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Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?

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I am grateful for comments and suggestions from Jennifer Arlen, Yoshiro Miwa, Mark Ramseyer, Mark Roe, workshop participants at Harvard Law School, and participants at the May 2003 conference on "A Modern Regulatory Framework for Company and Takeover Law in Europe - The Corporate Governance and Takeover Recommendations of the High Level Group of Company Law Experts to the European Commission." I thank David Marx for his research and assistance in compiling the data reflected in Figure 4 and the Appendix. All errors are mine.

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Abstract

In this paper, I draw on economic theory of ownership structure; empirical research on ownership, value and takeovers; and comparisons to US law to argue that the proposed break through rule (BTR) is not clearly better than the status quo, from either a political perspective, or an economic perspective, with implications for any directive on takeover bids (DTB). The good (a step toward an integrated EU capital market) cannot wait on the perfect (ideal takeover rules), but neither should it be pursued without regard for the difference between the two. This suggests that if the BTR is adopted, it should be kept flexible with a mixture of regulatory tools – sunsets, opt-outs, and industry-based exemptions – that reflect the fact that regulation will inevitably be both imperfect and difficult to modify once adopted. The best rationale for the BTR – that many ownership structures in EU firms reflect historic national market structures and may increasingly impede achievement of economies via cross-border mergers – would be better addressed by rules requiring control of such firms be made contestable on a periodic rather than a continual basis.

Keywords: takeover regulation, ownership structure, voting rights, private benefits of control, corporate control

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Ownership, Takeovers and EU Law*:*

How Contestable Should EU Corporations Be?

John C. Coates IV*

Revised Draft – July 9, 2003

In this paper, I draw on economic theory of ownership structure; empirical research on ownership, value and takeovers; and comparisons to US law to argue that the proposed break-through rule (BTR) is not clearly better than the *status quo*, from either a political perspective, or an economic perspective, with implications for any directive on takeover bids (DTB). The good (a step toward an integrated EU capital market) cannot wait on the perfect (ideal takeover rules), but neither should it be pursued without regard for the difference between the two. This suggests that if the BTR is adopted, it should be kept flexible with a mixture of regulatory tools – sunsets, opt-outs, and industry-based exemptions – that reflect the fact that regulation will inevitably be both imperfect and difficult to modify once adopted. The best rationale for the BTR – that many ownership structures in EU firms reflect historic national market structures and may increasingly impede achievement of economies via cross-border mergers – would be better addressed by rules requiring control of such firms be made contestable on a periodic rather than a continual basis.

1. The DTB and the BTR

Six months ago, the European Commission (EC) presented a new proposal for a Directive on Takeover Bids (DTB).[1] The new DTB follows the European Parliament's surprise "rejection" – 273 members of Parliament (MEPs) voting for, 273 against – of the prior proposal,[2] which was the culmination of over a decade of compromise, debate and conciliation dating back to 1989. Following this defeat, the EC created a group of "High Level Company Law Experts," led by Professor Jaap Winter, and gave it the task of

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* Professor of Law, Harvard Law School. I am grateful for comments and suggestions from Jennifer Arlen, Yoshiro Miwa, Mark Ramseyer, Mark Roe, workshop participants at Harvard Law School, and participants at the May 2003 conference on "A Modern Regulatory Framework for Company and Takeover Law in Europe - The Corporate Governance and Takeover Recommendations of the High Level Group of Company Law Experts to the European Commission." I thank David Marx for his research and assistance in compiling the data reflected in Figure 4 and the Appendix. All errors are mine.

[1] Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (Presented by the Commission of the European Communities), Brussels, Oct. 2, 2002, COM (2002) 534 final.

[2] OJ C 162, June 6, 1996, COM (95) 655 final (amended proposal for a "framework" directive after consultations with Member States, setting out general principles but not attempting detailed harmonization of takeover rules); *see also* OJ C 64, Mar. 14, 1989, Bull. EC Supp. 3/89 (original proposal for directive regarding takeover bids); OJ C 240, Sep. 26, 1990, COM (90) 416 (amending 1989 proposal to reflect opinions of Economic and Social Committee and European Parliament).

developing responses to three issues raised by the European Parliament.[3] The Winter group published two reports: one on takeover bids in January 2002 (Takeover Bid Report),[4] which formed the basis for the new DTB in October 2002, and a broader one on company (corporate) law in November 2002 (Company Law Report),[5] which formed the basis for a new company law "Action Plan" related by the EC in May 2003.[6]

Perhaps because of the closeness of the vote by which the prior proposal (the old DTB) was defeated, the old DTB and the new DTB are remarkably similar. Their scope, organization, and overall goals are the same: to facilitate the integration of European capital markets through takeovers, to "offer transparent pan-European rules for the conduct of takeover bids to the benefit of shareholders," to "facilitate company restructuring," and to "contribute to making Europe more competitive." In contrast to current law, which varies widely from country to country in the EU, the DTB would create a uniform floor of minority shareholder protection for takeover targets; create a framework for determining which legal authority will supervise takeovers and enforce the new rules; and impose disclosure and procedural requirements on bidders, including the requirement of a mandatory bid once a bidder acquired a control block, at a threshold to be specified by member states.

The most controversial portion of the new DTB also continue to be not the proposed rules governing bids *per se*, nor the rules governing bidders, but the rules governing targets. One proposed target rule comes straight out of the old DTB: the so-called "neutrality rule" (NR) would forbid a target board from taking "any action other than seeking alternative bids which may result in the frustration of the bid…" unless the board obtains prior shareholder approval of the action.[7] The NR closely tracks an established norm in the UK, enforced under the auspices of the London Stock Exchange.

A second element of the proposed target rules is new: the so-called "mini-break-through rule" (mini-BTR) provides that "any restrictions on transfer of securities … shall be unenforceable…."[8] Likewise, any special rights of the shareholders concerning appointment or removal of directors cease to have effect following a bid in which the bidder obtains the requisite minimum. The mini-BTR would apply equally to restrictions in a company's charter, restrictions in agreements between the target and its shareholders, and restrictions in agreements among shareholders.

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[3] The three specific issues referred to the Winter group were: (1) how to create a "level playing field" for shareholders in different countries within the EU, (2) the definition of an "equitable price" to be paid to minority shareholders in takeovers, and (3) the right for a majority shareholder to buy out minority shareholders. Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, European Commission, Brussels, Jan 10, 2002, at 1.

[4] Id.

[5] Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe, Nov. 4, 2002.

[6] Communication from the Commission to the Council and the European Parliament, Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, May 21, 2003.

[7] DTB Article 9.

[8] DTB Article 11.

What the new DTB does not do, however, is include the full "break-through rule" (BTR) proposed in the Takeover Bid Report. Arguably the most radical idea in the Takeover Bid Report, the BTR would allow any bidder acquiring more than a majority (or a required supermajority, but no more than 75%) of the target's cash flow rights to "break through" any mechanism or structure that frustrates its control of the target. The BTR was directed at two types of defenses: (1) multiple class capital structures, which limit the voting rights of some shareholders, and (2) capped or time-phased voting restrictions, which condition voting rights on holders not having, or not having recently acquired, control.[9] In general terms, the goal of the BTR is the same as the overall goal of the DTB – to transform control of listed EU firms into a commodity available for purchase throughout (and outside) the EU.[10]

Instead of adopting the BTR, however, the new DTB specifically exempts "securities carrying double or multiple voting rights."[11] The DTB also provides that the mini-BTR does not apply to "securities without voting rights which carry specific pecuniary advantages." The EC explained the omission of the BTR as follows:

> The [BTR recommendation] met with opposition from virtually all Member States and interested parties, notably because of the legal problems to which they may give rise (application threshold, concept of risk-bearing capital, compensation for rights foregone, etc.). Moreover, a large majority of those questioned were opposed to the inclusion in the proposal of measures that would have had far-reaching implications for company law.[12]

2. <u>The High-Level Goals of the DTB</u>

Before analyzing the BTR, I should begin by acknowledging the importance and value of the high-level goals of the DTB. A unitary EU capital market would be a significant good for the EU and the global economy. A more unified system of regulating takeover

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[9] The application of the BTR (and the mini-BTR in the new DTB) to golden shares – which provide one shareholder (usually a government) with a veto over transfers of control or other rights that interfere with such transfers – is unclear. However, on June 4, 2002, shortly after the Takeover Bid Report was issued, the European Court of Justice (ECJ) reversed prior opinions of the EU Advocat General and significantly restricted the usefulness of golden shares as a generic form of takeover defense by limiting their legality to precisely tailored provisions justified by a compelling, current state interest, under Article 56 of the Treaty Establishing the European Community (Treaty of Rome, as supplemented by later treaties). *See* Commission v. France, C-483/99; Commission v. Portugal, C-367/98; Commission v. Belgium, C-503/99. These decisions were followed by two more on May 13, 2003 striking down "golden share" legislation in Spain and the UK as incompatible with EC legal principle of the free movement of capital. Commission v. United Kingdom, C- 98/01; Commission v. Kingdom of Spain, C-463/00.

[10] The Takeover Bid Report distinguished these "technical" defenses from "structural" defenses that arise by virtue of how ownership of normal one-share-one-vote common stock was dispersed or concentrated among individual holders (*i.e.,* control blocks), groups (*i.e.,* cross-holdings) or holding companies (*i.e.,* pyramids). Neither the mini-BTR nor the full BTR would apply to "structural" defenses. *See* note 24 *infra*.

[11] The EC Company Law Action Plan recommends further study of whether Member States should be required to bar new listings of DC structures. Action Plan at 14.

[12] *Supra* note 1, at 4.

bids would facilitate the development of an integrated capital market. Such a system of rules would itself improve transparency in a critical area of law.

A brief contrast to the US will make the point. US takeover law can be intricate at the firm level, requiring bidders and lawyers to analyze the precise control structure of a target before proceeding with a bid. Bidders nonetheless face a stable and relatively uniform scheme for regulation in analyzing, planning, and implementing M&A transactions. Tender offers (bids) themselves are regulated by a uniform set of federal laws: the Williams Act, the SEC's rules, and relevant federal court decisions. Efforts by individual states to interfere are constrained by the US Constitution's Supremacy and Commerce Clauses[13] and, more importantly, by the ability of corporations (with board and shareholder consent) to choose their state of incorporation regardless of the location of a company's headquarters. Freedom to reincorporate has created a stable equilibrium in which one state (Delaware) directly writes corporate law for about two-thirds of US public companies (and through mimicry writes most law for the rest),[14] with no pressure from local interest groups that have strong interests in impeding transfers of control.[15] Thus, contrary to the Takeover Bid Report's statement that "the laws of the various states in the US regulating takeover bids differ widely,"[16] takeover law for all practical purposes is quite similar for the vast majority of US public companies.

