/controllers of the company, because reciprocity here qualifies a BNR which applies to the company without shareholder decision. So, in this instance the modern theory about default rules is complied with: those who would benefit from the change must persuade the shareholders to qualify a default which is apparently in the shareholders' interests. In dispersed shareholding companies, the shareholders' coordination problems are partly addressed by this formula, because it is the management which

[117] See LA Bebchuk and A Hamdani, above n 21. Regarding the merits of and problems associated with the Directive's optional arrangements see also G Hertig and J McCahery, 'Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?' (2003) 4 European Business Organization Law Review 179.

[118] The reciprocity qualification to the opt in needs renewal every 18 months if it is to continue to be effective, but the Directive does not stipulate a supermajority vote for this decision: Art 12.5.

[119] Cf the discussion in Section II(a)(iii) above.

needs to convene the meeting and put the reciprocity proposal to the shareholders. If shareholders' responses to requests for pre-bid authorisation of defensive measures where the bidder is not subject to reciprocity are exactly the same as their response to a post-bid request for authorisation of defensive measures in such a case, then management has no incentive to seek pre-bid authorisation.[120] If, however, as argued above,[121] a significant number of shareholders may in fact treat voting on pre-bid authorisation differently from deciding whether to accept an offer, once it is made, then there may be advantages for management in seeking to make use of the reciprocity qualification. In short, the management may find the burden of persuading the shareholders (even where they are highly sophisticated) less heavy pre- than post-bid, despite the fact that the only purpose of the reciprocity resolution is to increase the management's defensive powers if a bid materialises. One argument the management could use to win support for the proposal could (and most likely will) be the positive effect a strong bargaining position could have on the premium paid by an acquirer.

Whilst the reciprocity qualification to the mandatory BNR is irrelevant where the company has a secure single controlling shareholder (absent unusual circumstances, the management will always do what the controlling shareholder wants), the reciprocity rule may have attractions for non-secure blockholders. Assume that multiple large shareholders (or a single insecure blockholder) have enough shares to control the company's general meeting (because of the apathy of the non-controlling shareholders) but fear that an offer put to the shareholders individually would prove attractive to a sufficient proportion of the non-controlling shareholders to permit the offer to succeed. Similarly, the controller might fear that dramatically more shareholders might show up in a post-bid general meeting deciding about defensive measures than in a "normal" meeting. Such fears could be founded in the notion that, after announcement of a bid, the proportion of more activist shareholders (esp. event-driven hedge funds) increases dramatically. 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. The latter worry might be further amplified by the EC's more recent attempts to facilitate (cross-border) exercise of voting rights.[122] There might also be a particular post-bid risk where one of the large shareholders defected to the acquirer.

The controllers fear in other words that their control of shareholder meetings might be undermined in what is in effect a postal ballot of all the shareholders. In such a case the blockholders might wish to give the board of the target (ie themselves, in essence) the power to escape from the BNR; after all, they are able – under "normal circumstances" – to control the board's decision whether or not to take defensive measures in the face of any particular bid, and can therefore screen-out unwanted bidders. As mentioned above,[123] increasing the managerial

[120] Unless the managers want to avoid the time constraint linked to post-bid decision making.
[121] Section II(a)(i).
[122] See Directive 2007/36/EC, above n 30.
[123] Section II(a)(i).

discretion can be regarded as value-increasing from the non-controlling shareholders' point of view *ex ante*, thus rational shareholders will sometimes vote in favour of such a proposal.[124] Even where the management would not be able to convince a rationally acting shareholder body of the advantages of increased defensive powers, a reciprocity proposal could still prove successful, where a sufficient amount of shares are in the hands of rather passive investors. Their apathy will (rationally) be higher in an ex ante ballot, where the expected costs are still discounted by the uncertainty of the reciprocity rule's relevance, than in a post-bid scenario, where the wealth effect of defence is predictable with near-certainty. In addition, some of the involved institutions might be conflicted or financially unsophisticated, with weak incentives to force the company to implement a value increasing strategy. Again, this effect is likely to be greater *ex ante* than *ex post*.

In short, the reciprocity exception operates here as a way of watering down the mandatory BNR and of preserving management or (insecure) blockholder control. Management or blockholders might prefer not to be subject to a BNR at all but that choice is not available to them. Instead, they can reduce the range of situations in which their control will be tested, especially if the reciprocity option is given a wide scope by being available, for example, against all non-EU bidders or in all situations where one of the bidders is not subject to the BNR.[125] As we shall see below, opt outs by companies where the BNR has been made mandatory by the member state, which has also made the reciprocity exception available, is the one area where we have found significant company-level decision-making – though not in all jurisdictions where the exception has been made available.

IV. THE CHOICES MADE – MEMBER STATES

(a) Transposition choices

We have scored the choices made available to the member states, as set out in Diagrams 1 and 2 above, in the following way. We assign three points to member states that decided to make the BNR mandatory. In a second step, we assign one point for the decision *not* to make the reciprocity exception available. The highest score (4) is thus assigned to those countries which have chosen not to opt out of the BNR and have not applied the reciprocity exception, and the lowest score (0) to those states which have made the BNR optional and have given companies opting back in the freedom to do so on the basis of reciprocity. A member state which does not make the BNR mandatory but does not make the reciprocity exception available scores 1. So, the higher the score, the more friendly to bidders is the member state, as far as the BNR is concerned.

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[124] See Section V(b) regarding some French companies making use of this possibility.
[125] See Section III(b)(ii) and (iii) above.

As pointed out above, the decision to make reciprocity available on the company level is of rather minor importance in practice. Combined with a non-mandatory BNR it does not seem to influence the outcome of the rules ultimately applicable to the companies to any meaningful extent. As an add-on to a mandatory BNR the reciprocity exception can have some practical consequences (as will be seen in the French example), but certainly to a far lesser extent than the decision whether the BNR is mandatory in the first place. For example, a member state combining a mandatory BNR with a reciprocity exception effectively opens its market for corporate control at least regarding all *domestic* takeovers; in addition, the UK, as a very important originator of cross-border bids, and any other state which has made the BNR mandatory will also benefit from this choice. It was our intention to account for these differences in practical impact by assigning a substantially higher "score" to the opt out or not decision than to the reciprocity choice.[126] Of course, such a score necessarily involves an element of judgement, as it can hardly be quantified to what extent one choice is more important than the other. Our method of scoring also leads to unambiguous results in the sense that the score directly translates into a specific combination of choices made by the member state.

Table 1 sets out the results of our scoring.

[126] The '0'/'1' division is somewhat debatable. If the alternative for the shareholders to opting in with reciprocity is not opting in at all, then it can be argued that '0' is the better choice from the bidder's point of view (ie for bidders subject to a BNR). However, if the comparison is with opting in without reciprocity, '1' is clearly more bidder friendly.

TABLE 1

MEMBER STATE IMPLEMENTATION SCORES: BNR

Country	BNR SCORE
Austria	**4**
Belgium	**0**
Bulgaria	**4**
Cyprus	**4**
Czech Republic	**4**
Denmark	**0**
Estonia	**4**
Finland	**4**
France	**3**
Germany	**0**
Greece	**3**
Hungary	**0**
Ireland	**4**
Italy	**2***
Latvia	**4**
Lithuania	**4**
Luxembourg	**0**
Malta	**4**
Netherlands	**0**
Poland	**0**
Portugal	**3**
Romania	**4**
Slovakia	**4**
Slovenia	**3**
Spain	**3**
Sweden	**4**
United Kingdom	**4**

Fourteen member states (out of twenty seven) chose not to opt out of the BNR and not to make the reciprocity exception available. Five further states did not opt out but made reciprocity available. All the remaining eight member states opted out of the BNR on the basis that the reciprocity exception was to be made available as well, ie they maximised the choices available to their companies. However, since we found no companies to have opted back into the BNR, the member state choice as between making reciprocity available or not has had no practical

significance in relation to the opting back in decision. What does seem to be the case is that the incentive provided by the reciprocity option for companies to opt into the BNR is weak.

Italy, to which we assigned a score of '2', calls for a special explanation. Since enactment of the Directive, Italy has adapted its rules regarding the BNR (and the BTR) several times, starting from a strict BNR. In its latest version,[127] Italy still maintains its formal opt out of the BNR, adopted in 2008,[128] together with a reciprocity option – a choice that would generally yield a score of zero according to the methodology described above. However, while the application of the BNR remains optional in Italy, the "direction of choice" has been reversed, as the BNR was adopted as a default rule. As a consequence, Italian companies will be subject to the BNR *unless they opt out* of the rule by amending their articles of association.

