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A New look at the Debate about the Takeover Directive

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Abstract

With a view of the projected revision of the takeover directive, this paper calls attention to some items that would usefully be revised. Especially attention is drawn to the mandatory bid rule, the scope of which should restricted to share acquisitions – and not apply to other control changes - , while company law in general should strictly regulate conflicted transactions, thereby eliminating control premia, and hence the need to proceed to a mandatory bid. Multistate takeover should be reregulated, taking into account the new supervisory structure, esp. ESMA. Also some of the blanks should be filled e.g. on squeeze outs, sell outs, and other specific requirements like "acting in concert". As to the most controversial item of defensive techniques, a fundamental revision seems unlikely, but one could be considered to allow these techniques, but subject their effectiveness to a qualified vote in the general meeting, the shareholders voting according to the rules applicable before the bid.

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The revision of the Takeover Directive of 2004, about 8 years after its adoption, stands before us. This is 7 years after adoption, and barely 5 years after its final date of implementation. Is there enough new material to proceed to an in-depth revision? Or should it be a mere clean-up of the imperfections left in the Directive, especially dealing with the numerous blanks that where left behind? From a pragmatic point of view the latter position can be defended, as anyone who has lived through the original drafting will still remember the traumas that the adoption of this Directive left behind.

One should, however, be aware that work on a takeover directive did not start in 2003 but goes back to the mid-1970s, (the Pennington report for those who still remember) and that effective preparation took place in the 1990s and early 2000s, so that the Directive essentially reflects the ideas of the last decades of the 20th century. Therefore revision of the Directive cannot be limited to its technical updating, but should attempt to take account of the evolutions that have taken place since then. This paper aims at pointing at some of these changes, also mentioning some elements where the ongoing financial crisis will have an influence.

Therefore the time has come to reopen some of the core debates, and it seems unlikely that these will be avoided in any case.

1. The changed environment,

The financial markets have changed substantially since the late 1990s: most striking is the interconnection between markets, the springing up of new execution venues, being MTFs, OTFs, or other trading mechanisms, and the rise of the institutional investors. This may at least necessitate the adoption of a wider definition of the scope of a future directive, extending the present notion of "admission to trading on a regulated market" to trading on publicly accessible trading venues. As a consequence, trading will take place in several jurisdictions other than that of the primary listing, leading to an increase of multistate transactions and diversity of jurisdictions concerned, and likely to call for more robust decision-making in a cross-border context. This point will be developed later.

We have seen that the acquisition of control not only takes place by buying shares, but also by acquiring derivatives that give access to shares[1]: these are the high profile cases of hidden ownership that took place in VW, Continental or the French Hermes shares, and other important companies where one party accumulated contracts for difference on the underlying shares that did not have to be disclosed since they were not acquisitions. This technique has falsified one of the fundamental understandings in our markets for corporate control, i.e. that control will not be

[1] On 14 September 2011 ESMA launched a call for evidence on empty voting, including hidden ownership, building further on the Commission's work in this field (ec.europa.eu/internal_market/securities/docs/transparency/Directive/com-2010-243_en.pdf). See also the statement of the European Corporate Governance Forum, 20 February 2010, at /ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_empty_voting_en.pdf; on empty voting and similar subjects see: David Skeel, Behind the Hedge, LEGAL AFF., Nov.–Dec. 2005, at 28, 29–30 (emphasizing that Perry's economic incentives were diametrically opposed to the interests of other Mylan shareholders—the more overpriced the acquisition, the more Perry would have profited due to its stake in King). For thoughtful and extensive analysis of the new vote buying techniques, see generally Henry T.C. Hu & Bernard Black, The New Vote Buying: Empty and Hidden (Morphable) Ownership, 79 S. CAL. L. REV. 811 (2006); Marcel Kahan & Edward B. Rock, Hedge Funds in Corporate Governance and Corporate Control (Univ. of Pa., Inst. for Law & Econ. Research Paper No. 06-16, 2006), available at http://ssrn.com/abstract□919881.

acquired surreptitiously. Traditionally this matter should be part of the Transparency Directive where it is planned to be dealt with more explicitly[2].

Another substantial factor of change relates to the supervisory system that has considerably changed in 2011. I refer here to the creation of a European regulatory and - in some fields - supervisory body, the European Securities and Markets Authority (ESMA). Although the ESMA regulation does not include the Takeover Directive 2004/25 among its core competences, it mentions that 'the authority shall also take appropriate action in the context of take-over bids, clearing and settlement and derivative issues"[3] One can understand this wholesale reference as an indication that the position of ESMA will further have to be defined in the forthcoming directives and regulations as projects have already been tabled in two of the three topics mentioned [4]. The precise impact of the institutional change will be briefly mentioned later.

The most fundamental evolution however relates to company law - including corporate governance - itself. The 2004 Directive was conceived in times where the company paradigm was mainly based on the dispersed ownership model in which since individual shareholders are unable to exercise power, the management mainly dominates the company, and the takeover instrument was needed to discipline that management[5]. Conversely, the concentrated ownership model was disfavoured and the Takeover Directive contains some provisions reducing the block holders' or controlling shareholders' power: these are the provisions about the board's neutrality, the breakthrough rule, and the ineffectiveness of restrictions on the transfer of shares as far as the bidder is concerned[6]. Most of these rules have in practice not been very effective due to the opt-out clauses of article 12[7]. Since then much has changed: the corporate governance movement was still in its infancy and its ideas are almost entirely absent from the Directive. The financial crisis has shaken our belief in several aspects of the prevailing thinking of the late 1990s: the efficient market hypothesis is put into doubt or at least is not the only explanation theory put forward. The capture of boards by the management was originally aimed at by appointing independent directors, but results have remained elusive, if not worse. At the same time, the position of the CEO has been weakened[8]. New forms and techniques of monitoring have been investigated and sometimes applied, especially by relying on significant shareholders (private equity) or by empowering institutional and professional investors (stewardship). The role of the shareholder as part of the company decision-making process has come to the forefront by strengthening his legal position or facilitating the exercise of his vote (Shareholder Rights Directive) and the beneficial influence of

[2] The Transparency Directive, art.10 (b) deals with an empty voting case in some instances; but the threshold is too low to be useful in the takeover context. A revised proposal is expected somewhere in 2012

[3] Art. 1 (3) ESMA Regulation1095/2010 of 24 November 2010, OJ 15 December 2010.