As important as this state of affairs is the fact that it can be cheaply communicated to business people. At the most general level, the business community "gets it." And "it" does not change very much.[17] However much ink we US legal academics spill analyzing and arguing the nuances of the fiduciary duties of corporate boards in the takeover context, a CEO who fell asleep in 1979 and woke like Rip Van Winkle in 2004 would not need many minutes or dollars to catch up on his practical and strategic grasp of the law-in-practice of M&A today.[18]

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[13] *See* John C. Coates IV, State Takeover Statutes and Corporate Theory: The Revival of an Old Debate, 64 N.Y.U. L. Rev. 806 (1989) (analyzing U.S. Supreme Court jurisprudence under the Commerce Clause and the Supremacy Clause as it applies to state takeover statutes).

[14] *See generally* John C. Coates IV, Explaining Variation in Takeover Defenses: Blame the Lawyers, 89 Cal. L. Rev. 1301, 1358, 1409 (2001) (reporting that of 62% of US firms going public 1991-1992 were incorporated in Delaware, increasing over the 1990s to 75% for IPOs in 1998-99; and analyzing state takeover laws relevant to proxy contests and finding them nearly uniform in effect); John C. Coates IV, Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence, 79 Tex. L. Rev. 271, 320-23 & n.203 (analyzing so-called "shark repellents" and state takeover statutes and showing that, with the exception of the poison pill and the classified board, such provisions and statutes have little or no practical effect on takeovers when targets have already adopted poison pills or can adopt poison pills on short notice, as nearly all US public firms can do).

[15] *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).

[16] *Supra* note 3, at 6.

[17] The remarkable, jingoistic assertion of the European Parliament's Committee on Legal Affairs and the Internal Market in its Draft Report on the new DTB (Mar. 11, 2003), at 28, that "since 11 September 2001, the USA has enshrined in law a series of unilateral provisions that are a serious obstacle to investment in the USA by foreign companies" is to my knowledge a gross exaggeration at best.

[18] Arguably, only one thing of importance has changed in US law regarding takeovers: the development of "poison pills" (known to their defenders as "shareholder rights plans") and their judicial approval in the mid-1980s. Pills had the effect of channeling takeover bids for US companies into one of two routes (transactions negotiated with a target's board or combination tender offer – proxy fights), and also had the

The stability and transparency of the overall US system of regulation is conducive to planning and execution of transactions. Stability and transparency are in my view more important to the ability of the US to sustain M&A booms like that of the 1990s than any particular rule affecting takeovers. As an example of the kind of principle or rule that one might think would be important, but turns out not to be, at least in the US, no authoritative legal doctrine or statute in the US affirmatively provides that protection of shareholders is in itself an overriding goal of the law. Shareholders in fact are protected in many ways by the US legal system, and target shareholders benefit directly from almost all M&A transactions. But shareholders are protected and benefited not because of any top-down articulation of shareholder-protection as an end to be pursued through the details of the legal system, but because their participation is essential in a capitalist economy and the net effects of the system of rules must benefit them overall, at least as they are enforced in practice, and as they are supplemented by norms and ideological consensus regarding the social value of profit-seeking and self-interest.[19] The more easily that fact can be convincingly communicated to shareholders, and the less frequently that fact can be brought into question by significant changes to the law (or scandals like Enron, Global Crossing, Tyco, Adelphia, Worldcom, and HealthSouth), the more likely shareholder participation will follow.

If US experience is any guide, then, achieving a unitary framework for regulating takeover bids in Europe would facilitate M&A transactions and the restructuring that they generally precede. By reducing country-by-country variation in how M&A is regulated, and by limiting the overall amount of potential change in the system, any plausible DTB would create an important set of conditions (stability, transparency) for an active M&A market. That "high-level" goal should not be forgotten in an effort to perfect the details of the new DTB.

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effect of eliminating two-tier takeover bids and greenmail. Pills may also have reduced overall takeover bid activity, at least in the early 1990s, although the direct effect of pills on takeovers has not been nearly as important as their indirect effect, *via* staggered boards. *See* Lucian A. Bebchuk, John C. Coates IV and Guhan Subramanian, The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy, 54 Stan. L. Rev. 887 (2002). Some US legal academics argue that even the combination of pills and staggered boards has had little overall effect, due to independent boards, active institutional shareholders, and executive compensation. *E.g.*, Marcel Kahan and Edward B. Rock, How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law, 69 U. Chi. L. Rev. 871 (2002).

[19] This is why a spectacular failure like Enron did not in itself have much effect on US stock prices, but why the series of corporate scandals and failures that began the following January, from Global Crossing to Tyco to Adelphia to Worldcom, did send the US stock market into a long slide.

3. Doubts about the BTR

With that basic point in mind, I turn first to the BTR. As articulated by the Takeover Bid Report, the BTR is primarily directed at provisions that interfere with "proportionality" between cash-flow rights and control rights.[20] Proportionality raises important general questions about how firms should be governed. But why is proportionality important to the regulation of takeovers? The answer (presumably) is that disproportionality can facilitate barriers to takeover bids. Multi- or dual-class (DC) capital structures can make it easier for one shareholder to maintain control over a firm without paying for the cash-flow rights that accompany voting rights in single class structures. In the EU, at least, it is cheaper, *ex ante*, to create an absolute or near-absolute takeover defense using a DC structure than it is using a single-class structure. As takeover regulation, then, the BTR is directed primarily at companies that *both* (1) have DC structures and (2) have shareholders that could plausibly use high-vote shares to impede transfers of control.

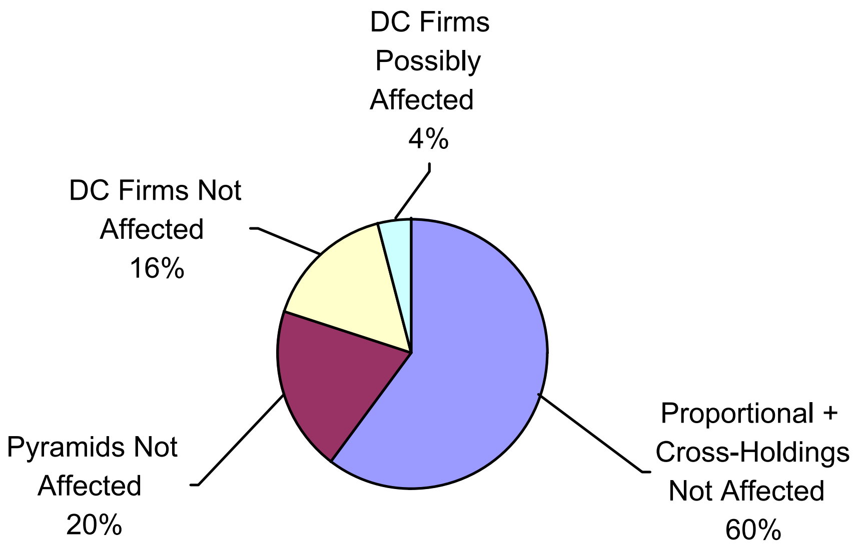
a. BTR Will Make Less than 3-4% of EU Firms Vulnerable to a Bid

Recent empirical research, however, suggests that such companies are relatively rare in the EU. Bennedsen and Nielsen (2003) report that out of 5,162 public companies in the EU, 1,035 or 20% have DC structures.[21] Of those, however, only ~50 are currently invulnerable to a takeover and would be made vulnerable under the BTR, and only another ~150 would be vulnerable under the BTR and currently have a significant degree of disproportionality between the voting and cash flow rights held by their largest shareholders. The rest of the DC firms would either continue to be invulnerable to a takeover under the BTR or currently lack sufficient disproportionality for a DC structure to contribute meaningfully to takeover defense by a current control shareholder. In all, as reflected on Figure 1, only 5% of all public firms would even be potentially put at-risk of a takeover by the proposed BTR.

[20] *Supra* note 3, at 3-5.

[21] Morten Bennedsen and Kaspar Nielsen, The Impact of a Break-Through Rule on European Firms, Working Paper (2003). Bennedsen and Nielsen also show that DC structures are also common in the UK, a country where dispersed ownership is modal, takeovers are common, and minority shareholder protection is thought to be good. In the US, too, DC structures are not uncommon. *See* Figure 3 and note 41 *infra*.

Figure 1 **Effect of BTR on EU Public Firms**



Sources for data: Bennedsen and Nielsen (2003) (DC data); Faccio and Lang (2002) (pyramid data)

But even this analysis overstates the potential value of the BTR to the creation of an EU-wide takeover market. That is because it implicitly assumes that companies would not dynamically respond to the adoption of the BTR, when they certainly would. Even the NR, as proposed in the DTB, could be deferred for up to three years by Member States; if the full BTR would to be included in the final DTB, political realities would require a deferral period. Thus, subject companies would have ample time to respond. They could do so in at least four ways. The first and simplest response is for large shareholders of currently vulnerable companies to increase their current holdings of cash-flow rights above the 25% threshold so that no bidder could acquire sufficient cash-flow rights to trigger the BTR. (This assumes as seems plausible that Member States most affected by the BTR established the highest permissible threshold.) Bennedsen and Nielsen's empirical analysis suggests that ~40 or 20% of DC firms that would be put at-risk by the BTR would plausibly be able to respond in this manner.[22]

For the remainder, the percentage of cash flow rights required to obtain such a veto block would be large enough that another, more costly alternative might be relatively more attractive: switching to a pyramid or cross-holding structure. Kraakman, Bebchuk, and Triantis (1999) have shown[23] – and the Takeover Bid Report acknowledges[24] – that from

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[22] Id.
[23] Reinier Kraakman, Lucian A. Bebchuk, and G. Triantis, Stock Pyramids, Cross-Ownership, and the Dual

the perspective of both control and cash-flow rights, the same results produced by DC structures can be produced through either pyramids or cross-holding structures. Bebchuk and Hart (2002)[25] argue that firms will recognize this equivalence and that vulnerable DC structures will switch to pyramids or be forced to do so by bidders. Nothing in the DTB (or in the EC's subsequent Company Law Action Plan) would prevent firms from substituting these structures for DC structures.[26]

Gordon notes that the effects of a relatively common 10-to-1 super-to-normal vote DC structure could only be accomplished through a 3- or 4-level pyramid.[27] Further, the transaction costs associated with such a switch could be substantial. Another alternative response would be for at-risk firms to reincorporate outside the EU.[28] This, too, would be expensive, as the "real seat" doctrine followed in EU countries would require firms to not only reincorporate but to relocate their headquarters. Thus, not all at-risk DC firms would evade the BTR. At the same time, for many, the switch would be worth it to a controlling shareholder, when compared to the risk of a loss of control. On balance, the most one can confidently say about the net effect of the BTR is that it would make *less than 3-4%* of public firms in the EU more vulnerable to a takeover bid than they are now.

b. The BTR Will Not Create a 'Level Playing Field'

The fact that many firms could evade the BTR raises two further troubling issues. The likelihood of evasion only underlines the fact that the DTB – with or without the BTR – will not create or even meaningfully contribute to a true "level playing field" for firms within the EU. The fact that DC firms are equivalent to pyramids and firms controlled through cross-holdings not only raises the risk of strategic evasion, but it means that disproportionality can make takeover defenses cheaper at a range of public companies,

Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights, National Bureau of Economic Research Working Paper No. 6951 (1999); also published in RANDALL K. MORCK. ED., CONCENTRATED CORPORATE OWNERSHIP (2000). For related articles that also note the importance of considering substitutes in designing regulations, see Jennifer Arlen and Eric Talley, Unregulable Defenses and the Perils of Shareholder Choice, Working Paper (Apr. 15, 2003) (various substitutes for takeover defenses common in the US); Ronald J. Gilson, Evaluating Dual Class Common Stock: The Relevance Of Substitutes, 73 Va. L. Rev. 807 (1987) (leveraged buyouts as substitutes for dual class recapitalizations).