As we have argued above,[129] the mechanism employed for implementing the optional arrangements may have an important impact on the rules finally applicable to the companies. Apart from alleviating the coordination problems among shareholders, reversing the direction of the choice mechanism also alleviates the problems connected to the supermajority requirement for opt in decisions[130] required by the Directive. In a "typical" opt out jurisdiction, a blockholder in a *de facto* controlling position with significantly less than 50% of the voting rights[131] can effectively block any opt in proposal by his fellow shareholders, even if they overcome the collective action problem. This also leads us to assigning a score of '2' to Italy. As the value of the rules *per se* is not objectively quantifiable, our aim must be to assign scores with "ordinal accuracy"; for our purposes, this means that we try to assign higher scores to more pro-shareholder choices. In these terms, Italy's score can be explained as follows. The choice restricts management discretion to a greater extent than the rules in countries scored '0' (ie where the BNR is optional and reciprocity is available), because in the latter, a supermajority needs to support the BNR to put it in place, while in Italy 33%[132] of the shareholders are sufficient to block an opt out decision.

Similarly, Italy's new framework constrains management (and/or insecure blockholders) to a larger extent than countries with a score of '1' (ie where the BNR is optional, but no reciprocity exception exists), as an equivalent shareholder body would always adopt *more, or at least equally, bidder-friendly* rules in Italy, as it would in a typical '1'-scored country. Where a supermajority of shareholders supports adopting a 'strong' BNR, it can do so in both cases.

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[127] See Legislative Decree No. 146, art. 1(3), 25 September 2009 (published in the G.U. no. 246 of 22.10.2009), which amended Art. 104 of the Legislative Decree No. 58. It will come into force on 1 July 2010.
[128] See also below, text to n 147, for more details.
[129] Section III(c).
[130] Art 12.2; see also above section III(c).
[131] Depending on the national corporate law and the expected attendance of the relevant general meeting, a blockholder with around 15%-25% will probably be able to block any supermajority-requiring decision.
[132] In the new Italian takeover regime opting out of the BNR supposes an amendment to the articles of association of the company. This requires a supermajority of 2/3 of the voting rights.

Where only a simple majority favours such rules, a BNR will apply in Italy (because the company cannot opt out), while a company in a '1'-country would be unable to opt in. Where a majority, but not a supermajority, favours increasing management discretion, it is true that a reciprocity exception can be adopted in a jurisdiction like Italy,[133] but not in a country scored '1'. However, this situation in Italy would lead to the BNR still being applicable to all bidders who are themselves subject to a BNR,[134] while the same shareholder body, on the other hand, would not apply any form of the BNR in a country scored '1'. Finally, where a supermajority of shareholders favours authorising the managers to take defensive action as they think fit, the BNR will apply neither in Italy nor in any jurisdiction scored '1'.

As regards jurisdictions scored '3', Italy never yields a more pro-shareholder outcome when comparing equivalent shareholder bodies' choices, but in one case (where a supermajority exists which favours increasing management discretion), a company subject to Italian law will not apply the BNR (ie opt out), while this option does not exist in countries with a score of '3'.[135] The score of '2', therefore, seems to properly reflect the relative "bidder friendliness" of Italy's new rule.

Also worth mentioning are Denmark and Portugal, both of which seem to have adopted an "automatic" reciprocity rule: in contrast to the Directive's requirements, they do not require regular shareholder approval for the reciprocity exception to kick-in, but rather apply the rule in any case. While this seems irrelevant in the case of Denmark,[136] as it has opted out of the BNR, and no company seems to have opted back in again, this could be significant in Portugal (a '3'-country).[137]

(b) Comparison of pre- and post-transposition position

We have discussed so far the choices which the member states made in implementing the BNR. Given the options made available to the member states, it is not surprising that the resulting pattern of regulation is not uniform across the EU. However, it would still be possible for the Commission to claim that the Directive had made progress towards a single market in which companies were more open to takeovers, if the BNR were more widespread post-Directive than it had previously been.

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[133] The reciprocity decision does not require a supermajority decision under the new law, unless the decision requires a change of the articles, for example, to give the board the right to issue shares free of pre-emption rights.

[134] Because a simple majority can only adopt the reciprocity exception, but will be unable to opt out entirely from the BNR.

[135] However, it might be questioned whether the difference between Italy's choice and a typical '3'-scored jurisdiction has much practical relevance, since this will mainly concern secure blockholder cases where the BNR is less relevant; see above section II(b).

[136] For the rule, see § 81c (5) of the Danish Public Companies Act.

[137] See also below section V(b).

Table 2 sets out our assessment of the national positions on the BNR before and after the transposition of the Directive. In assessing the 'after' position we have taken the most recent set of rules. In some jurisdictions, such as Hungary, Italy and Poland, an initial set of policy choices with regard to the transposition of the Directive was subsequently altered.[138] As we noted in Section II of the paper, the absence of a BNR pre-Directive does not mean there were no controls over board discretion once a bid has been launched. Equally, it is possible that a member state may have made progress towards a BNR post-Directive without actually getting to the position where it applied a ban on defensive action across the board. However, we are not aware of any state falling within this category.

It might be argued that all member states have made some progress in a bidder friendly direction because all member states must now make the BNR option available to companies in their jurisdictions (with or without reciprocity), if they do not impose it as a mandatory rule. Thus, the shareholders of German or Dutch companies may now opt into the BNR. Whereas previously they could not commit the board in advance to a 'no frustration' response to a bid, this option is now available. However, in the face of the difficulties of exercising that choice and the fact that we could find no examples of opting back in,[139] we do not find it convincing to argue that a move from no or a limited BNR to an optional BNR constitutes a step in a bidder friendly direction, and we have not so treated it in Table 2. Finally, even if examples of this could be found, management-inspired opting in to the BNR by potential acquirers as a shield against potential targets invoking the reciprocity exception is not a step in a bidder-friendly direction, when comparing pre- and post-Directive national laws. This is because, before transposition, reciprocity was not an element in member states' takeover laws, so that opting in by potential acquirers operates only so as partially to counteract the bidder unfriendly and newly introduced reciprocity exception, thus at best restoring the status quo ante.

If these arguments are accepted, then only Cyprus, Finland, Latvia, Malta and Romania show a significant shift in a bidder friendly direction through its introduction of a mandatory BNR without reciprocity. Apart from Finland, however, the capital markets in these jurisdictions are particularly small.[140] As far as Malta is concerned, the pre-implementation general company law was already strongly influenced by UK law, and it included a UK-type "proper purposes doctrine". This might make the actual changes effected through the adoption of a "bright-line" rule appear somewhat smaller than in other jurisdictions.[141] Regarding Finland, the adoption of the BNR took place through a non-binding "recommendation" in the Helsinki Takeover Code; nevertheless, Finland seems to be satisfied that this, in combination with general corporate law,

[138] We will return to the reasons for this below.
[139] See the discussion below in section V
[140] The market capitalisations of those jurisdictions are: Latvia: GBP 1.15 bn; Malta: GBP 2.50 bn; Cyprus GBP 6.3 bn; Romania: GBP 7.4 bn. The aggregate of these four jurisdictions corresponds to about 2/3 of the Czech capital market or 1% of the UK market.
[141] s 136A (3) (e) of the Maltese Companies Act 1995, inserted in 2003. Regarding the relevance of the proper purposes doctrine, see also text to n 16 above.

meets the standards required by Article 9 of the Directive.[142] Otherwise, no other member state with a significant market capitalisation adopted the mandatory BNR where it previously did not impose it.

In fifteen member states the law remained broadly as it was. Those member states used their BNR choices to maintain the status quo. Five countries can be classified as moving moderately in a less bidder friendly direction, through the introduction of reciprocity exception to a previously mandatory BNR. This group consists of France, Greece, Portugal, Slovenia and Spain. Finally, two states moved in a significantly less bidder friendly direction, Italy and Hungary. In both cases a previously mandatory BNR were made optional, and the reciprocity exception applied.

The quite widespread take-up of the BNR on a mandatory basis in large part reflects the fact that the BNR was quite widely established in member states' legal systems prior to the adoption of the Directive.[143] We return to this point in section V below.

[142] Which is indicated, *inter alia*, by the absence of an opt in possibility for Finish companies.
[143] Nine of the fourteen '4' states were also '4' states before transposition see also M Goergen, M Martynova and L Renneboog, "Corporate Governance Convergence: Evidence from Takeover Regulation" ECGI Law Working Paper 33/2005 at 28 (70% of all EU countries required shareholder approval of defensive measures by 2004. Unfortunately, this figure does not distinguish between pre- and post-bid approval.)