[4] See EMIR proposal (on [OTC] derivative transactions, central counterparties and trade repositories) and Clearing and Settlement proposals (see: Enhancing Safety of European financial markets: common rules for CSD and securities settlement, /europa.eu/rapid/pressReleasesAction.do?reference=IP/11/29&format=HTML&aged=0&language=en&guiLanguage=en); See; Proposal for a regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC, Com(2012)73/2

[5] Gilson R, Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy, Aug 2005, ECGI - Law Working Paper No. 49/2005, calls attention to this shift in academic analysis and mentioning the IMF's and World Bank's preferences for the dispersed ownership model in the 97-98 Asian financial crisis, and in other later actions.

[6] Art. 9 to 12, Takeover Directive

[7] See Commission staff, Report on the implementation of the Directive on Takeover Bids, SEC(2007) 268 21 February 2007, http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf noting that some states even strengthened their antitakeover provisions; See further the analysis by Davies, P.L., Schuster, E.Ph., Vande Walle de Ghelcke, E., The Takeover Directive as a Protectionist Tool ? http://ssrn.com/abstract=1554616

[8] See Ed Rock E. and Kahan, M. , Embattled CEOs, http://ssrn.com/abstract=1281516

block holders and even controlling shareholder as elements of growth, stability and long term investment are being rediscovered.[9] All these elements are likely to have a profound influence on the revision of the Takeover Directive.
When outlining a new takeover regime, the overall setting should be taken into account without remaining focused on one single factor like the control premium or private benefits of control[10]. A new regime should strive to strike a balance between flexibility including contestability and stability and long term value creation, including in terms of human capital[11]

2. The two types of takeovers in the Directive

The fundamental structure of the Directive is based on the existence of two types of takeover bids that have quite different regulatory features: the open voluntary type and the mandatory bid. These two types correspond to different objectives: the first one is a technique for the integration of different businesses, whether with the agreement of the target or not, and is in that sense a regular commercial transaction, although usually taking place off-market. A specific but important feature is that it allows the company to be auctioned to the highest bidder and the price is freely determined and reflects supply and demand on the control market. The Directive is mainly concerned with ensuring that the transaction can take place in a fair and transparent way, with full disclosure so that investors can make a reasoned choice. Rather few bids take on an aggressive or unsolicited character: in practice, it happens frequently that these are open and voluntary bids taking place on a consensual basis, the former block holders in the target tendering their shares within the bid. Economically, these transactions come down to an economic merger, an alternative technique to a more complicated legal merger. Once the company is put into play and in case the target board disagrees, the takeover rules become fully operational. In the European approach[12] the board is held to neutrality, expressing a fundamental distrust of the board that is assumed to pursue entrenchment in its personal interest, and not to strive at maximising shareholder value, as in the case in US especially Delaware law

The mandatory bid appears similar but has quite different characteristics. It is based on the idea that someone acquiring control in a listed company is obliged to extend an offer to all shareholders, and eventually to take over the entire company. Control is defined by the Member States as ranging between 25 and 50%. Often control is acquired after a transfer of a block of shares by the previous block holder, or controlling shareholder, but accumulation of a block in the market beyond the threshold, or even other forms of creation of a control position – through acting in concert – would also lead to the same obligation.
The rule raises considerable doubts with respect to its justification, its scope and the rules of application of the requirement, and finally as to its wider externalities. Many of these objections have several times been analysed and described before the rule was introduced as a Europe-wide

[9] See Gilson, R, nt 5, mentions that insulation from market pressures may lead to support for longer term investment to the extent that this is in line with technological developments (p 35)
[10] See Burkart, M. and Panunzi, F., Takeovers, ECGI - Finance Working Paper No. 118/2006, http://ssrn.com/abstract=884080

[11] Many of these elements are discussed in
http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-631-kay-review-of-equity-markets-interim-report

[12] Followed by most EU Member States, 14 out of 27 did not opt out of the neutrality rule, while 5 added to the rule the reciprocity feature; 8 did opt out thereby rendering the neutrality rule inapplicable, some with an opt-in for companies, which none did. see P. Davies, nt. 7.

obligation[13]. Many years after its introduction, these arguments remain valid, although the actual practice has in some respects followed different paths.

The rule applies to all companies with listed shares, irrespective of whether the equity is widely dispersed or held by one or a few controlling shareholders. Generally the rule is based on the inequity that the controlling shareholder on his own can take advantage of the control premium, being the difference between the price actually paid and the normal value of the equity, usually the pre-bid market price[14]. As the seller would pocket that premium, it would be legitimate that all shareholders would be entitled to it in practice by giving all shareholders the right to receive an offer at the same – but proportionally reduced - price. If not, as the buyer has paid the premium, he will consider himself to be entitled to receive the same premium benefit as his predecessor, to take advantage of new private benefits and continue to act to the detriment of the other shareholders.

In national law, the ambit of the rule has been defined very broadly. Although other cases have been mentioned under national law, the usual cases are the following.

The rule applies not only to private transfers of control, but also to a bidder acquiring shares on the market, or from a number of larger shareholders none of which could aspire to exercising control. Hence, in these cases no premium is paid, and control is not acquired, but "created". Therefore this party is bound to bid for all shares although the obligation is not linked to the transfer of a control premium, but to the mere fact that he acquires control where there was none before[15]. One could imagine that a mandatory bid would be justifiable as his control position may open the way for later private benefits of control: but this is not the hypothesis, as the mandatory bid protects the previous shareholders, not the later ones. But in the absence of any threat of appropriation of private benefits - see further - one really does not understand why the mere acquisition of control is treated differently from exercising control.