[24] *Supra* note 3, at 6. In fact, the Takeover Bid Report singles out pyramids as "difficult to justify from a general capital markets and company law perspective," and candidly acknowledges that the only reason their proposed BTR would not apply to pyramids and cross-holdings is practicality. Id. at 38-39. The Company Law Report proposes that such structures be addressed with improved disclosure, rules on conflicts of interests in groups of listed companies with cross-holdings, and through the delisting of holding companies whose "sole or main assets are their shareholding in another listed company." Company Law Report at 94-100. The EC Company Law Action Plan endorses the recommendations on disclosure and conflicts of interest, and recommends further study of the possibility of delisting "abusive" pyramids, including the views of the Committee of European Securities Regulators (CESR). Action Plan at 18-20.

[25] Lucian A. Bebchuk and Oliver Hart, A Threat to Dual Class Shares, *Financial Times*, May 31, 2002.

[26] *See* note 23 *supra*.

[27] Jeffrey N. Gordon, Economic Nationalism and Corporate Governance: German Shareholder Capitalism in the European Union, Working Paper (2003), at n. 151.

[28] Reincorporation would not need to go beyond Europe, of course: neither Switzerland nor Norway is part of the EU, and both are physically close to countries in which Bennedsen and Nielsen find a high incidence of at-risk DC firms (Italy and Germany for Switzerland; Sweden and Denmark for Norway).

some of which will, and most of which will not, be affected by the BTR. As reflected in Figure 1, Faccio and Lang report that roughly the same percentage (20%) of public firms in the EU have pyramid structures as have DC structures.[29] Likewise, the largest shareholders of many DC firms currently have what Bennedsen and Nielsen refer to as "comfort" that their firms will not be taken over, even if the BTR were adopted, because they already own more than 25% of their firms' cash flow rights.[30] Even without considering the contribution of cross-holdings to disproportionality, these figures suggest that no more than 12.5% of EU public firms with disproportional capital structures will be affected by the BTR.

But the failure of the BTR (and the DTB more generally) to achieve a "level playing field" would be worse than reflected by discrepancies among DC firms, or between DC firms and other firms with disproportional capital structures. As noted by Berglöf and Burkart in a recent survey of theory relevant to any evaluation of the BTR and the rest of the DTB:

> In half of the listed non-financial firms in Austria, Belgium, Germany and Italy a single shareholder controls more than 50% of the votes (compared to 9.9% in the UK). In Dutch, Spanish and Swedish firms the median blockholder holds 43.5, 34.5, and 34.9%, respectively.[31]

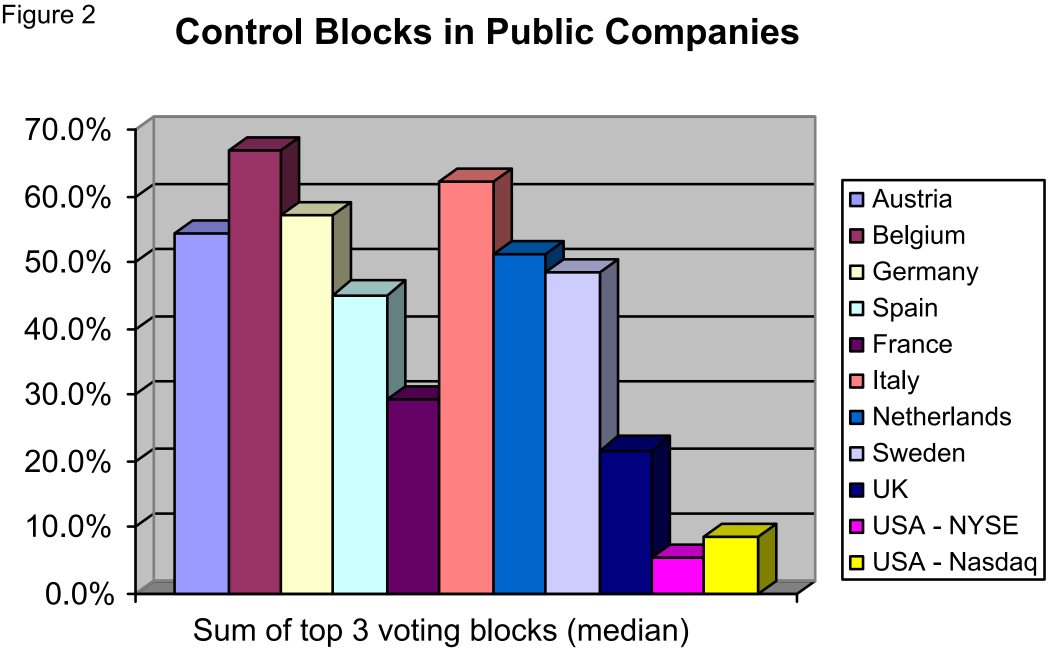
Their conclusion is illustrated in Figure 2, which uses data from Barca and Becht (2001).

[29] Cf. M. Faccio and L. Lang, The Ultimate Ownership Of Western European Companies, 65 J. Fin. Econ. 365 (2002) (reporting pyramid statistic) with Bennedsen and Nielsen, *supra* note 8 (reporting DC statistic).

[30] By some measures, Bennedsen and Nielsen estimate that nearly half or more of DC firms will fall into this category in Austria, Denmark, France, Germany, Italy and Sweden – precisely the countries in which DC firms currently pose the greatest impediment to takeover bids. *Supra* note 8, at Figure 2 Panel B. Put differently, the BTR will not achieve a level playing field for takeover bids even as regards countries in which DC structures have historically been most common.

[31] Erik Berglöf and Mike Burkart, European Takeover Regulation, Economic Policy April 2003, at 179. They rely for data primarily on F. BARCA AND M. BECHT, EDS., CONTROL OF CORPORATE EUROPE (2001).

Figure 2



The bulk of the massive concentration of voting control among public firms in the EU, reflected in Figure 2, does not result from disproportionality. Rather, it simply reflects the fact that owners of a large percentage of public firms in a majority of countries in the EU have chosen to retain a control block in an ordinary one-share/one-vote capital structure. All these firms have an absolute defense to hostile takeover bids not supported by their controlling shareholders. Becht and Mayer understate the point when they say: "Control may not be contestable, even under 'one-share-one-vote.'"[32] The BTR will have no effect on most of the takeover-proof EU public firms.

c. The Political Costs of the BTR

Thus, the BTR will do little to achieve a "level playing field." Since a level playing field is one of the key stated objectives of the DTB, one of the principal public-regarding political objections made to the old DTB by members of the European Parliament,[33] and one of the three issues that the Winter group was asked to address, the BTR seems to be in need of further justification. Nor is the BTR likely to reduce political opposition to the

[32] Introduction, in Barca and Becht, *supra* note 16, at 11. The Takeover Bid Report notes this point only in passing – lumping proportional control blocks in with a laundry list of "general factors" that affect takeover bids, which it contrasts with "company level factors" such as DC structures. *Supra* note 3, at 18. Nothing in the Company Law Report or the EC's Company Law Action Plan (other than proposals for improved disclosure) would address one-share/one-vote blocks.

[33] Of course, many members of the European Parliament may have opposed the old DTB anyway, for other reasons (*e.g.*, concerns about employees, ties to entrenched management, worries about the ability of US firms to buy EU firms on the cheap), even if it had done a better job of creating a "level playing field" within Europe. But the political force of these other objections was surely enhanced by nationalist fears stimulated by the "level playing field" argument.

overall DTB from specific Member States or specific constituencies within those Member States. Although the number of European DC firms that would be put at-risk by the BTR would be small in absolute terms, and very small relative to all public firms, some of those that would be put at-risk are quite large, with both the incentive and the capacity to organize and lead substantial political opposition to the DTB. At least 20 of the 500 largest firms in the EU, including such well-known firms as Groupe Danone, Telecom Italia, Fiat, Perelli, and Fresenius, would be placed at risk of takeover, using the criteria developed by Bennedsen and Nielsen.[34] Many of the companies that would be put at-risk by the BTR are located in Germany, and representatives from Germany are for many political reasons already likely to be among those opposing the new DTB, just as German representatives opposed the old DTB.

But the BTR's impact would not be limited to one country – many are located in Italy, Denmark and Sweden – and the political opposition to its adoption could be even larger than to the older proposal. A significant number of at-risk firms are also located in the UK, representatives of which were political supporters of the old DTB, and could otherwise be expected to support the new DTB. Because of the UK's robust public capital markets, at-risk companies in the UK are a small percentage of UK public companies, but for political purposes, that fact is not as helpful as the fact that a number of UK firms would be put at-risk: basic public choice or economic analysis of politics suggests that a small number of highly interested firms will tend to have a greater political impact than a large number of modestly interested firms, even if the theoretical sum of interest of the latter group is larger than that of the former group.

Some of the political currents swirling around the DTB and the BTR are opaque, at least to this US observer. One would think, for example, that representatives from the UK would be most in favor of rules helping to produce a "level playing field," since UK firms are currently most vulnerable to hostile takeovers, both because of existing UK laws and because of the relatively dispersed ownership of most UK firms, as reflected in Figure 2. One would also think that representatives from Germany would be most inclined to accept either the old or the new DTB, which would facilitate cross-border bids generally without doing much to render vulnerable the majority of German firms (protected by state ownership, large blockholdings, pyramids, and DC structures). Yet in fact political forces in the UK and Germany seem to be taking the opposite tacts: those from the UK favored the old DTB, and are neutral or critical of the BTR (because the Takeover Bid Report did not include any compensation for holders of high-vote stock), and those from Germany favor the BTR as a step towards a level playing field, and opposed the old DTB. Perhaps these positions are political masks; perhaps the BTR is being supported by German MEPs in the hopes that it will function as a political poison pill that will reduce the odds that any DTB will be enacted. Or perhaps as with politics generally there is no simple mapping from publicly disclosed interests to publicly announced positions that can easily explain the facts.