TABLE 2*

Country	BNR score before	BNR score after
Austria	**4**	**4**
Belgium	**0**	**0**
Bulgaria	**4**	**4**
Cyprus	**0**	**4**
Czech Republic	**4**	**4**
Denmark	**0**	**0**
Estonia	**4**	**4**
Finland	**0**	**4**
France	**4**	**3**
Germany	**0**	**0**
Greece	**4**	**3**
Hungary	**4**	**0**
Ireland	**4**	**4**
Italy	**4**	**2****
Latvia	**0**	**4**
Lithuania	**4**	**4**
Luxembourg	**0**	**0**
Malta	**0**	**4**
Netherlands	**0**	**0**
Poland	**0**	**0**
Portugal	**4**	**3**
Romania	**0**	**4**
Slovakia	**4**	**4**
Slovenia	**4**	**3**
Spain	**4**	**3**
Sweden	**4**	**4**
United Kingdom	**4**	**4**

***Many states had a BNR before transposition but reciprocity was in effect unknown. We have used the scoring deployed above in Table 1 but have assigned 0 to the situation where there was no BNR and 4 to the situations where there was.**
**** The BNR is the default rule in Italy, but shareholders can vote to opt out of it; see section IV(a).**

Despite the number of member states scoring '4' after transposition of the Directive, the post-transposition state of the takeover laws in the member states was overall less favourable to the BNR than it had been previously. It is perhaps not surprising that the member states as a whole have not moved in a direction more favourable to the BNR. The effect of the options created by the Directive was to leave the decision on whether to adopt a BNR to the legislative processes of the member states, subject to the minor qualification that companies must be free to opt into the

BNR if the member state chooses not to make it a mandatory rule. For the reasons mentioned briefly above and examined more fully below,[144] this option has been of no practical significance so far and seems unlikely to become more than a minor feature of takeover practice. Leaving it aside, one can say that since takeover legislation has been on the agendas of all member states for the past couple of decades following the takeover boom of the 1990s,[145] it is not surprising that member states which were in favour of the BNR had adopted it in advance of the Directive. In short, the Directive added nothing (or virtually nothing) to the member state-level impetuses in favour of the BNR and, where these impetuses existed, they had already resulted in the adoption of the rule.

However, this does not explain the discernible shift away from the full mandatory BNR in the post-Directive period in a significant number of member states. It may be that the Directive, by causing member states legislatively to address once again the issue of the BNR (if only to provide the company-level opt into the Directive), caused the domestic political forces pro and con the BNR once again to deploy their strengths in favour of their preferred position. In the majority of states, the outcome of this renewed policy debate was the same as the pre-Directive position. This explains the large number of member states whose score in Table 2 remained the same, pre- and post-transposition (whether the pre-Directive position was a 0 or a 4).[146]

In a minority but nevertheless significant number of states the policy debate triggered by the need to transpose the Directive led to a recalibration of the competing arguments and a different legislative outcome. In some cases the outcome was in favour of the BNR (Cyprus, Finland, Latvia, Malta and Romania). In a larger number of cases (including some economically significant countries) the result was a move away from the mandatory BNR. This is most obvious in the two states which abandoned a pre-existing mandatory BNR, ie Italy and Hungary. The Italian debate was particularly lively,[147] involving as it did three successive legislative responses to the BNR. The first was to maintain the pre-existing BNR; the second was to make it an opt-in rule for companies as Article 12 of the Directive contemplates, and the third and distinctive approach was to make the BNR as a whole a default rule (ie to allow companies by shareholder vote to opt out of the BNR entirely and not just as against companies not subject to the BNR).[148] Hungary, too, initially implemented the Directive by maintaining its pre-existing

[144] See section V(a).
[145] M Martynova and L Renneboog (above n 79) 2.
[146] It is conceivable that some 0 states moved or is not an act which can be carried out directly by the shareholders (because that power lies with a supervisory board) in the direction of the BNR in the transposition process but fell short of adopting it fully. We are not aware of this in any of the member states.
[147] It is set out in G Ferrarini and G Miller, A Simple Theory of Takeover Regulation in the United States and in Europe, Working Paper No. 139/2009, available at http://ssrn.com/abstract=1497083 who adopt an interest group analysis which we have found helpful.
[148] See also section IV(a) above. The new rule applies from 1 July 2010. *See* Legislative Decree No. 146, art. 1(3), above n 126. The change to the existing law was led by the industry and CONSOB who took the view that the crisis-driven opt out of the BNR was no longer justified. For a description of the new takeover regime in Italy see F Mucciarelli, 'Opa ostile e passivity rule (Sviluppo dell'attuale quadro normativo, Misure difensive, Responsabilità

mandatory BNR but then made the BNR optional.[149] What we cannot estimate is whether the existing mandatory BNR would have been maintained in these two countries had the Directive not required transposition. The fact that post-Directive both countries initially confirmed their existing BNRs but then substantially modified them might suggest that the transposition process itself was relatively unimportant. It was the events subsequent to the transposition which brought about the reversal of the positions adopted at transposition. In the case of Italy that event was the collapse of the stock markets in 2008 and the fear that Italian companies would easily be taken over by foreign (especially non-EU) bidders.[150] In the case of Hungary the triggering event for the reversal was a bid by a foreign acquirer for a large domestic company in a sensitive sector or the economy, ie the bid for MOL, the largest Hungarian oil company, by OMV, an Austrian company.[151]

In the case of the member states which maintained the BNR which had previously existed, but made it subject to a shareholder option to take up the reciprocity exception to the rule, the case for the Directive itself contributing to this development is stronger. The notion of reciprocity seems to have been generated by the policy discussions over the Directive. None of the pre-existing member-state BNRs was subject to a reciprocity exception. Having first generated the idea of reciprocity and then having made it available in the Directive,[152] it is perhaps not surprising that a number of member states took it up. In particular, seventeen of the twenty seven EU Member States had a mandatory and unqualified BNR pre-transposition. Six introduced the reciprocity exception to that mandatory rule post-transposition. The significance of the reciprocity option depends, of course, on the willingness of companies to make use of it. If no use is made of it, it will have no greater significance than the option for companies in jurisdictions with non-mandatory BNRs to opt into rule, which none has done. We examine this below in Section V.

(c) Transposition choices and economic nationalism

A final question is whether there is an association between decisions by member states to qualify a pre-existing mandatory BNR (either by opting out of it altogether or by making the reciprocity exception available) and the resurgence in the forces of economic nationalism in the European Union.[153] The question is particularly pertinent in relation to the introduction of the reciprocity exception to the mandatory BNR, since that exception permits the taking of defensive measures against out-of-state acquirers (unless they are subject to a BNR as well). The exception does not deter same-state acquirers. It is difficult – and politically impossible – for the European

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degli amministratori, Ruolo dell assemblea)' in *La nuova disciplina OPA: Azione di concerto e Patti parasociali* (*forthcoming*).

[149] Initial implementation by Act CLXXVI of 2005; amendment by Act CXVI of 2007.

[150] The relevant law was Legislative Decree No. 185, 29 November 2008, Art.13. It might have been thought that the reciprocity exception would have been enough to meet this point.

[151] For this reason Act CXVI of 2007 is colloquially referred to as the '*Lex MOL*'.

[152] Or, at least, arguably having done so. See text to n 98 above.

[153] Analysed by Hopt, above n 112.

Commission to challenge decisions made by member states by taking up options explicitly provided for in the Takeover Directive. However, any association between choices under the Directive and economic nationalism can be tested indirectly by looking at Commission challenges to non-takeover but related legislation by member states on the grounds that it infringes either or both of the Treaty provisions on free movement of capital or freedom of establishment within the Community.[154] In these situations the Commission is explicitly acting to protect the interests of acquirers from other member states. The non-takeover legislation in question typically does not apply across the board, but only to companies in 'sensitive' areas of the economy, which is sometimes equated with recently privatised companies.[155] The restrictions imposed have been many and various but at their core involve either state approval for the acquisition of non-trivial shareholdings in the companies covered and/or the retention by the state of powers to veto significant management decisions.

[154] A summary of surveillance and enforcement actions taken by the Commission in the area of capital movements is available at: http://ec.europa.eu/internal_market/capital/analysis/index_en.htm.
[155] The companies may or may not be listed on a regulated market and thus within the scope of the Takeover Directive.