[13] See E. Wymeersch, Mandatory takeover bids: a critical view, in K.J. Hopt and E. Wymeersch (Ed), European takeovers, law and practice, 351-368, 1992; The Takeover Bid Directive, Light and Darkness http://ssrn.com/abstract=1086987; S.M. Sepe, Private sale of corporate control, Why the European mandatory bid rule is inefficient http://www.unisi.it/lawandeconomics/simple/043_Sepe.pdf; L. Enriques, The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation? (2004) 4 European Company and Financial Law Review; SSRN, 702461, and Harmonisation as Rent-seeking? In: G. Ferrarini a.o. (ed.) Reforming Company and Takeover Law in Europe, 2004, 767, argues that not the shareholders, but the controlling shareholders and the directors, and the advisers to the companies, including the supervisors are the real beneficiaries of this rule. See J. Lau Hansen 'When Less Would be More: The EU Takeover Directive in its Latest Apparition' (2003) 9 The Columbia Journal of European Law; B. Sjäfjell 'The Golden Mean or a Dead End? The Takeover Directive in a Shareholder versus Stakeholder Perspective' in: S.M. Bartman (ed) European Company Law in Accelerated Progress, Kluwer Law International, 2006; M.J. Sillanpaää 'Enhancing Shareholders' Equality by a Takeover Bid Rule in the Articles of Association' in Law under Exogenous Influences, M. Suksi (ed) (Turku, Turku Law School, 1994); R. Skog Does Sweden Need a Mandatory Bid Rule? A Critical Analysis (Stockholm, Juristförlaget, 1995): J. Schans Christensen, Contested Takeovers in Danish Law: A Comparative Analysis based on a Law and Economics Approach, Copenhagen, 1991, pp. 226-231. Since the enactment of the Directive, criticism has been muted.

[14] The premium is also defined as the difference between the price per share paid by the acquirer and the price quoted in the market the day after the sale's announcement. See Dyck, A and Zingales, L, Private Benefits of Control: An International Comparison, http://ssrn.com/abstract=296107
This approach is more adapted to control acquisition in a dispersed market.

[15] The Directive, article 5 declares the rule applicable to acquisition of shares leading to control, without mentioning a specific threshold, what was left to the Member States. Concerted action is also expressly mentioned.

A comparable situation occurs when a control position is the result of a number of shareholders acting together to influence the future of the company[16]. According to the legislation in some states, these shareholders will be obliged to jointly launch a mandatory bid for all shares, although they have not paid any premium or acquired any share. The mere creation of control is the trigger, raising difficult questions of interpretation as to what constitutes this “concerted action”. As the latter notion has been interpreted very extensively in order to avoid any risk of evading the mandatory bid, useful agreements have been prevented and this in cases in which there was no fear of private benefits, and in which the partners in the concerted action would have been particularly anxious to avoid any suspicion of conflicts of interests. Another consequence of the broad reading of “concerted action” is that one has seen parties to an agreement among shareholders developing elaborate and refined agreements in order to avoid seeming to act in concert, e.g. by merely agreeing to expose their respective positions before a general meeting but without reaching a formal agreement on a common position[17]. Placed before the risk of a mandatory bid, parties will not enter into such an agreement[18], and rather than build a stable shareholder basis, will maintain dispersed positions that over time are likely to destabilise the company. In times when long term investment is politically desirable, this cannot be the recommended course of action.

Other cases of acquisition of control may trigger the bid obligation: a capital increase, even a merger although these are usually exempted for policy reasons such as the will to strengthen the capital base, or to allow for necessary economic reconstruction.

Although the logic for mandating a bid upon paying a control premium to a selling shareholder can be supported, the existing legislation is not linked to the existence of a control premium or to any evidence thereof. It is linked to the acquisition of shares, exceeding a threshold. As other formal thresholds, the cliff effect is evident: parties acquire 29.9% and are not bound to bid, while once they cross the threshold, a bid becomes inevitable[19]. That payment of a control premium up to 29.9% is innocent but triggers very considerable obligations at a tenth of a percentage more, is puzzling, the more so since no proof is required either of the fact that the last acquisition transferred control, or that any control premium was paid. In the latter case, the premium effectively paid would have been a very small one, as relating to only 0.1% of the shares. The case has also been discussed whether a bid obligation exists if the threshold is exceeded as a consequence of the company repurchasing some of its own shares. It is argued that by not triggering the obligation to make a bid, this technique is an easy way of circumventing the bid obligation as the shareholder whose position is increased is a significant shareholder who is likely to have influenced the repurchase decision. Unnecessary to add that in these cases issues such as the existence of a control premium or the reality of a control acquisition are not separately analysed. By detaching the bid obligation from the core notion of acquisition of shares with a control premium, the legislation has extended the scope of the rule beyond its original purpose that is to ensure that shareholders are treated equally and that the selling controlling shareholder is not the only one who can pocket the control premium. It has developed into a theory whereby all or most transactions that lead to a change in control should be subject to the bid obligation, thereby evidently rendering restructuring of companies much more difficult. The rule is sometimes justified by the consideration that a change of control is a danger to the shareholders, as the new

[16] See according to the UK definition of “Board Control seeking” as the core criterion, see Takeover Panel, practice note 26, 9 September 2009; /www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PS26.pdf
[17] See about this case, CBFA Annual Report, Verlag DC 2007" ,57
[18] Or hide it, or frame the agreement in such a way that it does not entail binding obligations, but merely the engagement to talk to each other.
[19] Usually legislation provides a so-called “white wash” for cases of inadvertent crossing of the threshold.

controlling shareholder might abuse his position, attributing to himself additional private benefits, or might destroy the company altogether by striking out excess capacity in the market. But these are side effects: there is no reason to assume that the new controlling shareholder will be worse than the previous one. Therefore in the absence of control premia paid on a change of control, there is no reason not to allow minority control changes.

According to the mandatory bid rule as applicable to mere control transactions, only a bidder for all the shares will be entitled to undertake the target's restructuring, which means that the rule introduces an incentive to further concentration in the industry. Indeed only the largest companies are able to offer an attractive price for all the shares of the target company. At least in certain, smaller European states, one has witnessed that this rule has led to playing all larger local companies into the hand of companies originating from abroad, usually from the larger states. Diversity has suffered.