Putting politics aside, if the DTB could be passed with the BTR, a large portion of public firms in the EU will remain outside the takeover arena, and to that extent the DTB will

[34] *Supra* note 8.

not directly facilitate Europe-wide restructuring, another stated goal of the DTB. Nevertheless, if the BTR were otherwise of clear benefit, with few costs, one might be inclined to respond with Voltaire's maxim: "*Le mieux est l'ennemi de bien*."[35] But as I will now discuss, the BTR will in some ways make things worse than the *status quo*.

d. The Economic Costs of the BTR

While the BTR will produce few certain benefits, it will produce sizeable certain costs. First, strategic reactions to the BTR discussed above – purchases of additional cash flow rights to achieve a takeover veto; switches to pyramids and cross-holding structures to replicate disproportionality without concern about the BTR; and reincorporations outside the EU – will generate transaction costs. In addition to substantial fees of lawyers, bankers and brokers needed to implement these strategic reactions, top management of affected firms will face significant distraction as they worry about preserving the control of their firms: if US takeover experience has any lessons, it is that top managers worry about few things more than loss of control. When top managers are distracted, ordinary business suffers. From a social perspective, these costs will be a pure loss, since no gain will be achieved in terms of making those firms more likely to be takeover targets.

Worse, as Bebchuk and Hart point out, *new* European firms that go public (including spin-offs of existing public firms) are likely to adopt pyramids and cross-holding structures at the outset if pre-IPO shareholders or other control persons wish to preserve their "lock" on control while selling more than a majority of the cash flow rights to the public. To the extent more pyramids and cross-holdings result, either mid-stream (through switches) or from newly public firms seeking to avoid the BTR, matters will be made worse from the perspective of transparency: while DC structures make takeover deterrence cheaper, pyramids and cross-holdings do that and also make it much more difficult for outside investors to understand, evaluate, and monitor existing controllers. As the Takeover Bid Report notes,

> Pyramid structures … undermine the transparency of the ownership structure of listed companies; [and] … affect the pricing mechanism with regard to listed shares at all levels in the structure….[36]

By inducing more pyramids or cross-holding structures, the BTR will reduce transparency and impair capital markets outside the scope of takeover bids.

Finally, both existing or new public firms that have both a conventional one-share/one-vote structure and a single (or small group) of controlling shareholders may simply turn down net present value projects if they would require the shareholders to put their control positions at risk.

4. Why Do Takeover-Proof Firms Exist?

[35] VOLTAIRE, DICTIONNAIRE PHILOSOPHIQUE ("the perfect is the enemy of the good").
[36] *Supra* note 3, at 39.

To know whether the costs of the BTR are greater than its benefits – which as discussed above will be small – one needs, as a starting point, some basic theory about why concentrated ownership (through control blocks and disproportional structures) persist in public firms in the first place. While many things remain uncertain about ownership structure, one thing seems likely: concentrated ownership depends upon "private benefits of control" (PBC).[37] As I use the term, PBC are any benefits that a control person derives from their control of a firm that are not shared proportionally with non-controlling shareholders.

The composition of PBC in practice is much less certain. At least three kinds of PBC can be distinguished: (1) transfers of value from minority shareholders to a controlling shareholder that are inefficient in the sense that the gain to the control person from the PBC is less than the loss to the minority shareholder ("bad PBC");[38] (2) transfers of value that are efficient in the sense that the gain is no less than the loss ("good PBC," called "amenity potential" by Demsetz and Lehn[39]); and (3) value that is no meaningful sense a "transfer" because it is inherent in control ("inherent PBC").[40] Each type of PBC is

[37] Other things may also be necessary, or may contribute to concentrated ownership. For example, control shareholders may profit when they sell shares to public investors if the latter may fail to "price" properly the difference between contestable and non-contestable control structures. Or control shareholders may not internalize the full benefits of future takeover bids when choosing an ownership structure. Lucian A. Bebchuk and Luigi Zingales, Corporate Ownership Structures and the Decision to Go Public: Private versus Social Optimality, in Morck, *supra* note 16, at 55. In addition, as noted below, concentrated ownership may arise to control managerial agency cost problems, which can be viewed as an extreme form of private benefits of control.

[38] This seems implicit in the Winter Group's endorsement of proportionality, *supra* note 3, at 21, and is consistent with some of the more prominent theoretical analyses of control blocks, which argue that control shareholders extract PBC from minority shareholders, lowering not only firm value but social welfare. *E.g.*, Lucian A. Bebchuk, A Rent-Protection Theory of Corporate Ownership and Control, NBER Working Paper 7203 (1999); R. La Porta, F. Lopez de Silanes, A. Shleifer, and R.W. Vishny, Legal Determinants of External Finance, 52 J. Fin. 1131 (1997); R. La Porta, F. Lopez de Silanes, A. Shleifer, and R.W. Vishny, Investor Protection and Corporate Governance, 58 J. Fin. Econ. 3 (2000).

[39] Harold Demsetz and Kenneth Lehn. The Structure of Corporate Ownership: Causes and Consequences, 93 J. Pol. Econ. 1155 (1985); Clifford G. Holderness, A Survey Of Blockholders and Corporate Control, Fed. Res. Bk. of N.Y. Econ. Pol. Rev. 51 (April 2003). Olaf Ehrhardt and Erik Nowak, following Michael Jensen, argue that good PBC cannot exist, because a control shareholder will maximize the sum of PBC and his share of firm value, which will always diverge from firm value alone. Private Benefits and Minority Shareholder Expropriation - Empirical Evidence from IPOs of German Family-Owned Firms, Working Paper (March 2002) (citing Michael Jensen, Value Maximization, Stakeholder Theory, and the Corporate Objective Function, 7 European Fin'l Mgt., 297 (2001)). This argument pushes logic beyond its limit. While actions that benefit a control shareholder may reduce firm value, many actions that produce PBC would also maximize firm value. Illegal insider trading could benefit a control shareholder on an expected basis (if enforcement is imperfect) and harm firm value on an expected basis (if there is a non-zero chance the insider is caught and any harm to the shareholder's reputation will also harm the firm) (*e.g.*, Martha Stewart); but if enforcement is good enough, or profit low enough, a shareholder will choose not to trade (for her own reasons), and that choice will (compared to the alternative) maximize firm value, too. Conversely, consider a high-profile, high-risk, and high-cost investment opportunity with positive expected value (*e.g.*, Berkshire Hathaway's purchase of Tyco convertible bonds). If the control shareholder pursues the opportunity through the firm, and the investment pays off, the shareholder will have benefited along with other shareholders, but will also added to his reputation in a way not shared with other shareholders.

[40] Ehrhardt and Nowak, *supra* note 32, use a different typology, distinguishing PBC in two dimensions: pecuniary vs. non-pecuniary, and transferable vs. non-transferable. They equate bad PBC with what

discussed briefly below, but the key point for this analysis is the BTR can be expected to have only marginal effects on PBC of any type, and may reduce social welfare by interfering with contracts designed to protect good PBC or inherent PBC.

a. Bad PBC

Bad PBC are the sort of PBC that most commentators seem to have in mind when they talk of PBC: excessive (often hidden) compensation or perquisites of office, extraction of value through self-dealing transactions, excessive risk aversion, or choice of suboptimal business or operational strategies to satisfy some personal preference of control shareholders.[41] In each case, the PBC represent a reduction of firm wealth at the expense of minority shareholders, and what is more, a reduction that is greater than any benefit to control shareholders, resulting in social loss. (If the control shareholder valued the PBC more than the minority shareholders valued the loss to firm value they create, the PBC would be "good PBC.") If bad PBC of this sort could be eliminated or reduced, social welfare would be enhanced.

b. Good PBC

At the time the firm sells shares to the public, existing controlling shareholders may value control (and the PBC it provides) more highly than anyone else would value those PBC. In standard neo-classical models of the firm, this is not possible, because control is not treated as a consumption good and no firm is unique, so control provides no unique PBC to any particular controlling shareholder. But casual observation suggests this picture is too simple.

Founding families often give their names to firms and work to inculcate a preference for maintaining control in the second- (or even third-) generation family members, who join the firm's management.[42] Thus, for example, Ford Motor Company continues to be dominated by the Ford family, and retains a disproportional capital structure. In the worlds of fashion, art, and music, creative entrepreneurs who produce new cultural products often (if not always) have a much greater psychic investment in control of the uses of their products than they can monetize on the capital markets. Recent research suggests that enough California vineyards are owned by hobbyists who enjoy producing high quality wines for its own sake that they lower the financial returns of, and

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pecuniary PBC. But not all bad PBC are pecuniary: a control shareholder choosing a low-risk strategy based on his risk preferences could harm minority shareholders more than the choice benefits him. And not all pecuniary PBC are bad: a shareholder could force the sale of a personal asset to a controlled firm at a price that exceeds his private valuation, producing pecuniary PBC, but if the sale price is below market price, neither the firm nor minority shareholders will have suffered. For a US legal case that plausibly illustrates the latter possibility, *see* Cookies Food Products, Inc., v. Lakes Warehouse Distributing, Inc., 430 N.W.2d 447 (Iowa 1988).

[41] *E.g.*, Bebchuk, *supra* note 33, at 16; S. Johnson, R. La Porta, F. Lopez-de-Silanes, and A. Shleifer, Tunneling, Am. Econ. Rev. 22 (2000).

[42] D.J. Denis and D.K. Denis, Majority Owner-Managers and Organizational Efficiency, 1 J. Corp. Fin. 91 (1994) find that public firms with majority owners are more likely to have DC structures and family owners.

discourage profit-maximizing owners from competing in, the high-end wine segment.[43] A similar effect is reported in high technology companies, where part of the incentive for innovators is their sense of ownership over the technology itself, in all its possible uses (or, more often, from their perspective, misuses), and the initial innovators are very plausibly the highest-valuing owners of the rights to dispose of the technology they have created.

Holdnerness notes that control shareholders are commonly corporations, or are individuals that control other businesses.[44] Where this is the case, synergies can arise between the parent (or commonly controlled) companies and the firm in question. These synergies can benefit minority shareholders even if they are not shared on a purely pro rata basis, and are another type of good PBC.