TABLE 3

COUNTRY	BNR SCORE BEFORE	BNR SCORE AFTER	COMMISSION CHALLENGE	AVERSE ECJ DECISION
Austria	**4**	**4**	**NO**	
Belgium	**0**	**0**	**YES**	**C-503/99**
Bulgaria	**4**	**4**	**NO**	
Cyprus	**0**	**4**	**NO**	
Czech Republic	**4**	**4**	**NO**	
Denmark	**0**	**0**	**YES**	
Estonia	**4**	**4**	**NO**	
Finland	**0**	**4**	**NO**	
France	**4**	**3**	**YES (2)**	**C-483/99**
Germany	**0**	**0**	**YES**	**C-112/05**
Greece	**4**	**3**	**YES (2)**	
Hungary	**4**	**0**	**YES (2)**	
Ireland	**4**	**4**	**NO**	
Italy	**4**	**2**	**YES (4)**	**C-58/99; C-326/07; C-174/04; C-463, 464/2004**
Latvia	**0**	**4**	**NO**	
Lithuania	**4**	**4**	**NO**	
Luxembourg	**0**	**0**	**YES**	
Malta	**0**	**4**	**NO**	
Netherlands	**0**	**0**	**YES**	**C-282, 283/04**
Poland	**0**	**0**	**YES (2)**	
Portugal	**4**	**3**	**YES (4)**	**C-367/98**
Romania	**0**	**4**	**NO**	
Slovakia	**4**	**4**	**YES**	
Slovenia	**4**	**3**	**NO**	
Spain	**4**	**3**	**YES (2)**	**C-463/00; C-207/07**
Sweden	**4**	**4**	**NO**	
United Kingdom	**4**	**4**	**YES**	**C-98/01**

Table 3 sets out in summary form the position roughly since 2000. Whilst not conclusive, it suggests a correlation between lower scores on the transposition of the Takeover Directive and the adoption of other legislation protective against takeovers by foreign acquirers which either the Commission thinks or the European Court of Justice (ECJ) has found to be in breach of the

Treaty provisions.[156] Of the states with a mandatory BNR before and after transposition only the UK and Slovakia have been the subject of a Commission challenge, and only the UK has been subject to an adverse ECJ ruling.[157] Except for Slovenia, all the states which either abandoned an existing mandatory BNR (Italy, Hungary) or qualified it with the introduction of the reciprocity exception (France, Greece, Portugal and Spain) have been the subject of one or more Commission challenges to recently introduced protective, which have led in some of the cases to decisions from the ECJ adverse to the member state. There were also Commission challenges to protective legislation in all six countries (Belgium, Denmark, Germany,[158] Luxembourg, Netherlands, Poland) which adopted the mandatory BNR neither before nor after the implementation of the Directive.

V. THE CHOICES MADE - COMPANIES

(a) Opting into the BNR

Companies have not chosen to opt into the BNR where these rules have not been made mandatory by member states. We have already indicated above that the default is a difficult one for the shareholders to alter.[159] From a shareholder perspective, seeking to open up the company to offers, we may speculate that the opting in provisions of the Directive do not substantially strengthen the hand of the shareholders as against incumbent management (plus controlling shareholders). In other words, although the BNR provides an effective legal device for making the company attractive to bidders, it does not make it easier for shareholders to secure the passing of resolutions opposed by the management (or management plus blockholders). A resolution to opt into the BNR – which requires a supermajority[160] – is not any easier to secure in presence of controlling shareholder opposition[161] than any other resolution of the shareholders which is so opposed. Further, had the shareholders' position as against management (and

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[156] Information about particular infringement cases is available on: http://ec.europa.eu/internal_market/capital/analysis/index_en.htm#infringments. In some cases the Commission has not taken its case to the Court because the member state implemented the requested changes. This was so in the cases of Hungary in relation to Act CXVI of 2007 and Italy in relation to the acquisition of stakes in domestic banks. In other cases the procedure is still ongoing, either because the complaint has been referred to the ECJ, whose decision is awaited, or the member state's response to the Commission's request for amendments to the domestic law is not yet clear.

[157] This concerned a share cap in the airports operator, British Airports Authority, which effectively made it bid-proof. After the adverse judgment of the ECJ, the cap was removed and the company was later acquired by the Spanish company, Ferrovial (with associates). The acquisition was financed with large amounts of debt which the company has subsequently struggled to repay.

[158] The German challenge was to the special law for the Volkswagen company. Its more general protectionist legislation did not attract a Commission challenge, but for a sceptical account of these rules see Hopt, n 112 above.

[159] See Section III(c).

[160] Art. 12.2. It sets a particularly stiff hurdle. In the case of Sweden all the shareholders present at the meeting must vote in favour of opting in and there is a quorum requirement of 90% of the shares. Opting in for a Swedish company is in consequence practically impossible, though the Swedish requirements are an outlier and other member states use more attainable supermajority requirements. (Sweden has different levels of requirement for changes in the articles, according to the nature of the change. See Companies Act, ch 7, ss 42-45. The most demanding level has been chosen for opting in).

[161] As argued above (section II(b)), this is particularly important with regard to insecure (<50%) blockholders.

controlling shareholders) changed in favour of an increase of the non-controlling shareholders' influence before the transposition of the Directive, in many jurisdictions there are other steps they could (and would) have taken to render the company more attractive to potential bidders, even in the absence of the opting in arrangements. An example of alternative action might be replacing the incumbent board with directors more ready to contemplate selling the company.

However, opting in needs to be considered also from the point of view of management (plus controlling shareholders). From their point of view, the incentive to opt in is to *avoid* the use of the reciprocity exception by potential targets which the company might wish to acquire. Performance based remuneration, perhaps combined with golden shares or high self confidence, can also play a role in the management's incentive to opt in. This incentive is perhaps at its strongest where the company has nothing to fear from a BNR, for example, where there is a blockholder with *de jure* control of the company without resort to disproportionate voting rights, so that the BNR in no way threatens the blockholder's position. However, the strength of this incentive depends upon the reciprocity exception being available to potential targets and those targets having taken up the exception. In relation to potential targets in those countries scoring 4[162] in the above table, the incentive for potential acquirers to opt in for the purpose of avoiding reciprocity does not exist, because reciprocity is not an option for the targets. This is the case for potential acquirers both from within those jurisdictions and those incorporated in another member state. Fourteen countries,[163] including the UK, fall within the category of jurisdictions which provide potential acquirers with no incentive to opt in.

Even in relation to the seven[164] countries scoring 0 (where reciprocity is available), the incentive to potential acquirers (whether from those or other jurisdictions) to opt in depends on whether potential targets in those jurisdictions have taken up the reciprocity exception. As we have stated, where the BNR is not mandatory, there have been no opting in decisions so far, whether on the basis of reciprocity or otherwise. So, this incentive to opt in as a potential acquirer is currently very weak.

Overall, we find no evidence of companies opting into the BNR where this is not mandatory and for the reasons given above, we do not find this situation surprising. The incentives for company controllers (whether management or blockholders) to opt in are weak or non-existent, whilst the incentive for non-controlling shareholders are strong, but the Directive does nothing to help them overcome opposition from the controllers to the opting in decision. However, we have still not considered the final company level option which may be available, ie to take up the reciprocity exception to the mandatory BNR where a member state has chosen to make it available (ie '3'

[162] Likewise, this argument would also apply to countries scoring 1, but no country has chosen this option.
[163] These are Austria, Bulgaria, Cyprus, Czech Republic, Estonia, Finland, Ireland, Latvia, Lithuania, Malta, Romania, Slovakia, Sweden, and the UK.
[164] ie Belgium, Denmark, Germany, Hungary, Luxembourg, Netherlands, and Poland.

states). Here we do find significant company-level activity in one such state, and so our task is to explain its presence in that state and its absence in the others.

(b) Taking up the reciprocity exception to the mandatory BNR

Where the BNR is mandatory but the shareholders may introduce a reciprocity exception to the rule, the incentives to act or not would appear to be as follows. Non-controlling shareholders would probably not be in favour of introducing the exception, unless they had a very high degree of confidence that the management would use the discretion vested in them to advance the interests of the shareholders as a class (for example, by negotiating a higher price with the bidder or encouraging an auction). Unlike with an opting resolution where the BNR is not mandatory, the shareholders do not have to take any action to secure the application of the BNR; the burden lies with the controllers of the company if they wish to introduce the reciprocity exception to the mandatory BNR. They need to persuade the shareholders to pass a resolution adopting the reciprocity exception, though the Directive does not require supermajority support for the resolution. They will also need to seek periodic (in effect, annual) renewal of the authority given by the resolution.[165] In terms of the controllers' incentives to take that initiative, much turns on how highly they rate the chance of their company being subject to an offer from an acquirer which is not subject to the BNR. Acquirers from outside the EU are likely not to be subject to a BNR and this will also be true for acquirers from some important EU member states, such as Germany. So, the incentive for controllers of potential targets in category 3 countries to seek to introduce the reciprocity exception is quite strong, unless there is some more easily adopted or more effective way open to them of achieving protection against acquirers.