The usual hypothesis in which the mandatory bid rule applies is the one in which a controlling shareholder, or minority block holder sells his block[20] for a considerable premium, and leaves all the remaining shareholders in the cold. The control premium stands financially for several components: usually these are considered to be due to future private benefits, which the seller can receive as the buyer expects that he too will be able to extract from the firm. But apart from these benefits, the premium may also stand for whether an opportunity value – it is difficult to put one's hand on a large block without upsetting the market, and the seller is unlikely to agree if he does not get a very attractive price – or a justified remuneration for the control function, i.e. taking up of the day-to-day responsibility for the management or exercising the monitoring function that can be expected from him, while on the basis of his direct access to the information, his reaction to ongoing developments will be much faster. Moreover, it may also stand for the seller bearing the risk of a non-diversified portfolio. Therefore not all components of the control premium can be considered "objectionable", or are to be shared with the other shareholders.

The consequences of the rule are considerable: the acquirer is obliged to bid for all shares, in several jurisdictions at the highest pre-bid price so that the control premium is spread over all shares and will benefit all tendering shareholders. But in other jurisdictions other price formulas are used such as the highest pre-bid price over a certain period of time, which may not necessarily achieve the same equal treatment effect. The bidder's financing needs will be considerably higher, leading to hesitation to initiate the transaction, which may in turn lead to freezing the control block if no bidder is willing to pay the excessive premium requested by the seller, to be multiplied over all shares. However, one will never know which transactions were prevented as a consequence of the rule. Once having paid the full bid price, the bidder may lack the additional funds to restructure the firm that has now come under his control.

The actual practise is also revealing: these days most control transactions take place as voluntary bids, outside the mandatory bid framework, allowing the objectives of the mandatory bid rule to be achieved but without applying it. Also, in voluntary bids, there is no minimum price and the selling block holder cannot impose his conditions. In many cases, bidders are not interested in acquiring a minority stake, but bid for all shares, and will attempt to go private if the conditions for a squeeze-out are realised, after which they can freely restructure the firm, or integrate it into other parts of their group. This leads to delistings, eliminating all concerns about private benefits, and to further erosion of the range of shares on offer in the markets. In times where more and more companies leave the markets, this policy is not what is needed.

[20] This is usually a 30% or 1/3rd block, standing for working control in most companies with wider ownership.

Block holders will often not agree to transfer their block beforehand: they may commit themselves to tender their shares - not agreeing to a binding transfer - in the later bid, leaving room for further improved or counterbids. Hence these bids are fully contestable control transactions. But recently the fear that voluntary bids may not offer the best price for investors has been raised. With the very low market valuations in today's market, bidders may acquire even very well run companies "on the cheap", with some complaints that shareholders do not get the "fair" value for their shares. Therefore it has been proposed that these voluntary bids should only become binding if at least half of the outstanding shares have been tendered, which would in fact be equivalent to half the shares voting for the takeover[21]. The rule would probably not apply to mandatory bids, as this would be an incentive for the bidder to limit his stake to the minimum he has acquired pre-bid

3. Private benefits of control

The mandatory bid rule has now been firmly anchored in our market practices and in the share valuations, and it would be very difficult to reverse it. It is understandable that people object that the bidder gets access to considerable private benefits, and that he would be able to receive these on the back of the other shareholders. But whether the remedy for that evil is the mandatory bid is far from sure: is this not fighting a real evil with the wrong weapons?

As far as the "private benefits of control" are concerned, one should further analyse the extent to which they constitute a valid basis for the mandatory bid rule. The control premium covers more than private benefits[22], that only relate to the extraction of benefits due to conflicts of interest situations. As stated above, not all benefits flowing to controlling shareholders or block holders are the result of abusive conduct: some will especially represent the normal remuneration for the control function in the company, other stand for an illiquidity premium. Therefore, one does not see why a full bid for all shares is needed when control is acquired that would *not* lead to private benefits, e.g. in jurisdictions where private benefits are reported to be very low to negligible[23]. One could add the cases of long standing controlling shareholders, e.g. old industrial families concerned about their reputation[24], who would consider private benefits contrary to their philosophy or ethics or where the presence of numerous family members would exclude one of them taking advantage of his leading position. Moreover, there is no obvious direct relationship between private benefits and control transactions: controlling shareholders will have been able to enjoy their private benefits obviously without much controversy, and this long before the takeover. But once they sell their control block, the private benefits suddenly become controversial, and

[21] The rule has been considered in the Netherlands (Bijlage bij Kamerstuk 31083 nr. 4 , 29 November 2011: Besluit houdende wijziging van het Vrijstellingsbesluit overnamebiedingen Wft) but has not yet been adopted.

[22] See on that subject the distinction proposed by Gilson, nt.5, between efficient and inefficient controlling shareholders, depending on whether their added value exceeds the private benefits, and aimed at introducing a wider assessment base than mere private benefits.

[23] Gilson, nt. 5, based on earlier work of Tattiana Nenova and Dyck and Zingales,nt. 1 compares three legal systems where private benefits presented significant differences depending on the quality of the law. In terms of difference to market price, the private benefits were reported as being 1% in Sweden, 29% in Italy and 36% in Mexico. In terms of the control block premiums, the figures were respectively 7%, 37% and 34%.

[24] This element is mentioned by Coffee, J., The Rise of Dispersed Ownership; The Role of Law in the Separation of Ownership and Control, ssrn 254097 ; Stulz, R. and Williamson, R. 2001, "Culture, Openness and Finance," NBER working paper 8222 (9 April 2001) analyses a predominant characteristic for explaining a country shareholders' and creditors' rights: 'a country's principal religion helps predict the cross-sectional variation in creditor rights better than a country's openness to international trade, its language, its income per capita, or the origin of its legal system."

should be shared with all shareholders. This position is not logical, nor satisfactory from a policy point of view.