Even if controlling shareholders are scrupulously honest and talented and work to maximize firm value, the presence of good PBC will give a reason to maintain a "lock" on control.[45] And, if their capital needs are large enough, they may use DC structures to maintain their control while selling more than a majority of their firms' cash-flow rights to the public.[46] Any law – such as the BTR – that effectively taxes or prohibits such structures in such firms will reduce social welfare.

c. Inherent PBC

Some PBC, finally, are inherently non-contractible – they cannot be shared with minority shareholders, whether minority shareholders would (in theory) value those PBC more, less, or the same as control shareholders. Only one person can have final authority over the *New York Times* or *Le Monde*, for example. Indeed, media companies are often controlled by one shareholder, regardless whether they have public investors. Figure 3 shows that DC structures are more common in the media industry than in other industries, among mature US public firms and in US firms going public.[47] (The same is true of the

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[43] Fiona M. Scott Morton and Joel M. Podolny, Love or Money? The Effects of Owner Motivation in the California Wine Industry, 50 J. Ind. Econ. 431 (2002).

[44] Holderness, *supra* note 34, at 55.

[45] Of course, many entrepreneurs are wealth constrained and risk-averse, and have other desires that lead them to sell control of their firms (and technologies) to the public. Thus, inside ownership is inversely correlated with firm size. Clifford G. Holderness and Dennis P. Sheehan, The Role of Majority Shareholders in Publicly Held Corporations 20 J. Fin. Econ. 317 (1988). But some can be expected to (and do) retain control even if they take their firms public.

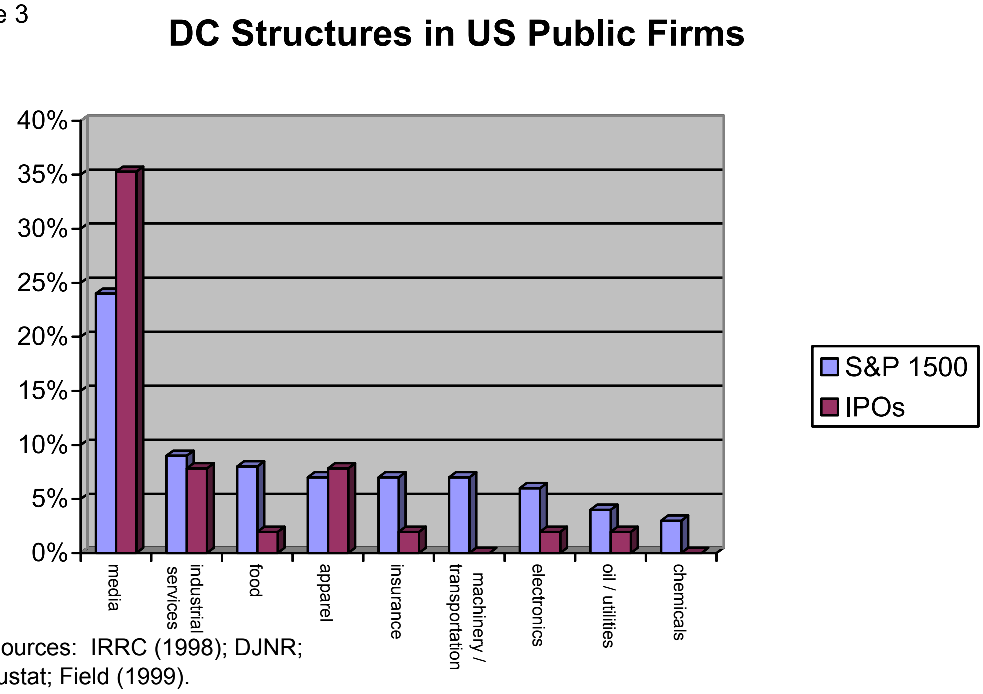
[46] Controllers typically follow a "pecking order" when deploying capital: first rely on internal finance, then if external finance is needed, turn first to debt, then hybrid securities such as preferred stock, and only then voting equity. *See* S.C. Myers, The Capital Structure Puzzle, 39 J. Fin. 581 (1984). This pattern illustrates the limitations of the Modigliani-Miller theorem that capital structure "does not matter," with the implication that debt can always be used instead of equity. *See* F. Modigliani and M .H. Miller, The Cost of Capital, Corporate Finance and the Theory of Investment, 48 Am. Econ. Rev. 261 (1958). *See also* M. Attari and S. Banerjee, Strategic Underinvestment, Managerial Entrenchment and Ownership Structure of a Firm, Working Paper (Tulane University) (2002) (insiders may "underinvest" relative to first-best if investment requires issuing outside equity and risking control; DC structures may mitigate this problem).

[47] Figure 3 uses data on firms with dual class common stock in IRRC, Corporate Takeover Defenses (1998) (which includes the S&P 1500), excluding tracking stocks (based on Dow Jones News Reports), and data on firms with dual class common stock in sample of 1,019 firms that went public 1988-1992, from Laura

firms listed in Appendix A, discussed below, one of which is the firm that owns the *New York Times*.)

More generally, only one person can be the ultimate boss in a hierarchy, and thus only one person has no boss; this is an inherent feature of firms that cannot be plausibly changed by contract. True, even the ultimate boss of a public company must satisfy suppliers of capital and labor, and customers, and is thus constrained in many ways. But empirical evidence suggests that many entrepreneurs are consistently willing to "pay" for formal autonomy by obtaining predictably lower average absolute (*i.e.*, not risk-adjusted) rates of return.[48]

Figure 3



Data sources: IRRC (1998); DJNR; Compustat; Field (1999).

As with good PBC, inherent PBC will motivate owners to retain a lock on control, even if they go public, and to use disproportional structures if their capital needs are sufficiently large and the discount on non- or low-voting shares is not too great. And again, any law that prohibits or taxes disproportional capital structures for such owners will reduce social welfare, either by discouraging pursuit of socially useful projects that could have been funded with the capital raised by selling low- or no-vote shares, or by inducing owners to forego control (and the inherent PBC that control protects) in order to pursue those projects.

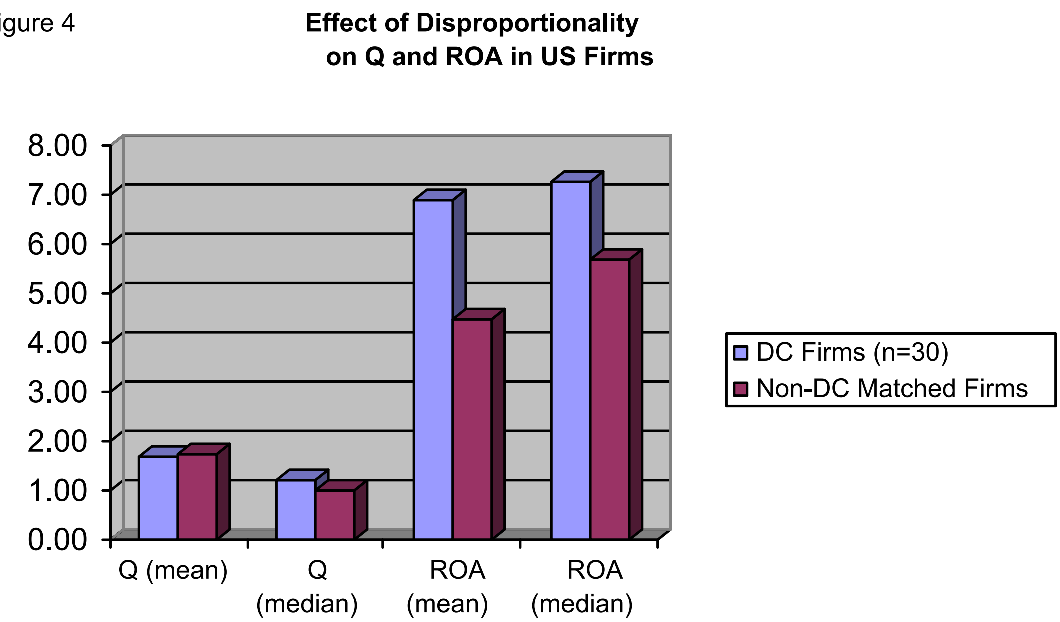
Casares Field, Control Considerations of Newly Public Firms: The Implementation of Antitakeover Provisions and Dual Class Shares Before the IPO, Working Paper (Feb. 10, 1999), subsequently published in slightly different form as Laura Casares Field and Jonathan M. Karpoff, Takeover Defenses of IPO Firms, 57 J. Fin. 1857 (2002). *See also* Scott B. Smart and Chad J. Zutter, Control as a Motivation for Underpricing: A Comparison of Dual- and Single-Class IPOs, 69 J. Fin. Econ. 85, 105 (2003) (DC structures are disproportionately present in sports management, entertainment and media industries).

[48] Barton H. Hamilton, Does Entrepreneurship Pay? An Empirical Analysis of the Returns to Self-Employment, 108 J. Pol. Econ. 604 (2000).

d. Which Type of PBC Dominates? Do DC Firms Underperform?

Any rule that effectively reduces PBC in public firms generally might improve social welfare if the incidence of bad PBC was greater than the incidence of good and inherent PBC. Few attempts have been made to estimate the distribution of types of PBC.[49] As a simple, indirect test, the following analysis was conducted. From 206 US public firms listed by the Investor Responsibility Research Center as having DC structures, 30 were chosen randomly, and each firm's 2001 annual proxy statement was examined to verify that the firm was listed on a stock exchange or Nasdaq from 1995 to 2000, and that it in fact had a DC structure giving disproportionate voting rights to one or a small group of shareholders. Each firm was matched with a public firm with a proportional (one-share-one-vote) structure, from the same industry (2-digit SIC codes) and roughly the same size (1997 assets). Tobin's Q and return on assets were compared for each pair from 1997 to 2000. Results are summarized in Figure 4.

Figure 4



DC firms had larger median Q, mean ROA and median ROA, and smaller mean Q. For such a small sample, it is not surprising that none of these fairly small differences are statistically significant at a 95% confidence level, and the only difference that approaches statistical significance is for mean ROA ($p<.12$). From these (admittedly limited) data, one cannot conclude anything one way or another about the effect of DC structures on

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[49] Studies of the existence and size of PBC exist, *e.g.,* M.J. Barclay and C.G. Holderness, Private Benefits from Control of Public Companies, 25 J. FIN. ECON. 371 (1989), but not the source of PBC. An exception is Ehrhardt and Nowak, discussed *supra* note 39, and in the text below.

firm value or performance. Nor can one conclude that bad PBC outweighs good or inherent PBC, or *vice versa*.