France, Greece, Portugal, Slovenia and Spain fall within the category of having made the BNR mandatory but subject to reciprocity (ie they scored 3). As far as we could establish, no company has taken up the reciprocity exception to the mandatory BNR in Greece, Slovenia or Spain. Portugal is a somewhat exceptional case, as the implementing legislation seemingly does not call for pre-bid authorisation by the shareholders for the reciprocity exception to apply.[166] Rather, it automatically applies as against bidders not subject to "the same rules". This clearly does not meet the requirements set out in Art 12.5 of the Directive.[167]

In relation to France, however, about a fifth of the CAC 40-companies have taken up the reciprocity exception. Although this up-take does not (yet) seem to have provided a sufficient incentive for companies in other jurisdictions to opt into the BNR to avoid the reciprocity exception – possibly because the French companies are seen as unattractive takeover targets for

[165] Art 12.3 and 12.5
[166] See Art 182 para 6 of the Portuguese Securities Code.
[167] The same seems to be true for Denmark, which did not, however, make the BNR mandatory. Absent company level opt-ins, the rule is therefore virtually irrelevant at the moment.

other reasons – we do here have a not insignificant corporate level response to an option made available by the legislature and one which stands out in contrast to the absence of corporate level responses to legislative options in other countries.[168] It is therefore worth investigating, independently of its impact on the choices of other companies, why these large French companies have taken up the reciprocity exception to the mandatory BNR.

Part of the answer might be that the French legislature did not simply make the reciprocity exception to the mandatory BNR available, but also provided a mechanism through which the company could take defensive action. This was the issuance of defensive warrants[169] (*bons Bretons* – after Mr. Thierry Breton, the Minister of Economy, Finance and Industry at the time), based, though with some significant differences, upon the US 'poison pill'.[170] By 2008 seven companies[171] among the CAC 40 had secured resolutions from their shareholders taking up the warrants option. The advantage to companies of a legislative specification of a defensive mechanism which can be used to introduce the reciprocity exception is that doubts arising from general company law about the legality of this type of defensive measure are eliminated or at least significantly reduced.[172] Further, this particular legislatively endorsed defensive measure has no continuing impact on the company's future operations, if it is successful.[173] However, the company is not bound to introduce the reciprocity exception through defensive warrants. French companies which have sought prior shareholder authorisation for the issuance of warrants in the face of a takeover from a company not subject to the BNR have also often sought authorisation simply to issue fresh capital in those circumstances, whilst others have sought pre-bid authorisation for post-bid share issues but not for the issuance of defensive warrants.[174]

Nevertheless, it seems unlikely that one can explain the take up of the reciprocity exception in France simply on the grounds that the legislature has designed an effective mechanism for making use of it – especially as some companies which have taken up the reciprocity option have not made use of defensive warrants. It is more likely that an explanation can be found in the

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[168] And to some extent in France itself where no company has chosen to opt into the BTR.
[169] Commercial Code Arts L233-32.II and L233-33.
[170] In particular, the requirement for shareholder approval for the creation and issuance of the warrants. Where the reciprocity exception does not apply, the issuance of the warrants requires shareholder approval post bid: Commercial Code Art L233-32.III. In the US the shareholder rights plan can be adopted on the authority of the board alone, without either pre- or post-bid shareholder approval, assuming, as will invariably be the case, that the company has sufficient authorised but unissued capital. The French scheme also allocates warrants to the acquirer in respect of the shares it already holds – but not, of course, those it has contracted to acquire in the bid – thus respecting the principle of equal treatment of shareholders.
[171] Air Liquide, Bouygues, Essilor, Pernod Ricard, Peugeot, Saint Gobain, Veolia Environnement. See Herbert Smith, *Overview of defences used by companies listed on the CAC 40 to prevent unsolicited takeover bids*, February 2008 (available on http://www.herbertsmith.com/NR/rdonlyres/64ED9941-EF44-4B7D-B560-FC4087038A43/5567/DefencesOPA_Eng_Feb2008.pdf).
[172] See the discussion in Section II(a)(i).
[173] If the bid is withdrawn, as it is overwhelmingly likely to be in the face of the dilutive effect of the warrants, the warrants lapse: Commercial Code Art L233-32.II.
[174] For example, Dexia, EADS, LVMH, Sanofi-Aventis. See Herbert Smith, above n 170.

structure of the shareholdings in French companies. France is known as a country in which state ownership of and intervention in the corporate sector has traditionally been extensive, but also as one in which that role has been substantially reduced in recent decades.[175] Although in the French privatisations the initial aim was to put in place long-term, stable shareholders (*les noyaux durs*), who would discourage takeovers, those holdings too have been eroded since the 1990s.[176] The result is a shareholding structure in large companies which, whilst certainly concentrated, is less so than in many other continental European countries. Becht and Mayer calculated the median size of the largest voting block in the CAC 40 at 20% in the late 1990s, substantially bigger than the UK median figure of 10% but also significantly smaller than that for the other European countries studied, where it was often in excess of 50% and in no other continental European case did it fall below 34% (the Spanish figure).[177] Later work put the percentage of listed companies in France where no single shareholder held more than 25% of the votes at 37% in 2006, as compared with 16% in 1996.[178]

Thus, one can think of France as a country with control in many companies in the hands of multiple large shareholders. This control may be effective in the normal run but is insecure and subject to challenge from an acquirer which may be able to wrest control away from the blockholders by acquiring the shares of the non-controlling shareholders and, possibly, inducing one of the controlling coalition of shareholders to defect. In this situation the controlling shareholders may have an interest *ex ante* in strengthening management against an acquirer by authorising pre-bid, defensive measures to be taken post-bid. The pre-bid authorisation of defensive measures is a form of commitment by the multiple large shareholders to keep control of the company in their own hands and not to sell out to an acquirer. Furthermore, as pointed out above, the change in the shareholder structure typically associated with the announcement of a bid – from a more passive institutions/private investor-mix towards a more activist/hedge-fund dominated structure – can make this strategy seem even more plausible. The relative lack of interest of the non-controlling shareholders in defensive measures may well not be replicated once a bid is made. However, the arguments in favour of the resolution may not always persuade the shareholders. In 2008 two resolutions (at Capgemini and Vallourec) authorising defensive share warrants were withdrawn from the AGM agenda at a late stage, apparently for fear they would not be accepted by the shareholders; and although the resolutions proposed at other

[175] VA Schmidt, *The Futures of European Capitalism* (OUP, Oxford 2002) esp at 117.
[176] B Clift, "Second Time as Farce? The EU Takeover Directive, the Clash of Capitalisms and the Hamstrung Harmonization of European (and French) Corporate Governance" (2009) 47 Journal of Common Market Studies 55, 68-69.
[177] M Becht and C Mayer, 'Introduction' in F Barca and M Becht (eds), *The Control of Corporate Europe* (OUP, Oxford 2001) 19. The European jurisdictions studied were Austria, Belgium, Germany, Spain, France, Italy, Netherlands, Sweden, UK.
[178] J Franks et al, above n 70, Table 2, Panel B.

companies were passed, and passed comfortably, they were among the resolutions receiving the lowest levels of shareholder support.[179]

There is a third element in the explanation of the willingness of French CAC companies to take up the reciprocity option. This relates to the range of alternative defensive mechanisms available. The reciprocity exception is far from a complete protection against an unwelcome bid. It may have the virtue (from the adopting shareholders' point of view) of being usable against US or German companies, which are rarely subject to the equivalent of the BNR, but it is not a protection against a bid from an acquirer located in any jurisdiction where the BNR is mandatory, such as the UK or Sweden. One might expect French controlling shareholders whose position is insecure to seek a protective device which operates across the whole range of acquirers, especially as France has opted out of the breakthrough rule. However, France has long had and still maintains a mini-BTR which catches two pre-bid defences which might otherwise be popular, namely, the voting cap and restrictions in the articles on the transfer of shares.[180] In this context pre-authorised defensive measures may be seen as a useful supplement to the traditional French defensive measure – double voting rights – which some half of the CAC 40 have in place but which again constitute a far from unbreakable defence.[181] Thus, for large French companies whether to seek shareholder authorisation pre-bid for the taking of defensive measures post-bid (and notably the issuing of defensive warrants) is a far from straightforward question. There is some risk that the shareholders will not approve the resolution, in which case the company may simply have signalled to the market that it is a potential takeover target. Even if the resolution is approved, it will not be effective in the face of a bid from an acquirer subject to the BNR. On the other hand, pre-bid authorisation of post-bid defensive measures may substantially reinforce the defensive measures otherwise available to the company. In the light of these considerations it is perhaps not surprising that the take-up of the reciprocity exception among the CAC 40 has been significant, but not the majority response.[182]

This analysis may also explain the failure of companies in Spain to take up the reciprocity option. Voting caps are a widely used mechanism in Spanish companies, more frequently used

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[179] HQB Partners, *CAC 40 2008 AGM Season – Trends and Observations*, available on http://www.hqbpartners.com/upload_files/French%202008%20AGM%20Season%20Review.pdf and ibid, *An Overview of the CAC 40 2009 Annual General Meeting Season*, Table 1, available on http://www.hqbpartners.com/upload_files/CAC%2040%202009%20AGM%20Season%20Review.pdf.

[180] Arts L 233-34 and L 225-125 of the Commercial Code; art 231-43 of the General Regulation of the AMF.