But if the premium is paid for the higher returns the buyer will achieve as a consequence of his reorganisation of the firm, there is no reason why the tendering shareholders should benefit from this premium from the outset, while the buyer's subsequent efforts would benefit all future shareholders, especially those that stayed on board. The problem is not the control transaction, but the private benefits that are reallocated as a consequence of the control transaction. Therefore the private benefits issue should be further discussed.

As mentioned above, not all private benefits are illegitimate, but only those that are the result of the possibility of a shareholder taking advantage of his powerful position to direct company advantages to himself, his family or the group he directs. There may be private benefits of this type at the level of the board, the management, but the most important ones relate to the shareholders, often in the context of a group of companies. Whether real or perceived private benefits can flow to any of these parties can be attributed to the absence of a solid legal regime for related-party transactions and other conflicts of interest situations, but are not the only factors limiting the grant of private benefits. According to Dyck and Zingales[25], an alert press[26], tax compliance – especially on transfer pricing - and enforced competition rules were also very - if not more - important drivers explaining considerable differences between jurisdictions in this respect[27]. These should be considered as enhancing instruments for a regime that strongly regulates private benefits. One could argue that if such a solid legal regime applied, private benefits would largely disappear. In some jurisdictions there are considerable restraints on private benefits or related-party transactions; these may be due to ethical constraints or tradition, but more visibly to legal provisions submitting related-party transactions to strict conditions, both in terms of financial conditions and of economic justification. The regime would apply on a permanent basis, and not be limited to a specific transaction like a change of control. The overall situation in the EU Member States is very diverse, and the effectiveness of the existing provisions may need to be evaluated.

To the extent that private benefits are the core justification for the mandatory bid rule, it is more than excessive to require that all shares have to be acquired because there is a fear of private benefits. It would be more intelligent to restrict these benefits on a permanent basis: it looks illogical that private benefits are more or less allowed, or at least are not strictly forbidden during the existence of a company, but become objectionable once the control block changes hands. If on the basis of adequate regulation the private benefits would disappear, the buyer of control will be less inclined to include the present value of these benefits in the offer price, and the seller will have to accept that fact the more easily as he did not get them either. Therefore the restriction on private benefits should be imposed as a permanent discipline, not as a one-off restriction at the moment of a control transaction, triggering numerous unintended consequences for several parties concerned.

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[25] See Dyck and Zingales, nt 1

[26] Also underlined by Gilson, R, nt,5 at p.33.

[27] Dyck and Zingales, nt. 1 found that the average level of private benefits differ substantially across different legal families. "Private benefits are highest in former communist countries (34 percent), then countries with a French code (21 percent), and countries with a German, English, and Scandinavian code seem to have the lowest level of private benefits (11, 6 and 4 percent)". But this conclusion was further refined as many factors influence the possibility of reaping private benefits; among these "a high level of diffusion of the press and a high rate of tax compliance were identified as the most important institutional factors" (p.38)

The conclusion of this analysis should be that the automaticity of the mandatory bid should be limited to cases where a controlling block is acquired – hence not mere control transactions - but could be waived if strong evidence is produced and guarantees offered that strict rules on related-party transactions apply, the latter having to be better defined. The legal basis could be found in the company provisions on conflicts of interest, preferably strengthened by internal instruments – such as charter provisions, codes of conduct including corporate governance techniques – and supervisory guidance from the market supervisors[28] along with appropriate disclosures to the shareholders. The securities supervisor should be put in charge of determining whether these conditions are met, and if so may waive the mandatory character of the bid[29].
The issue of the related-party transactions and more generally of the way of dealing with conflicts of interest largely exceeds the subject of takeover bids, but is a general company law concern that also manifests itself as a core issue in the field of groups of companies where much of the hotly debated issues flow from the existence of intragroup transactions concluded among related parties. Therefore it is urgent that work be started on this topic, for which several models have been developed in the Member States, some relying more on a general fiduciary duty which is difficult to enforce, others on internal procedures allowing for objective decision-making by the board and approval by the general meeting or by the non-conflicted shareholders in the general meeting[30]. An alternative that has been suggested is the approval of the transaction by a special committee of the shareholders. The two main concerns are: is the transaction in the interest of the company, and secondly are the conditions of the transaction fair and at arm's length. Whatever the approach followed it should allow the elimination to a large extent of the negative effects of related-party transactions, and this on an ongoing basis and not only in case of control transactions. Provided this approach is successful, one could also reduce the scope of the mandatory bid obligation.

Recommendations

On the basis of the foregoing analysis, the following recommendations can be made
- there is a strong need to develop robust rules on related-party transactions and conflicts of interest. This topic does not belong in this Directive, but is a general company law subject aiming at protecting minority investors. It should apply on a permanent basis, and not merely receive attention in case of a change of control; it should be based on disclosure, expert evaluation and approval by independent directors, any other independent body or by the AGM.
- some transactions could usefully be excluded from the mandatory bid rule: these are mere control transactions such as market transactions, or concert agreements, where no control premium is involved;
- if no private benefits of control are involved – whether on the basis of strict regulation, or a strong showing of actual practice – the mandatory bid requirement could be waived by the competent authority (see art. Art 4.5)
- pre-bid transfer commitments should be declared unenforceable, urging parties to realise the transaction through an open, voluntary and contestable bid.

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[28] See infra about the role of ESMA. nt.3.
[29] See for the waiver: art 4 (5) Takeover Directive. This rule is severely criticised by Papadopoulos, Th., The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies, Law and Financial Markets Review-LFMR, Vol. 1, No. 6, pp. 525-533, November 2007
[30] For an analysis of three systems see: Conac, P-H, Enriques, L, Gelter,M, Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy, European Company and Financial Law Review, Vol. 4, No. 4, 2007, http://ssrn.com/abstract=1532221; see further: Bianchi, M. ,Bianco M, and Enriques, L., Pyramidal Groups and the Separation Between Ownership and Control in Italy, January 2006, ECGI - Finance Working Paper No. 118/2006, http://ssrn.com/abstract=293882; Italian Consob has adopted detailed "Regulations containing provisions relating to transactions with related parties" , see http://www.consob.it/mainen/documenti/english/laws/reg17221e.htm;