These results are broadly consistent with those from other studies of US firms. Field and Karpoff study over 1,000 US firms going public in the early 1990s, and find no evidence that DC structures (or takeover defenses generally) "degrade operating performance or are used to protect managers who are expected to perform badly."[50] In fact, they find that raw ROA and ROA adjusted by comparison to an industry-matched firm with the same IPO-year ROA are actually higher for firms protected by DC structures and other defenses in the first two years after an IPO, although the difference falls to statistical insignificance thereafter. Dimitrov and Jain study 178 US firms that announced a new DC structure from 1979-1998, and find that conversion to the DC structures produces positive abnormal results for minority shareholders.[51] They further find that the positive abnormal returns (of 41.67% over 48 months) are concentrated in those firms where the control shareholder does *not* list the high voting stock; firms where the high voting stock is listed along with the low voting stock produce returns that are not statistically different from overall market model returns. Event studies of DC structures likewise find evidence generally consistent with the notion that conversions to such structures are not generally harmful to minority shareholders.[52]

Ehrhardt and Nowak study 44 German firms that went public with DC structures 1970-1991, and find that such firms underperformed relative to a size-matched portfolio of firms over the three years after the IPO (measured both by stock returns and operating performance).[53] They attribute the underperformance to bad PBC (as noted above, they do not believe good or inherent PBC exist).[54] They explain the difference between their findings and the findings from the US in Field and Karpoff to laxer protections of minority shareholders in Germany, compared to the US, citing the now well-known comparative studies by LaPorta *et al*.[55]

But if weak shareholder protection is the explanation for Ehrhardt and Nowak's findings, German law must protect minority shareholders less well than they are protected in Denmark, as well in the US. Rose studies 102 firms listed on the Copenhagen Stock

[50] *Supra* note 41, at 1883.
[51] Valentin Dimitrov and Prem Jain, Dual Class Recapitalization and Managerial Commitment: Long-run stock market and operating performance, Working Paper (Dec. 11, 2001).
[52] Cf. M. Megan Partch, The Creation of a Class of Limited Voting Common Stock and Shareholder Wealth, 18 J. Fin. Econ. 313 (1987) (event study of 44 public US firms adopting DC structures midstream; finds a +1.2% average stock price reaction to announcement) and Jeffrey N. Gordon, Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice, 76 Cal. L. Rev. 3 (1988) (finding similar results) with Gregg A. Jarrell and Annette Poulsen, Dual-class Recapitalizations as Antitakeover Mechanisms, 20 J. Fin. Econ. 129 (1988) (finding a –0.82% average stock price reaction in similar study of DC recapitalizations).
[53] *Supra* note 34.
[54] Cf. Smart & Zutter, *supra* note 42, who find that DC IPOs underperform single-class IPOs in the US not because of sub-par operating performance but because the shares are less underpriced in the IPO itself, because firms without DC structures have a greater need to underprice in order to disperse shares widely among small holders as partial substitute for the takeover defense offered by DC structures.
[55] *See* sources cited in note 33 *supra*.

Exchange and finds that over half have DC structures.[56] Over the period 1995-1999, firms with high-levels of takeover protection (through DC structures or otherwise) perform no worse than those without such protection, whether measured by Tobin's Q, stock returns, ROA or ROE.

Even if it is true that more of the DC structures in the EU (or in Germany) are motivated by bad PBC than is the case in the US (or in Denmark), the BTR (and the DTB more generally) will do little to reduce bad PBC. The threat of takeovers reduces PBC only if a firm is a plausible takeover target. But as discussed above, only a minority of public firms in the EU are now takeover targets, and only a slightly smaller fraction will become takeover targets under the DTB, and an even smaller fraction would become takeover targets by virtue of the BTR. Other, more direct mechanisms would be necessary to reduce any bad PBC that induces concentrated ownership in the EU: better courts, better mechanisms to enforce shareholder rights outside the takeover context, more transparency, better audits, or better standards for ordinary governance of public firms. It is not necessary for this analysis to decide whether bad PBC is a big or small problem in the EU – and the contrasting results from the Denmark and Germany studies,[57] as well as studies showing large variations in premiums for voting shares and control blocks across countries[58] – suggest that bad PBC is probably a big problem in some countries and a small one in others. Whatever the case, the BTR itself will do little to reduce bad PBC.

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[56] Caspar Rose, Corporate Finance Performance and the Use of Takeover Defenses, 13 European J. L & Econ. 91 (2002).
[57] *See* sources cite in notes 34 and 50 *supra*.
[58] Alexander Dyck and Luigi Zingales, Private Benefits of Control: An International Comparison, Harvard Business School and University of Chicago Working Paper (2001); F. Modigliani and E. Perotti, Security versus Bank Finance: The Importance of a Proper Enforcement of Legal Rules, MIT Working Paper (2000); Tatiana Nenova, The Value of Corporate Voting Rights and Control: A Cross-country Analysis, 68 J. Fin. Econ. 325 (2003); cf. Barclay and Holderness, *supra* note 43; Luigi Zingales, The Value of the Voting Right: A Study of the Milan Stock Exchange Experience, 7 Rev. Fin'l Stud. 125 (1994).

e. Controlling Shareholders May Control Manager Agency Costs

In addition to these affirmative reasons for maintaining relatively concentrated ownership in a public firm (and for adopting DC structures if capital needs are large enough), there is an important negative reason for concentrated ownership to persist in public companies: such ownership structures may better align the incentives of (or constrain through monitoring) managers. As the Takeover Bid Report acknowledges, "a strong minority shareholder who controls the company from the inside may … overcome the problems related to disciplining management of companies with dispersed ownership."[59] Even if concentrated ownership protects "bad PBC," any rule that forces a firm into a dispersed or proportional ownership structure may reduce bad PBC only by creating even larger manager agency costs. At the highest level of abstraction, one would expect manager agency costs to exceed bad PBC when managers own little stock, and bear a small share of the costs through ownership. Even if bad PBC outweighs good and inherent PBC in the EU, and even if the BTR could reduce bad PBC or PBC overall, it could come at the cost of increasing manager agency costs by a larger amount.

A component of the BTR does address manager agency costs: by imposing the 75% threshold for application of the BTR, the BTR would encourage control shareholders to retain at least 25% of a firm's cash-flow rights. Thus, the BTR can reasonably be defended as helping insure that a control shareholder is more like a sole owner and less like a manager. As a matter of theory, however, it remains far from clear that managers need to own anything like 25% of a company to have a strong incentive to maximize overall firm value, and there is some evidence, albeit disputed, that firm value rises in a controller's ownership only to a level of about 5%, and falls thereafter to a level of about 30% as block ownership enable managers to entrench themselves, and then rises again thereafter.[60] This evidence suggests that if the BTR encouraged more firms to hold 25% blocks, performance would be lower than if firms had either 5% blockholders or 50+% blockholders. In any event, the findings on DC structures reviewed above suggests that the link between ownership and value (or performance) is not confined to DC firms, but extends to one-share/one-vote firms, which are not addressed by BTR.

f. US Law Permits Public Firms to Remain Takeover Proof

Consistent with the foregoing analysis, US law has never – and currently does not – prohibit takeover-proof companies. US firms can, and often do, ensure that they will never be subject to a hostile takeover in each of the ways used in the EU: retention of control blocks by pre-IPO owners, and use of disproportionate capital structures. Neither state corporate law nor federal securities law in any way prevents an entrepreneur from selling low- or even no-vote shares to the public. The only major constraint on DC

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[59] *Supra* note 3, at 24. See also Mark J. Roe, Corporate Law's Limits, 31 J. Legal Studies 233 (2002).

[60] Randall Morck, Andrei Shleifer and Robert W. Vishny, Management Ownership and Market Valuation: An Empirical Analysis, 20 J. Fin. Econ. 293 (1988). *But see* Charles P. Himmelberg, R. Glenn Hubbard and Darius Palia, Understanding the Determinants of Managerial Ownership and the Link Between Ownership and Performance, 53 J. Fin. Econ. 353 (1999) (arguing and presenting evidence that managerial ownership structure is endogenous and thus does not affect firm value).

structures occurs after a company has already gone public – at which point SEC Rule 19c-4 requires the stock exchanges (including Nasdaq) to impose a listing requirement that (in effect) no traded company may engage in a transaction that reduces or impairs the voting rights of already-issued stock, even with shareholder consent.[61] However, even this requirement can be "evaded" (if that word is appropriate) by a company that is willing to go fully private (buying back all of its stock, or engaging in a cash merger with a new, privately held shell company), and then go public again, with low- or no-vote stock being sold to generate proceeds to pay off any debt used to engage in the buyout. (Likewise, although US tax law discourages pyramids, many US firms sell minority stakes in controlled subsidiaries to the public.)

It is true that shares of DC firms are thought to sell at a discount to what one-share-one-vote structures would produce in IPOs.[62] For that reason, only 5-10% of all new firms, on average, have DC structures in the US, as reflected in Figure 3. But the fact of that discount suggests that IPO investors are not being fooled (at least fully) into paying more than they should for shares of a firm that may never be taken over, even when a takeover would increase the value of the firm in the hands of outside investors. And the presence of the discount on new DC firms says nothing about whether those firms are adding to or reducing social welfare. In order to know that, one would have to know the size of the PBC that the control shareholders retain, and they idiosyncratic value that they place on those PBC; only if the discount was larger than those PBC would one be able to make any statement about the relative efficiency of DC structures.

As illustrated by Figure 5, US firms can also greatly reduce the risk of being taken over on a hostile basis in one way not commonly found in the EU: adoption of a staggered board, which has its effect because of the poison pill.[63]

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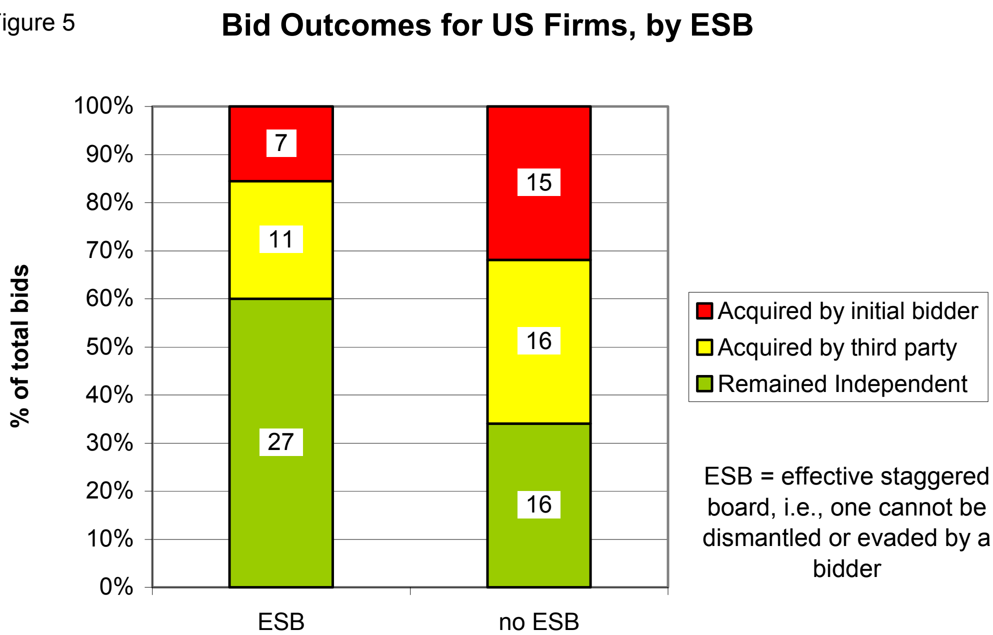
[61] The current US regulation of DC structures was adopted after much public debate over mid-stream conversions of one-share-one-vote firms to DC structures during the hostile takeover wave of the 1980s. For a policy analysis that helped produce the current US rules, *see* Gilson, supra note 24. The current SEC rule was declared to be beyond the SEC's authority in Business Roundtable v. SEC, 905 F.2d 406, 416-17 (D.C. Cir. 1990), thus theoretically enabling the NYSE or the Nasdaq to repeal their rules constraining midstream switches to DC structures, but both the SEC rule and the related NYSE and Nasdaq rules remain on the books.