[181] Herbert Smith, above, n 171. French companies also tend to have strong disclosure provisions in their articles, giving them advance warning of possible bids, which may be triggered at the 0.5% level and every 0.5% thereafter, requiring shareholders to disclose their intentions as against the company. Some 95% of CAC 40 companies have such provisions.

[182] Some 27.5% of CAC 40 companies have in place pre-bid defensive authorisation of post-bid defensive action (of one sort or another), as compared with over 50% having double voting rights but only 15% voting caps: ibid.

than in any other member state.[183] This mechanism can provide a truly powerful protection for an incumbent controller, even far below of de jure control. Thus, a voting cap might be a more attractive pre-bid defence, because it applies across the board, than pre-bid authorisation of post-bid defences, which needs to be renewed, in effect annually.

Greece, our third country allowing the reciprocity exception to the mandatory BNR, allowed for pre-bid authorisation of defensive measures before the implementation of the Directive. In addition, Greece adheres rather closely to the one share-one vote standard, disallowing, for instance, the issuance of multiple voting shares.[184] From this perspective, the lack of usage of the reciprocity option on the company level might be rather surprising. However, it might be an interesting observation that of the eleven *recently listed* companies examined by ISS,[185] seven used pyramid structures to enhance control and one made use of a shareholders' agreement. This constitutes a significantly higher proportion than in the larger sample drawn from all listed companies (where the one share-one vote principle seems to be more closely followed). One explanation might be found in the implementation of the Takeover Directive, which might have made controllers search for other mechanisms to entrench their control – preferably one that is applicable against all bidders.

Finally, we attempt to explain the non-take up of the reciprocity exception in Slovenia. Although Slovenian company law does not seem to provide for the typical pre-bid protection devices for incumbents that are available in Spain, no Slovenian company has made use of the reciprocity option so far. In part, this could be explained by the ownership structure of Slovenian companies, with state funds controlling 44% of all listed companies in the end of 2004.[186] Another 25% of the companies are controlled by domestic non-financial companies and 6% by foreign investors, which in average hold 48% and 52% of the shares, respectively.[187]Although the level of ownership concentration is somewhat lower than in other emerging markets (though still high, with the largest voting block averaging 35% of the shares), this partly seems to be the result of relatively high employee stock ownership as a consequence of the privatisation modalities.[188] Combined with German-type co-determination rules, a coalition between managers and employees might well be regarded as offering sufficient defensive potential against unwanted bidders.[189] In addition, the relative illiquidity of the Slovenian capital market[190] also makes

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[183] ISS Europe, ECGI and Shearman & Sterling, *Report on the Proportionality Principle in the European Union*, External Study Commissioned by the European Commission (2007) 20, available at: http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf.
[184] Ibid, 18.
[185] Ibid, 49.
[186] N Cankar, S Deakin and M Simoneti, 'The Reflexive Properties of Corporate Governance Codes: The Reception of the 'Comply or Explain' Approach in Slovenia' (2008) Centre for Business Research, University of Cambridge Working Paper No. 371, available at http://www.cbr.cam.ac.uk/pdf/WP371.pdf.
[187] A Gregoric and C Vespro, 'Block trades and the benefits of control in Slovenia' (2009) 17 Economics of Transition 175, 180.
[188] Ibid 177.
[189] Ibid.

sudden post-announcement shifts in shareholder structures (eg from passive investors towards event-driven hedge funds) far less likely.

VI. CONCLUSION

One of the Commission's main aims when it proposed a directive on takeovers as long ago as 1989[191] was to secure the introduction of a mandatory BNR in all member states. Judged by that standard, the Directive as adopted was clearly a major set-back for the Commission. The Directive left the decision whether the BNR should be mandatory to the legislative process of each member state, which, of course, was where the decision lay before the Directive was adopted. To that extent, the Directive simply reproduced the status quo ante. However, the Directive did cause all member states to revisit the policy underlying their existing provisions on the BNR, even if it left them free to determine the mandatory nature of the BNR as they wished, and so caused them consciously to reaffirm or amend their existing national positions.[192] The fact that more than half the member states[193] imposed a mandatory BNR after transposition of the Directive reflects more than anything else the fact that the mandatory BNR was a feature of member states' takeover laws before the Directive was adopted.[194] It was no doubt this type of consideration which led the Commissioner responsible for the Directive to remark at the time of its adoption that it was "not worth the paper it was written on".[195]

This view of the Directive's provisions on the BNR also suggests that investigation of the results of member states' transposition of the Directive would not yield anything interesting: the status quo would simply be maintained. The results we report in this paper certainly do not indicate that the overall configuration of member states' takeover laws in relation to the BNR has changed dramatically post-transposition. Neither, however, do they show that the status quo has simply been maintained. Unfortunately for the Commission, the changes we have identified show that overall the member states' takeover rules are now located somewhat further away from the Commission's ideal of a comprehensive, mandatory BNR than was the case before the adoption

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[190] N Cankar et al, above n 185.

[191] The initial proposal for a directive on takeover bids was presented by the Commission on 19 January 1989, see above no 5. The first report published by the Commission regarding the harmonisation of takeover rules, the so called "Pennington report", dates back to 1974 (COM Doc XI/56/74).

[192] Those states wishing to maintain (as close as possible) their "score 0" status quo (eg Germany) or who chose this regulatory option after the Directive came into force (eg Hungary) were required to legislate for the company-level opt back in. In fact, in all states the Directive generated a need to reflect upon the national takeover law, including therefore the national provisions on the BNR, as part of the process of transposition of the Directive as a whole, although, in some cases, a Directive-compliant BNR was achieved by encouraging and overseeing amendments to self-regulatory arrangements (eg in Finland).

[193] Fourteen out of the total twenty-seven member states; see Table 1 above.

[194] However, in some countries the decision to adopt a BNR will have been influenced by the expectation of a binding European rule to that end. Such expectations probably existed throughout the 15 years prior to the Directive's adoption.

[195] See n 9 above.

of the Directive. Only five out of the eleven states that did not have a mandatory BNR before decided to implement it as a consequence of the Directive. At the same time, almost half the formerly mandatory BNR countries diluted their former choice after the Directive.[196]

However, this headline figure is the product of *three* types of member state choice (ignoring the choice made by those member states which simply maintained the status quo). Some chose to adopt a fully mandatory BNR, not having previously imposed such a rule; some moved from a fully mandatory BNR to an optional BNR; and some qualified the previously fully mandatory BNR with the reciprocity exception. We need to look separately at each set of choices.

The decisions by member states to adopt a fully mandatory BNR, where no BNR was previously imposed, can be claimed by the Commission as an outcome of the Directive which was in line with its original policy objectives. Five member states[197] took this decision, ie moved from a score of '0' to a score of '4' as a result of transposition. It is also realistic to think that that these national decisions would not have been taken, had the Directive not required the member states to revisit their takeover rules and indicated to them that the Directive's preferred position was the adoption of a fully mandatory BNR. However, these were all countries with very low levels of hostile takeover activity where, with the possible exception of Finland, the adoption of a mandatory BNR was not a significant decision and where following the Directive's preferred option of a mandatory BNR may have seemed the path of least resistance. Regarding the latter argument, it should also be taken into account that four of these states (again with the exception of Finland) joined the EU after the Directive had been adopted. Given the amount of European legislation in company and securities law, one might expect that the substantial changes these countries had to undergo in order to adopt the *acquis* somewhat weakened possible political resistance.

The weakness from the Commission's point of view of the adoption of a policy of national choice in relation to the BNR is demonstrated by the decision of two states (Hungary and Italy) to abandon a previously fully mandatory BNR in favour of an optional BNR.[198] In terms of economic impact, the decision by these two states to adopt an optional BNR outweighed the decision by the five states just mentioned to adopt a fully mandatory BNR by a factor of three, with Finland representing 88% of the market capitalisation of the latter group of five.[199] This also seems to make it more likely that – with the exception of Finland – the countries that now apply a fully mandatory BNR, where they previously simply attached little significance to such a rule due to their relatively small capital markets, did not regard the change as an important one. Although the transposition process was not the cause of the decisions taken in Hungary and Italy,

[196] This is true for seven of the sixteen relevant countries; see Table 2 above.
[197] Cyprus, Finland, Latvia, Malta and Romania.
[198] Hungary moved from '4' to '0' in our scoring; Italy from '4' to '2'. For the explanation of the '2' score see section IV(a) above.
[199] That is, in terms of companies (by market capitalisation) being subject to the respective regulatory outcomes. See Table 4 and Chart 1 below.

the principle of national choice contained in the Directive permitted those states to respond as they did, whereas the Commission's proposed mandatory BNR would have closed off this option.