2. Multistate transactions

One of the original purposes of the Directive consisted in putting an end to the confusion that existed with respect to takeovers that took place in several jurisdictions. The solution adopted was the traditional ‘home state rule’, whereby the company’s registered office determined the supervisory competence if listed in that market, even if most of the trading takes place in other EU markets. In case of listing in another jurisdiction but not in the jurisdiction of the company’s registered office, the supervisory authority of the place of trading will be competent[31], but will necessarily have to take account of the legal regime of the state where the registered office is located. The solution adopted is even less convincing in case of “admission to trading” in several jurisdictions, in which case the place of first admission to trading will prevail, or in case of simultaneous admissions in multiple jurisdictions the state upon the choice of the issuer on the first day of the trading of its shares. All these “conflict of law” rules are based on a political compromise, but are far from the economic realities that would logically be based on the volume of trading. This may result in unfortunate outcomes when trading is concentrated in one state with considerable expertise in takeover matters, while competence is attributed to another state without any significant experience. The same applies with respect to the expertise of the law courts in said jurisdiction.

The criteria used in the Directive also fall short of modern practices: trading is increasingly scattered over several trading platforms and trading techniques, volume rapidly shifting from one market to another, leaving the initial moment of “admission” as not necessarily the most significant. Moreover, can the place of trading be determined if most transactions take place in an electronic trading platform, that is not necessarily located in any specific place and may be owned by a non-EU financial firm? Usually, competence is attributed on the basis of the location of the firm that organises the trading venue, but this may be controversial and could seriously disturb contested takeovers. In addition, the absence of rules relating to trading – or listing – in a third country has not even been mentioned: a reference to cooperation agreements in the Directive could be expected to have clarified this additional element of complexity, but no such agreement is known. My suggestion would be to replace these criteria, that looked simple and efficient in the 1990s, by a more cooperative approach, essentially giving precedence to the principal place of trading where the strongest public interest can be expected to be pursued, while also involving the other markets.

The Directive refined its approach with respect to multistate takeovers by splitting the competence between the market jurisdiction and the company jurisdiction. This split was presented as a neat one: the bid procedure normally went to the market-related rules and supervisory authority of the place of listing, while the enterprise aspects – including importantly the company law aspects – went to the registered office “authority”. Essential aspects such as the percentage of voting rights for defining “control”, the derogations from the bid obligation, or generally “ matters relating to company law” were put under the guidance of the jurisdiction of the state where the company has its registered office, but it is unclear who will decide.
Whether in that jurisdiction there was a supervisory authority in charge of matters relating to “company law” is far from sure, while that jurisdiction might not extend to companies listed exclusively in another state. Indeed in many jurisdictions there is no authority competent for company law matters, except the courts. All this certainly would have required a strong

[31] art 4 (2) (b), Takeover Directive

cooperation culture, especially as legal cultures are still quite different among Member States[32]. Since then matters have changed.

Recently, ESMA has been created with wide powers of coordination of the action of the national supervisory authorities[33]. In case a bid concerns shares not only listed but also traded in several jurisdictions that may each have a legitimate interest as to the fair and orderly development of the bid, ESMA would normally be the point of contact where common positions would be elaborated on the basis of the cooperation duty of the national supervisors concerned. One could consider that in case of multistate offers, a college of supervisors[34] would be created under the leadership of the authority of the market where the largest trading takes place, within which college coordinated standpoints would be developed and adopted in common. These decisions could be considered precedents for later decisions and made public for guidance of market practitioners. Moreover, in case no agreement could be achieved, the mediation powers of ESMA will usefully come into play, and lead to a binding decision for all national authorities involved[35]. This more cooperative approach implied a rethinking of the scheme underlying the present article 4, as all jurisdictions with a sufficient share of the trading would be involved.

More importantly for the future development of the rules on takeovers, in the fields identified in the future directive, the Directive should confer powers on the ESMA to develop regulatory standards[36] that, after endorsement by the Commission, could bring clarity in the numerous items that have been left open in the Directive or that will need interpretation in the very rapidly moving field of takeover bids. In the past, the Commission has not made use of the powers conferred on it by article 6 referring to the comitology procedure referred to in article 18, which dates back to the pre-CESR times. In the future, one can expect ESMA to adopt proposals for further interpretation of the future Directive's provisions contributing to fair and orderly markets. One could refer e.g. to article 13, where the Member States were invited to develop at that time non-harmonised rules governing the conduct of bids – such as the lapsing of a bid, revision of bids and competing bids -, a matter for which high level common standards might usefully be enacted as the rules and practices in one state might affect bids for companies in other states, while confusion would result in case of multistate bids[37].

But perhaps more importantly and beyond strict regulation, one should especially mention the powers of ESMA to develop guidance and recommendations[38]. It is well known that the takeover area is one of rapid and unpredictable developments and with considerable difficulty in establishing general rules of a binding nature. Better coordination by way of guidance to market practitioners would make the takeover procedure more predictable, or at least clarify the attitude that supervisors are likely to adopt, which is essential with respect to the strong conflictual nature of takeovers. This could apply to individual decisions of national authorities e.g. in the field of derogations, where divergent practices – or even regulations - exist. But actual practice will reveal that close follow-up on emerging and today unknown issues will be of great help to all parties involved. Although not binding in the legal sense, these recommendations would have a moral

[32] Art 4 (4) mentions cooperation but does not expressly refer to the matters mentioned here.
[33] Art. 31, ESMA Regulation, nt.3.
[34] Art,21, ESMA Regulation, nt.3.
[35] Art. 19 and 20, ESMA Regulation, nt.3.
[36] Art.10, ESMA Regulation, nt. 3.
[37] But it may be discussed and in which fields and to what degree of detail these Regulatory Standards would go, as many takeover and assimilated transactions are purely national. Priority should be given to multi-state transactions where differences in practice or interpretation may have a negative impact on ongoing bids. For a more interventionist view: Papadopoulos, Th., nt. 25.
[38] Art 16, ESMA Regulation

value having been adopted by the competent authorities in the EU. These recommendations could usefully inspire national authorities confronted with new issues, as is already the case today with the exchange of case law, or with an ESMA group exchanging experiences in this field.