[62] *See* Smart & Zutter, *supra* note 42, at 104-07 (DC firms have lower price/earnings multiples at IPO than similar single-class firms).

[63] *See* Bebchuk, Coates and Subramanian, *supra* note 14, at 930. The results in Figure 5 are over the nine months following announcement of a bid, and reflect a sample of 92 takeover bids, which comprise all takeover bids for US public companies 1996-2000. Of the targets, 45 had ESBs, 47 did not.

Figure 5



Source: Bebchuk, Coates & Subramanian (2002)

Thus, although contestable control can be found in about one-third to one-half of US public firms, many if not most US public firms do not leave themselves vulnerable to takeover bids. When viewed in that light, the US control market is no more or less contestable than the EU control market, despite the difference in ownership structures reflected in Figure 2.

Gordon points out that there may be other features of the US corporate control environment that could make it harder for managers of US firms to resist takeover bids even if they have the theoretical legal ability to do so.[64] Executive compensation, for example, is notoriously higher in the US than in Europe in large part because it consists of stock options, which in theory could provide managers with incentives to sell (to realize a deal premium, to accelerate vesting requirements, or to convert risky equity into cash). Preliminary analysis of cross-sectional analysis of US firms in the S&P 500, however, suggests that CEOs with more stock option holdings are not, on average, any more likely to sell their firms than other CEOs, and theory also suggests that stock options can have either positive or negative effects on manager incentives to sell the company, depending on (among other things) the volatility of the stock underlying the options and thus the time value of the options relative to their intrinsic value.[65]

Likewise, more general worries that the "culture" of Europe is less deal-, profit- or shareholder-oriented than in the US run up against the following facts:

[64] Jeffrey Gordon, An American Perspective on the New German Anti-takeover Law, With EU Implications, Working Paper (May 6, 2003).
[65] *See* John C. Coates IV and Reinier Kraakman, CEO Incentives and Merger Activity in the 1990s: Stock Options and Real Options, Working Paper (Mar. 7, 2003).

- In 1999, 369 bids have been reported for European firms, versus 20 for US firms.[66]
- In 1999, the dollar volume of EU hostile activity was 3x that in the US.[67]
- Overall European M&A grew rapidly in the '90s, faster than M&A in the US.[68]
- By 2002, 55% of worldwide M&A was European, more than double US levels.[69]

Whatever else one can say about corporate control in the EU, one cannot say that it is lagging the US in overall deal-making. Nor do the deals seem to harmful to shareholder-interests: Goergen and Reeneboog report that the stock market reaction to announcements of acquisitions of and by European firms are significantly positive for targets and neutral for bidders, as they are in the US.[70] While the BTR might stimulate additional M&A activity, and would probably shape the direction and nature of that activity, particularly by increasing cross-border M&A, which remains a non-trivial but minor part of M&A worldwide, it seems hard to argue that the BTR (or the NR, for that matter) are prerequisites for a robust M&A market.

5. Summary

In sum, the benefits of the BTR would not clearly be greater than its costs. Practically, the BTR will affect less than 3-4% of all public firms in the EU, leaving many more (more than half of public firms in many countries) outside the takeover market. That is because the primary means by which EU firms remain invulnerable to takeovers is through blockholdings in one-share-one-vote structures. Even as a means of addressing disproportionality more generally (outside the takeover context), the BTR will only affect a minority of firms with disproportional structures, as it will leave intact pyramids and cross-holdings. The BTR will not contribute much to a level playing field, and it will produce dead-weight costs as firms strategically react or anticipate its effects.

More generally, the goals of the BTR – to reduce the incidence of disproportional structures by increasing the degree to which DC firms are exposed to the discipline of

[66] These data are drawn from the Thomson Financial Securities Data (formerly SDC) database. My own analysis of data from SDC shows many fewer hostile bids in Europe (67), but still many more than in the US (12), even outside the UK (29). *See also* Marc Goergen & Luc Renneboog, Shareholder Wealth Effects in Large European Takeover Bids, Working Paper (Feb. 2, 2002) (reporting similar data for Europe, based on a study by Morgan Stanley).
[67] These data are drawn from the Thomson Financial Securities Data (formerly SDC) database.
[68] See Joseph A. McCahery, Luc Renneboog, Peer Ritter and Sascha Haller, The Economics of the Proposed European Takeover Directive, Working Paper (May 2003), at 28-30. UK activity represented a disproportionate share of this increase, but nearly 70% of M&A in the EU took place outside the UK. Id.
[69] These data are from a presentation by Robert Kindler of J.P. Morgan to the International Bar Association (June 12, 2003).
[70] *Supra* note 59 (tbl. 1). While stock market reactions to acquisitions of UK firms are about double those for non-UK European firms, reactions to acquisitions by UK firms have statistically similar stock price reactions as those by non-UK European firms. Id. (tbl. 3). A minority of US analysts of the M&A market have long been concerned that the high deal premiums expected by US shareholders may impose an inefficient drag on the corporate control market, and have called for legal changes designed to reduce that drag. *E.g.,* FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) at 168-74 (criticizing legal impediments to hostile takeovers); Alan Schwartz, *Search Theory and the Tender Offer Auction*, 2 J.L. ECON. & ORG. 271 (1986) (same); *but see* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982).

takeover bids – are themselves not clearly good from a societal perspective. Even if the BTR would create benefits for shareholders of some firms, or for shareholders in some countries, it will also impose losses on some control shareholders and on society more generally by preventing the use of DC structures to protect good or inherent PBC. Empirical studies of DC structures do not convincingly make the case that DC firms underperform on average. To the extent that some evidence is consistent with DC firms underperforming in some countries but not others, nothing in the BTR will reflect those distinctions. Worse, nothing in the BTR will address the underlying weaknesses in shareholder protection that allow bad PBC to arise in the first place, or that allow bad PBC to become so large in some countries and not others. Whatever one's instincts about disproportional structures, or about takeover-proofedness more generally, there is no clear answer to the question: would a ban on disproportional structures improve or harm social welfare?

These arguments are in addition to those advanced in the UK and elsewhere that the BTR would raise issues under the European Convention on Human Rights (would constitute a "taking" in US legal parlance) if holders of high vote stock were not compensated for the effects of the BTR.[71] Even if those distributional issues could be addressed with some form of compensation by Member States or by bidders (as recently argued in a draft report on the new DTB by the European Parliament's Committee on Legal Affairs and the Internal Market), the foregoing analysis suggests that the EC was correct to not include the BTR in the new DTB. Whether many of the same points could also be made about the lesser form of the BTR that is contained in the new DTB – the "mini-BTR" that applies not to DC structures but to transfer restrictions that have similar effects – is an empirical question that depends both on the relative size of bad PBC in the EU, but also on the incidence and importance of firms with restrictions that would be affected by the mini-BTR.

6. Implications

Politics cannot wait on science. Science – particularly social science – is slow. The evidence reviewed above regarding DC structures and concentrated ownership in public firms more generally is inconclusive at best. The difficulties in social science of finding ideal natural experiments or designing and implementing well-specified studies of existing institutions are widely known. Corporate finance, corporate ownership, and the relationships between control and performance across variable political and economic environments are all highly complex and multi-dimensioned. It seems unlikely that any consensus will soon develop about the general (as opposed to average) benefits of DC structures or other types of takeover defenses.

Yet politics moves in fits and starts, with laws adopted in windows of opportunity that can pass all too quickly. Above the level of details such as the BTR, a high-level need

[71] *See*, *e.g.*, City of London Law Society, Company Law Committee, Comments Submitted to the EC on the Text of the Draft Takeover Directive dated 2 October 2002 (Dec. 2002) (comments to draft Arts. 10 and 11); *cf.* European Shadow Financial Regulatory Committee, Takeover Bids in Europe Statement No. 13 (Feb. 4, 2002) (recommending five-year grandfathering to address concerns about "property rights").

persists for political structures to harmonize and increase transparency of takeover regulation the EU. If there is a political opportunity for a new directive, that opportunity should not be missed. Given the intractable nature of the policy issues involved, the good cannot wait on the perfect. But the image of the perfect – as far in the future as it is – should affect the *way* the good is pursued in the present. With that in mind, I make three specific suggestions about how the BTR should be implemented if it is included in any BTR.

a. Opt-Outs

First, even during the initial period of application of the BTR, the DTB should provide an exemption from its application for companies that go public for the first time and include in their charters (with full disclosure) provisions opting out of the new takeover regime. So long as the disclosure system is working adequately, new investors put on notice as to the vulnerability (or lack thereof) of a firm to the takeover market should be presumed to be better positioned to weigh the costs and benefits of DC structures. This will allow owners of a DC firm that is currently publicly held to undertake (at some expense) a "cleansing" process of raising sufficient private capital to buy out publicly held low or no vote stock, take their firm private, and then take it public again, with full disclosure. Because of the cost and public scrutiny that will attend such a process, DC firms that survive will be much more likely to be the kinds of firms that have good or inherent PBC motivating their concentrated control structures.

b. Sunsets

Second, the DTB should require EU-level *reenactment* of all of the controversial rules in the DTB, including the BTR (if it is included in the final version), as well as the mini-BTR and the NR. Currently, the new DTB proposes to require *reconsideration* of the DTB five years after its effectiveness.[72] (In US legal parlance, controversial rules such as the BTR should contain "sunset" provisions.) But given the weight of political inertia in a system with as many checks and balances as the EU, it is likely that any rule that by its terms will remain in force unless altered will in fact remain in force, even if the rule could not then command a new and sufficiently broad enough majority in favor. But because the BTR can plausibly harm social welfare more than it can improve it, a heavier burden should be placed on the political system for it to be locked into place indefinitely.