However, in terms of both numbers of states and economic impact, a bigger move away from the fully mandatory BNR occurred in the case of those five states[200] which moved from a fully mandatory BNR to a BNR qualified by the reciprocity exception, ie they moved from '4' to '3' on our scoring. In this category of case, however, it is arguable that the terms of the Directive as adopted contributed to the decisions taken by these member states. Certainly, none of the members states had adopted a reciprocity exception before the Directive and there might well have been considerable uncertainty about its legality. In fact, we suspect that a national rule with the same content as Article 12.3 would have been objected to by the Commission because of its impact on both third country bidders and bidders from other member states – especially if the member state had precisely followed the reciprocity option later included in the Directive (ie it produced an outcome equivalent to a score of 3 by our definition).[201] The Directive itself seems to have conferred legitimacy on the reciprocity exception, by making it available as an option in Article 12.3. The adoption by some states of the reciprocity exception to the BNR is perhaps our most important result, especially given its late inclusion in the Directive and the doubts expressed subsequently by commentators as to whether it was intended to be available as a qualification to the mandatory BNR or only to the company-level voluntary opt in to the BNR.[202]

Our overall conclusion, based on an analysis of the formal rules adopted pre- and post-transposition, is that that there has been a significant shift away from bidder friendliness in the transposition process. Expressing the results of Table 1, not in terms of the number of states but in terms of the importance of their national capital markets, we find that countries retaining the status quo (ie the same level of bidder friendliness) constituted 61% of Community market capitalisation, those moving in a less bidder friendly direction constitutes 37% of Community

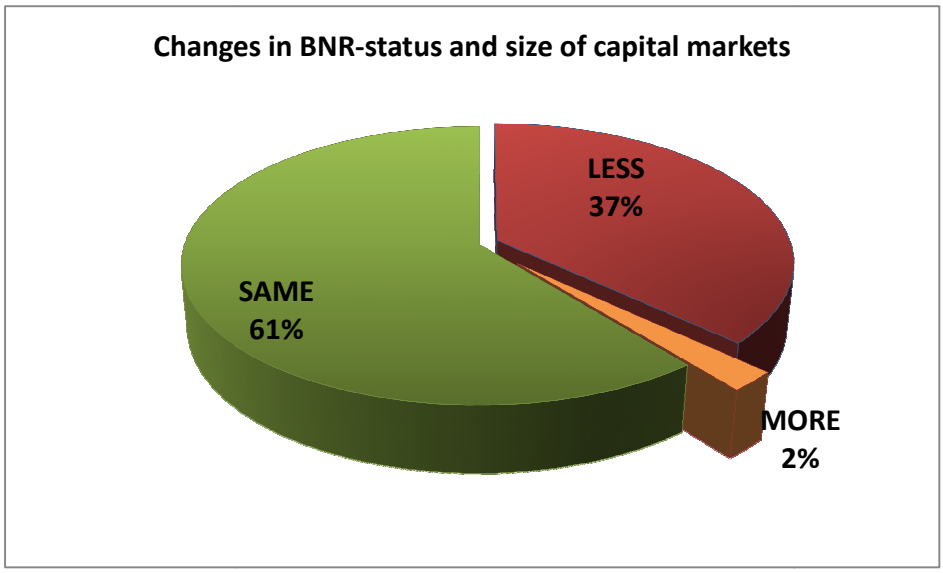
[200] France, Italy, Slovenia, Spain and Portugal.

[201] In this case (score 3), the outcome would not restrict any domestic, but only cross-border (including intra EU) acquisitions. To be sure, in theory the question whether or not the current framework is in-line with primary Community legislation is still live, but it has far less practical relevance (see the discussion in Section IV(c)). In addition, the fact that a score 3-result might have been incompatible with the Treaty before enactment of the Directive does not necessarily mean that it still is. As the BNR is now – to a certain extent – harmonised across the EU, the precondition for access to each member state's market for corporate control is generally available on the company level (through the compulsory option to take up a mandatory BNR). This certainly removes some of the "protectionist twist" from this regulatory option.

[202] The compatibility of a "score 3"-outcome with primary Community law may also bear some relevance in deciding its scope under the Directive. While a country with a score of 0 creates equal conditions for both domestic and EU-companies, in terms of access to the takeover market, a score of 3 could theoretically be seen as creating a certain bias towards domestic restructurings. Although the general availability of the BNR to all companies (via the opt in) can be regarded as eliminating this problem, this probably also depends on the factual difficulties of making use of it. As pointed out, no companies *actually* make use of the device, which calls into question whether the availability to companies of the option, in itself, is enough to insulate the concept against Treaty-incompatibility. See also the discussion in n 99 above. As Table 1 demonstrates, where member states have not made the BNR mandatory, they have uniformly made the reciprocity qualification available to companies opting back in (ie there are no states which score '1' under our system; all the non-mandatory states score '0').

market capitalisation, and those moving in a more bidder friendly direction constituted a mere 2% of Community market capitalisation (see Chart 1 and Table 4 below). As we suggested in Section IV(c), there is some evidence that the revision of takeover rules has been influenced by the growth of economic nationalism and a desire by member states to preserve corporate headquarters and employing entities within their own territories. As shown below, this concerns a large proportion (by value and in numbers) of European listed companies.

Chart 1[203]



[203] Sources: own calculations based on data from the Federation of European Stock Exchanges (available at: http://www.fese.be/en/?inc=art&id=3), NYSE Euronext (available at http://www.euronext.com/fic/000/054/615/546152.xls), NASDAQ OMX Group (data for the Scandinavian countries available at http://nordic.nasdaqomxtrader.com/digitalAssets/66/66299_statistics_december_2009_eur.pdf; data for the Baltic states available at www.nasdaqomxbaltic.com/market/); London Stock Exchange (available at: http://www.londonstockexchange.com/statistics/markets/markets.htm); Wiener Börse AG (available at: www.wienerborse.at/prices_statistics/statistics/monthly/monatsstatistik.html). All data based on end-of-year 2009; the attempt was made to exclude foreign issuers, secondary listings and non-regulated markets (to which the Directive does not apply), although some inaccuracies may persist.

Table 4

COUNTRY	BNR SCORE BEFORE	BNR SCORE AFTER	CHANGE IN BNR	Market Capitalisation (MEUR)
Austria	4	4	SAME	79,511
Belgium	0	0	SAME	181,059
Bulgaria	4	4	SAME	6,031
Cyprus	0	4	MORE	7,157
Czech Republic	4	4	SAME	31,265
Denmark	0	0	SAME	131,000
Estonia	4	4	SAME	1,850
Finland	0	4	MORE	141,000
France	4	3	LESS	1,356,491
Germany	0	0	SAME	900,772
Greece	4	3	LESS	78,505
Hungary	4	0	LESS	20,888
Ireland	4	4	SAME	42,720
Italy	4	2*	LESS	457,126
Latvia	0	4	MORE	1,317
Lithuania	4	4	SAME	3,220
Luxembourg	0	0	SAME	73,219
Malta	0	4	MORE	2,844
Netherlands	0	0	SAME	389,759
Poland	0	0	SAME	105,157
Portugal	4	3	LESS	68,478
Romania	0	4	MORE	8,402
Slovakia	4	4	SAME	3,614
Slovenia	4	3	LESS	8,462
Spain	4	3	LESS	584.569
Sweden	4	4	SAME	330,000
United Kingdom	4	4	SAME	1,949,352

Our analysis in the previous paragraphs has been based on the formal rules adopted by the member states. However, our results also shed light on the issue of the design of company-level default rules and on the question of whether the burden of reversing the default should be placed on the management of the company or on the shareholders. The Directive uses company-level defaults in three important areas. First, all member states which do not make the BNR mandatory

must allow companies by shareholder decision to opt into it;[204] second, member states may permit companies opting back in to the BNR to do so on the basis of reciprocity;[205] third, it seems member states may make the mandatory BNR subject to a company-level decision, again taken by the shareholders, to apply the reciprocity exception.[206]

In the most important of these cases – the decision whether to apply the BNR or not – the Directive therefore requires shareholder action *to restrict* management's discretion. The default is permissive of management – the default is that the BNR does not apply[207] – and the burden of reversing it lies on the shareholders; indeed, they can reverse the default only by supermajority vote.[208] We could not identify a single member state where the possibility to opt back in, in fact, played any practical role.

We suggest that this (negative) result gives support to the contention of Bebchuk and Hamdani[209] that where the legislature has two ways of expressing the default rule (as restrictive of management or as permissive in relation to management, but in each case reversible by shareholder decision), then the better policy is to choose the restrictive form of the default. This is because the collective action or coordination problems of the shareholders make it more likely that an inefficient pro-management default will persist than that an inefficient default constraining management will do so. In the latter case management will easily be able to put the question to the shareholders as to whether the default should be reversed; in the former case, shareholders may be ill-placed to raise the issue and the management (as well as insecure blockholders) will have no incentive to do so. After all, it is very unlikely that shareholders of all companies in "0"-scored countries simply consider the concept chosen by their legislator as the most efficient approach. We expect reaffirmation of this point, once Italy's new law comes into force, with very few (if any) companies opting back out.