These different arguments plead for giving ESMA a central role in the development of future, more precise rules and recommendations in the takeover field, along with coordinating action in individual cases.

Some will object that under their national supervisory structure, the bodies in charge of overseeing takeovers are not members in ESMA: this is the case in several Member States, such as the UK, Austria and Sweden. In fact, the regulation on ESMA contains an express provision taking that hypothesis into account by stating that for these specific matters, the national body in charge of takeovers will take part in the ESMA decision-making.[39]

Recommendations

The formal competence of ESMA in the future directive should be made explicit in the ESMA regulation

Blanks in the present Directive should be covered, whether by Commission regulation, by Regulatory Technical Standards or by guidance and recommendations.

For multistate transactions, coordination should take place within a college of supervisors, involving all jurisdictions where trading takes place, while the role of ESMA as coordinator and if needed mediator has to be stipulated in the future directive

The competence of ESMA for international matters could be extended to agreements e.g. on procedures or exchange of information in relation to third countries[40].

3. The takeover bid as a disciplining instrument

One of the traditionally strongly stressed advantages of takeover bids, especially those of the unsolicited type, is the threat a bid exercises on the incumbent management or on the board, and therefore the disciplining pressure exercised on them. Even without a specific threat, boards can be expected to be sensitive to the risk of unsolicited bids and take corrective action a long time in advance. A board receiving signals about an impending bid will normally become very nervous and attempt to thwart the bid, especially as long as the bid has not officially been announced. Indeed the Directive rules relating to defensive tactics only start to apply with the official announcement of the bid[41]. But the disciplining effect is abrupt, limited to a specific signal from the markets that is often difficult to distinguish from market rumours, and these rumours are not always taken very seriously by the incumbent board and management. To act on a vague signal involves a considerable risk for the target locking in shareholder value. As a consequence many companies have preferred to take protective action outside the bid context, and the legislation of several Member States has been generous in offering defensive techniques[42]. This leads to entrenchment by boards, and block holders, that may be detrimental to the interest of the company

[39] See art.40 (4) and (5) of the ESMA Regulation.
[40] Art. 33, ESMA Regulation
[41] art 9. 2 Takeover Directive, but Member States may be stricter by declaring the rule applicable once the bid is "imminent". See Take Over Panel, 6 Aug 2004 "Put up or Shut up" and no "intention to bid" statements.
[42] See for an overview of control enhancing mechanisms, ISS, Report on the proportionality Principle in the European Union, 18 May 2007

or of all shareholders[43]. The question is not: should management be disciplined, but is this the best way to achieve the objective of disciplining management

The topic of remuneration is a good example of an attempt to discipline management and board conduct that has evidently not yielded very convincing results. In this field, self-regulation has failed and hard regulation is not evidently optimal. Indeed in 2010 and notwithstanding the stricter and stricter regulations in the banking sector, remunerations have increased substantially, by 26 % according to some sources. And the renewed attempts to impose even stricter rules in the CRD IV is likely to increase the pressure for other ways to circumvent the fundamental concerns that are ultimately the level of remuneration and less its structure.

Therefore the issue is: what can be done if we want better and stronger disciplining of management and the board, what alternatives do we have that are less dramatic than a full takeover bid, are also less expensive, and would be more effective in terms of outcomes?

In the past several techniques have been tried: disclosures have been imposed, e.g. on remuneration, but the outcome has been the opposite of what was intended, i.e. in considerable increase in pay[44]. The presence of independent board members has been made mandatory, initially as a minority, nowadays often a majority of the board, but their effectiveness has not been overwhelming in the financial crisis. Moreover, their independence has often been considered more important than their knowledge and expertise. The introduction of the audit committee and other corporate governance instruments has certainly strengthened the position of companies and their returns[45]. New attempts were made more recently by trying to actively involve the shareholders, as the ultimate guardians of the corporate interest: indeed they bear the ultimate risk of wrong decisions and therefore could be expected to be the most interested party in seeing that decisions are in their interests, which are supposed to be identical with the company's interest. But here the difficulty is first to determine who are the shareholders – would they include the high frequency traders, or those with empty positions? -, and how to mobilise them, as for most of them share ownership is a matter of mere investment, not of entrepreneurship. Several initiatives have been put forward to activate the equity holders' interest, allowing e.g. institutional investors to vote on the basis of a record date – and not of their actual holding-, or making proxy voting or electronic voting more flexible. Mandatory voting, with disclosure of the positions taken, identification of the shareholder throughout the multi-layered securities depositary structure,

[43] The entrenchment of boards has a negative effect on the company's share evaluation. This is amply evidenced in the studies by L.Bebchuk (esp. Bebchuk, L., Cohen, A., and Ferrel, A., What Matters in Corporate Governance? http://ssrn.com/abstract=593423; also Bebchuk L. and Cohen, A., The Costs of Entrenched Boards http://ssrn.com/abstract=556987) dealing with the US staggered boards, the latter being rarely met in Europe. Although the principle would also apply to European companies with respect to fully entrenched boards, the stronger position of the shareholders, and their ability to dismiss the board might lead to a different analysis. The existence of control enhancing mechanisms would probably be the more significant factor of entrenchment. But these authors also mention the long term benefits that may flow from a better and more stable board, as that may induce management to make efficient long term investments, or avoid anti-takeover action that would divert them from pursuing the right business objectives. So nothing is uni-dimensional in this subject; see the Kay Review, nt 11.

[44] The role of remuneration advisers should be mentioned here as they may have had a more direct impact on this type of competition among managers. Idem about the publication of anti-takeover defences.