This suggestion should apply particularly to the BTR. The Takeover Bid Report itself acknowledges that regulations should only cautiously limit contractual freedom (as the BTR does). But the BTR is justified as helping to complete the unification of the EU's internal capital markets, by facilitating ("jump-starting") the takeover market for companies that otherwise would remain invulnerable to a takeover bid. Once that market is up and running, however, the rationale for displacing contractual freedom will steadily diminish over time. Once the benefits (and costs) of a freer market for corporate control

[72] If a given rule is delayed in being implemented, of course, the sunset period should not begin to run until the rule is effective. Thus, if the DTB were adopted in 2004 but the BTR or NR were to be effective in 2007, the sunset should occur in 2012.

become apparent to observers and market participants, a continued willingness by investors to invest in low- or no-vote stock, or otherwise to participate in disproportional structures, should no longer be taken as an informed or constrained form of participation, but an indication that such structures may provide sufficient benefits to allow their preservation.

c. Industry-Based Exemptions

Finally, if the BTR or the mini-BTR is adopted, consideration should be given to exempting, or modifying the rule as it applies to, firms in certain industries where good or inherent PBC are likely to be more common. This will necessarily be somewhat arbitrary in operation: not all firms in a given industry will have DC or other takeover-proof structures for the same reason, and some may well be dominated by bad PBC while others are cleanly run. But an industry-based approach seems no more arbitrary than adoption of the rule across the board, without any attempt to take into account the many DC structures that plausibly are adding to social welfare. An industry-based approach could look for guidance to the UK and the US, where DC structures are common but minority structures, and where they are concentrated in certain industries.

7. Alternatives to the BTR: Mandatory Re-Openings

Assuming these suggested modifications are insufficient to permit the adoption of a DTB with any form of the BTR (mini- or otherwise), what alternative rule might address some of the concerns that motivate the BTR? What, in fact, are the best rationales for the BTR? The political rationale – that the BTR is necessary to make more companies vulnerable to takeovers in Member States where DC structures substitute for other types of takeover defenses – is, as we have seen, not plausible unless political actors are (or believe their constituents are) badly informed about the details of the ownership structures of listed EU firms. What if any better rationale exists?

Perhaps the best rationale for the BTR is that many firms with DC structures were established long ago, when the firms had already achieved a then-efficient scale, and it was taken for granted that national borders imposed a high degree of constraint on further expansion of markets. Now that the EU has removed or at least greatly reduced those constraints, scale economies are not achieved in the most efficient manner (through M&A transactions) because controllers are unwilling or in some cases legally unable to sell or share control. Some DC structures, for example, include ultimate controllers who are trustees or similar agents who lack the legal power to alter their firms' control arrangements, or even if they have legal power, are so legally constrained in their ability to accept compensation for surrendering control that they have every incentive to resist doing so.[73] Especially when these structures were established several generations ago, the managers of these firms can fairly be said to be subject to the "dead hand of the past." To

[73] Marco Becht, for example, notes that in 1997, 30 (out of 117) listed firms in the Netherlands – including Royal Dutch / Shell, the 10th largest company in the world – used trust companies and other a DC structure to maintain control over the underlying listed firms. Report on Section 11- The Proposed Break-Through Rule (May 29-31, 2003), at 8, 18.

the extent these structures perpetuate national firms operating within national borders, they do in fact pose a barrier to the integration of the EU's internal market, with the political risks that continued fragmentation entails. These concerns, it should be noted, are distinct from those that arise from bad PBC – even if the trustees of a DC firm are perfectly honest and hard-working, taking nothing for themselves and serving solely the interests of shareholders, they could still be constrained by their existing control structure from pursuing efficient integration across national borders if that required giving up or sharing control.

Whether the BTR is the best remedy for such companies, however, is less clear. Instead of a continual prohibition on DC structures, as would be the case under the BTR, a better balance might be achieved with a periodic "re-opening" of control. Similar proposals have gotten some circulation in US legal academic circles in the last few years: perhaps any structure that facilitates takeover-proofedness should be required to be revisited every ten or twenty years at a general meeting of shareholders, at which all shareholders should be given equal rights to vote on continuation of the structure. Such a rule would insure that control of every listed company would be put up for auction every so often, facilitating the integration of the EU's internal market, but would not immediately and permanently displace existing DC structures.

The logic for linking such a rule to the lifecycle of the firm – rather than to any arbitrary enactment date for a new DTB – is essentially the same as that supporting a sunset provision in the DTB itself, and to rationales for more conventional legal constraints on especially long-lived restraints on trade otherwise imposed by contract, certain forms of property, or other private law arrangements.[74] Humans are fallible, particularly as regards the distant future. The likelihood that shareholders (even sophisticated, well-informed shareholders) can adequately understand and price the effects of takeover-proof defenses seems likely to diminish rapidly as the defenses operate into the distant future. Many of the rationales for DC structures – particularly the kinds of good PBC that inhere in specific individuals, such as founders – will tend to fall or disappear entirely if the management team changes or dies. True, some founders want to preserve control in order to pass a company to their descendents, but it hardly seems unreasonable to require such persons to revisit the capital markets every generation as a check on the kind of bad PBC that many observers tend to develop in family-dominated firms over time. This

[74] The rule against perpetuities, for example, has been justified on the ground that currently living persons may be reasonably thought to have legitimate, well-informed preferences regarding assets will be used by the next generation, but not regarding the generation after the next. *E.g.*, ROBERT COOTER AND THOMAS ULEM, LAW AND ECONOMICS (2d ed. 1995) at 133-36. Non-profit organizations, foundations, and trusts, too, are substantively constrained in the US through tax law, which requires them to make current expenditures or grants at specified levels or face current taxation, which effects over time a redistribution of ownership and control over assets from the trustees of those organizations to others, facilitating economic activity and discouraging efforts to lock up assets in perpetuity. *See, e.g.,* Evelyn Brody, Charitable Endowments and the Democratization of Dynasty, 39 Ariz. L. Rev. 873 (1997); Evelyn Brody, Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms, 40 N.Y.L. Sch. L. Rev. 457 (1996); Henry Hansmann, Why Do Universities Have Endowments?, 19 J. Legal Stud. 3 (1990); Jacqueline L. Salmon, Foundations Anxious Over Bill on Giving; Forced Charity Would Hurt Groups' Stability, Some Say, *Wash. Post* (July 8, 2003), at A03.

would have the Jeffersonian effect of reopening the contestability of control at periodic intervals and putting a check on the worst forms of corporate sclerosis.

Conclusion

The BTR was an inspiring, radical idea. It has already had two clearly good effects, one political, one intellectual. Politically, it has helped re-ignite efforts to adopt a DTB, which if successful would have political and economic benefits by helping create a more stable, transparent, and integrated capital market across the EU. Odds remain long that a DTB will be adopted amidst EU efforts to adopt a constitution and add 10 new Member States, but the odds that some form of DTB will eventually be adopted are much higher today than they were prior to the release of the Takeover Bid Report.

Intellectually, the proposal for a BTR has helped stimulate most of the research reviewed in this paper, has shaped academic and governmental studies, and has thus produced information crucial to our still-feeble efforts to understand, predict and effectively regulate the market for corporate control – all forms of underproduced public goods. For this alone, the public owe the authors of the Takeover Bid Report a debt of gratitude. Ironically, however, these studies suggest that the BTR, as proposed, would have minimal effect, either politically or economically, and thus the EC was correct to not include it in its full form in the new DTB.

More broadly, however, the BTR is not, on reflection, clearly a good idea. That is true even if it were supplemented with effective rules addressing the full range of DC structures and the clear substitutes for DC structures (pyramids, cross-holdings), and even if the EC could somehow develop rules designed to disperse ownership of the bulk of EU listed firms in order to facilitate the development of a more vigorous market for corporate control in Europe. In the absence of that hypothetical world of complete capital markets, different ownership structures can respond to different preferences of owners, to different market forces (in the product, labor or ordinary capital markets), and mandatory rules impeding particular ownership structures will certainly produce some degree of social loss. Until the case that the gains from the BTR (however supplemented) will outweigh those losses, the approach of a cautious, self-consciously fallible regulator should be to defer adopting the BTR. That is particularly true when the regulator (here, the EC) is unable to modify or amend rules easily and quickly in light of changing conditions.

Instead of endorsing the BTR as proposed, I have tentatively suggested two alternatives. The first alternative, or set or alternatives – opt outs, sunsets, and industry-based exemptions – is designed to minimize the harm that the BTR will surely inflict, in light of existing and developing research on the varying conditions in which concentrated control of listed firms may be socially optimal. The second alternative – mandatory re-openings – would replace the continual effect of the BTR with a periodically imposed constraint on especially long-lived control structures. This second alternative seems, in my view, to achieve the most defensible goals of the BTR while imposing a much lower level of cost on existing firms and controllers. Even this second alternative is far from perfect – but it is more likely than any version of the BTR to achieve a modest amount of good.

Appendix A

Firms used to generate the data reflected in Figure 4. The firms in the first column are 30 US public firms randomly selected from the 200+ firms identified by the Investor Responsibility Research Center as having DC structures in 1998. Proxy statements filed with the SEC were examined to verify that each in fact had a DC structure in which one or a small group of shareholders retained control through high-vote stock while selling low- or no-vote stock to the public. Each firm in the second column are in the same 2-digit SIC code industry group as the firm in the first column, and is approximately the same size in terms of 1997 fiscal year-end total assets.

Dual Class Companies	**2-Digit SIC Industry Group**	**Matched (Non-Dual Class) Companies**
Advanta	Nondepository financial	Green Tree Financia
Alberto Culver	Miscellaneous retail	Cole National
America West Holding	Air transportation	Alaska Airgroup
Brown & Sharpe	Industrial machinery	C-Cube Microsystems
Brown Forman	Food	Interstate Bakeries
Carter Wallace	Chemicals	Dial
Central Newspapers	Printing and publishing	Banta
Crawford	Insurance agents	White River
Dillard's	General merchandise stores	Costco
Dow Jones	Printing and publishing	Ziff-Davis
General Binding	Industrial machinery	Scotsman Industries
Hubbell	Electronics	Komag
Keane	Business services	Rational Software
Kelly Services	Business services	Adobe Systems
Lennar	General building contractors	Ryland Group
Meredith	Printing and publishing	Big Flower
New York Times	Printing and publishing	Gannett
Nike	Rubber and plastic products	Reebok International
Nortek	Lumber and wood products	Premdor
Oshkosh-B'Gosh	Apparel and textile products	Farah
Sotheby's	Business services	Compuware
Tecumseh Products	Industrial machinery	Pentair
Timberland	Leather and leather products	Wolverine
Times Mirror	Printing and publishing	Tribune
Tyson Foods	Food	Ralston Purina
Vishay Intertechnology	Electronics	LSI Logic
Wahington Post	Printing and publishing	McGraw-Hill
Marcus	Hotels and lodging	Four Seasons Hotels
Westwood One	Amusement and recreation	Ameristar Casinos
Wrigley William Jr.	Food	Earthgrains

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