By contrast, the default in relation to the reciprocity qualification to the mandatory BNR[210] is that reciprocity does not apply, so that the default is, in relation to management, the more constraining of the two forms of the BNR.[211] If management wishes to move to the less constraining form of the BNR, it must seek shareholder approval (which this time can be given

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[204] Art 12.2.
[205] Art 12.3.
[206] Ibid. Regarding the acceptability of this option see the discussion in n 99 above. As a matter of fact, five states make use of this option.
[207] If the reciprocity exception were widely adopted, that might mean that the default was constraining of the management of acquisitive companies, who might seek to reverse it. However, as we saw in Section III(b)(iii), that situation does not currently obtain.
[208] Art 12.2.
[209] Above n 21.
[210] Since there has been no opting back into the BNR, the issue of whether to do so with or without reciprocity has not arisen. However, since the default is that there is no mandatory BNR, it would seem that here too the default is the form of the rule which constrains management less.
[211] Art 12.3.

by ordinary majority vote). We reported that in the case of France[212] there had been significant voting activity by shareholders of CAC 40 companies in relation to the reciprocity exception, where management had initiated resolutions at annual general meetings seeking pre-bid approval for defensive measures to be taken post-bid against acquirers not subject to the BNR. This similarly supports the Bebchuk/Hamdani analysis. However, we did not find evidence of shareholder voting on the reciprocity exception in the other three[213] countries which made it available in relation to the mandatory BNR. We sought to explain this on the basis of, partly, the availability in those jurisdictions of pre-bid defences which operated generally (ie not only in relation to acquirers not subject to the BNR) and which would therefore be more attractive to management and insecure blockholders, than the reciprocity exception and, partly, of the structure of shareholdings which rendered the controllers' need for bid defences less pressing (and the entrenchment desire of management unachievable).[214]

This leads us to our reform proposal. It is clear that the Commission's initial vision of a mandatory, cross-Community BNR is not attainable. The optional nature of the BNR will therefore in all likelihood have to be retained when the Commission comes to review the Directive in 2011.[215] However, the optional nature of the BNR could be retained whilst restructuring and simplifying it. Our results could be seen as providing some support for an optional approach to the BNR which makes the option solely a company-level choice and which reformulates the default so that the BNR applies unless the shareholders (by ordinary resolution) choose to disapply it. Such a re-casting of the law would seem to have two main advantages. First, it would keep the member states, whose policies are often influenced by economic nationalism, out of the decision-making process.[216] The applicability or not of the BNR could become a matter for company-level decision-making alone. This would be a gain for Commission's goal of promoting the internal European market, as compared with the provisions of the Directive.

On the other hand, the reformulated option would imply that the Commission gave up on its original objective of imposing a mandatory BNR across the internal market. However, this is

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[212] Above Section V(b)

[213] This excludes the case of Portugal, as the reciprocity exception applies as an automatic qualification to the BNR; the Portuguese formulation of the reciprocity exception thus does not make it a default rule and so puts it outside the analysis of Bebchuk/Hamdani. See above V(b).

[214] One can also note that the low take-up of the reciprocity exception at company level has also reduced the incentives of the controllers of companies in jurisdictions where the BNR is not mandatory to opt into that rule. Irrespective of any non-controlling shareholder pressure to opt in, incumbents in such jurisdictions might have an incentive to opt in as potential acquirers, as a way of preventing potential targets from invoking the reciprocity exception against them. As things stand, that incentive exists only in the case of companies whose acquisition strategy is focussed on France.

[215] Art. 20.

[216] Community level decision-making does suffer – or at least traditionally has suffered - from the defects of inflexibility and an over-commitment to mandatory rules, but it does manage to dilute national particularism and the influence of purely national elites. Ferrarini and Miller, above n 146.

probably no bad thing. The 'varieties of capitalism' literature (distinguishing between 'coordinated' and 'liberal' market economies)[217] has taught us that there is more than one way of organising efficient production in a capitalist system and, as important, different member states have made different choices. From this perspective, imposing rules reflecting one model of firm organisation across all member states, as the Commission traditionally has been committed to doing, is likely to impose significant costs on those member states which have adopted a different model, whilst conferring only modest gains on those which have already adopted the preferred model.[218]

Central elements in difference between coordinated market economies and liberal market economies are the immediacy of the accountability of management to shareholders and the extent to which management is in a position to make credible long-term commitments to employees in return for human capital investment by the latter. The hostile takeover (or a real threat of it) can be seen as a powerful element in providing for immediate management accountability to shareholders and, in consequence, restricting the ability of management to make credible commitments to employees. Under our proposal a company would be free to choose the form of the BNR (mandatory or otherwise) which best fitted its business circumstances.[219] Where real value can be generated through a more "entrenched" system, shareholders are likely to approve changes proposed by the management.

Since the company's business model and shareholder body may change over time, it would not be appropriate to make the choice for or against a BNR a once-and-for-all decision. However, the issue of how often the controllers of the company would need to seek shareholder review of the prevailing choice is likely to be a sensitive one. The present eighteen month rule for the reciprocity exception in effect requires the shareholders to renew the authorisation at successive annual general meetings. In the light of the 'varieties of capitalism' discussion, such a short renewal period might have the disadvantage of being both, too short to reap the benefits usually associated with a lower degree of managerial accountability, and too long to make use of the disciplinary function of the market. In particular, it would not permit management to make credible long-term commitments to the employees or other stakeholders, as this time horizon does not sufficiently exceed the time frame within which the company will be bound by contractual agreements already. It might therefore be appropriate to allow shareholders to commit the company to opt out of the BNR for periods of up to, for example, five years. However, some form of renewal should, in our view, be introduced. As ownership concentration

[217] See P Hall and D Soskice, above n 82, 31.

[218] See G Hertig and J McCahery, "A Legal Options Approach to EC Company Law" in G Ferrarini and E Wymeersch, eds., *Investor Protection in Europe* (OUP, Oxford/New York 2006). The Commission's policies can be argued to be doubly incoherent because they do not consistently follow the same model. Thus, its employment law proposals have traditionally followed the 'coordinated' model whilst its recent company and financial law proposals have reflected more strongly the 'liberal' model.

[219] This is of course very close to the position Italy has ended up in as a result of its most recent reforms, except that Italy does not require the periodic shareholder re-validation of the opt-out choice which we advocate below. See Section IV(a).

typically decreases gradually following the initial listing, a once and for all, or hard-to-change rule might otherwise (in the long run) lead to similarly entrenched structures as in states currently scored zero. Blockholders would have a particularly strong incentive to opt out of the BNR before changing their position from *de jure* to (only) *de facto* controlling. As the pace and strategy of a blockholder's post-IPO divestiture can hardly be foreseen by investors, we do not believe that too much confidence should be put in market forces in this respect. [220]

Thus, opting out of the BNR would replace opting into it, as the Directive currently contemplates. However, the removal of the member state from the decision-making process on the applicability of the BNR would have a major impact, not only in states which have chosen not to make the BNR mandatory, but also in those states, such as the UK, which have taken the opposite approach. Under our proposal, the UK would no longer be able to insist that the no frustration rule applied to the management of British companies provided the shareholders had voted to remove it. It seems to us that it might be rational for shareholders to decide in some cases to give management more autonomy than the mandatory BNR entails, for the reasons given above, and the disapplication mechanism would be a method, at least in non-securely controlled companies, for the shareholders to commit themselves to a regime of relative management autonomy.[221] This is not an area, it seems to us, where the legislature can clearly say that one approach is obviously more efficient than the other. If the shareholders can genuinely decide (and periodically review their decision) whether the rule of post-bid shareholder approval of defensive measures or whether pre-bid approval of defensive measures serves their interests better, we should let them do so.

[220] This is relevant, because in the initial period, where the blockholder holds relatively large proportion of the company's votes (and capital), investors will not see the BNR as having an impact on their wealth (since the incumbent controls the decision in the presence as well as in the absence of a BNR). Only as the blockholder moves to significantly lower proportions of the share capital, or gives up his control completely (through dilution or further share dispositions), the wealth effects for shareholders kick in. It is therefore very hard for investors to assess the net-cost of a charter arrangement to this end.

[221] Or the shareholders might think that the board would be able to do a better job negotiating with a bidder on their behalf it if was not subject to a prohibition on post-bid defences. As we have noted above (text to fn 121 above), the pre-bid decision to opt out of the BNR is likely to be taken by a differently constituted shareholder body that the one which might be asked to approve defensive measures post-bid, because of post-bid activities of arbitrageurs.

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