[45] With respect to the contribution made by different corporate governance instruments to better return, see Gompers, P., Ishii, J., and Metrick, A., Corporate Governance and Equity Prices, http://ssrn.com/abstract=278920; Aggarwal, R, Erel, I, Stulz, R and Williamson, R, Do U.S. Firms Have the Best Corporate Governance? A Cross-Country Examination of the Relation Between Corporate Governance and Shareholder Wealth http://ssrn.com/abstract=954169, ECGI - Finance Working Paper No. 145/2007; Brown, L. and Caylor, M., Corporate Governance and Firm performance http://ssrn.com/abstract=586423

flexibility in the proxy mechanisms are being discussed or considered. Ambitious engagement initiatives were undertaken in the UK[46] to insure that asset managers – described as “stewards” - that are held to a fiduciary duty towards the beneficiaries in their asset management activity would more actively enter into dialogue and monitor the companies in which they invested their clients' moneys. It is still too early to evaluate these efforts – are they mere “gentle, harmonious exchanges of views” -, but it is interesting to mention that they point to the creation of stronger ownership nuclei – even as low as 1 to 3 % - that are absent in the UK companies where highly dispersed ownership has been the rule which tipped the power balance strongly in favour of management. Moreover, stronger engagement would allow the world of the financial shareholders to reconnect with the industrial world, as trust has been damaged.

Some have been playing with the notion of a “shareholder committee” as is known in the Swedish “remunerations committees” composed of significant shareholders, and to a certain extent also in the Netherlands. Shareholder committees would be composed of significant shareholders – not block holders in the traditional sense - that take a deep interest in the company's long term welfare and could have their voice heard or even decide on certain matters such as conflicts of interest, appointment of auditors or of independent directors. All these efforts aim at establishing stronger links between shareholders and the company's leaders, creating a better informed, more stable long-term relationship that would allow well informed continuous management monitoring and may contribute to the formulation long term policies. One can expect this action to support better run companies, that are less dominated by adventurous managers, are more productive, engage in longer term projects which is supposed to be beneficial to the shareholders. Therefore it is essential that the conditions under which this stewardship action can be developed be clearly spelled out, indicating the borderlines with full legal or de facto control, but also with the action of activist investors.

As a disciplining mechanism, a takeover – at least in its aggressive form of an unsolicited bid - is the most extreme and most aggressive one and clearly a case of a breakdown of any dialogue. But in terms of disciplining management's action, it is also the most expensive, unpredictable and very risk prone one for both target and bidder[47]. Therefore it is useful to point to alternative instruments that may be equally if not more effective as being specifically targeted to identified shortcomings of the target's company structure or management.

Activist investors play more or less this role as far as disciplining management is concerned, their intervention being mostly focused on specific, short time issues on which they want the company to act, but not on controlling the business, sitting on boards or even less on taking it entirely over or running it themselves. Not all activists act in an aggressive way: some merely address the company's governance, e.g. by requiring an under-performing CEO to leave, changing the composition of the board by including more expertise, or disposing of certain assets that may constitute a burden on the market evaluation of the shares. In some cases activists made demands for splitting up the company or prohibiting a merger to the dismay of several of its stakeholders. Whether that was justified or not depends on the merits of the individual case[48], but at least constitutes an example of external disciplining that is equally powerful as a takeover bid, but more targeted and easily realisable. The reaction of companies to activist shareholders is usually very

[46] See: Financial Reporting Council: The UK Stewardship Code, July 2010; see Cronin, Ch. and Mellor, J, An investigation into Stewardship, engagement between investors and public companies: Impediments and their resolution, FGRE and CEPS, June, 2011
[47] The absence of any pre-bid due diligence is undoubtedly a major risk for the bidder.
[48] In cases of splitting the company one often sees that the market valuations of the part is higher than the previous value of the integrated business

negative, but their role is prophylactic: therefore it is advisable to better define and streamline their activity, rather than curbing it entirely as seems to be considered in some jurisdictions.

Usually, the reaction of the shareholders to these more aggressive initiatives is crucial, which constitutes a return to the original company scheme, where the last word belongs to the shareholders. Activist action in the US often results in a takeover[49], with considerable profits if it succeeds. But one should distinguish: in case of a takeover, shareholders react individually without much if any organised dialogue among them. Each acts out of his individual financial position, not looking at the collective interest or the interest of the company as such. This sharply contrasts with the original company scheme, where decisions are taken after collective deliberation in the general meeting, or at least after an exchange of views may have taken place. Both techniques of decision making present affinities as resulting in the same outcome but are fundamentally different as based on collective v. individual decisions

So the argument that takeovers are needed for disciplining management has only relative value, relates to takeover as a disciplining instrument of last resort, not the preferred one and should be considered in the broader context of other external monitoring instruments. More attention should be paid to these instruments and the legal conditions under which they can take place.

4. Anti-takeover defences

The most controversial articles of the Directive are the much-discussed articles 9 to 12. These are the result of a difficult negotiation that ultimately ended in a miserable compromise that had little substance and was even counterproductive at least if one looks at the later assessment by the Commission e.g. on the board neutrality rule. It is not clear whether it would be advisable to revise these articles, as the price may be that the revision of the entire Directive will be blocked for a long time. The board neutrality rule has survived better than expected. Moreover, the present equilibrium – which is essentially a free for all – has not frequently prevented takeovers from taking place, the case of state intervention excepted. It is unclear whether it has urged management to act like in the US, i.e. activate the defences to better protect the shareholders financial rights and improve shareholder value.

But the intellectual debate should at least take place.

Some have proposed a system that would be based on a mandatory board neutrality rule, with on opt-out for companies individually, probably with a supermajority[50]. Whether that would allow the controversy to be solved can be doubted: targets could still adopt pre-bid defences, making any neutrality purposeless. In companies with controlling block holders, the outcome is likely to be defensive, while in the companies with dispersed ownership, the outcome will be known in advance: institutional investors or arbitrageurs are very unlikely to vote for an opt-in that might seriously damage the return on their portfolios.

[49] Schor, M, and Greenwood, R, Investor Activism and Takeovers, http://ssrn.com/abstract=1003792, indicating abnormal return for companies ultimately taken over, but not for the failed attempt.

[50] See P. Davies, nt.7. A similar, but more generally applicable proposal was formulated by Hertig, G., and McCahery, J.A., Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?, August 2003, ECGI - Law Working Paper No. 12/2003 ;http://ssrn.com/abstract=438421 who proposed that companies opt-into the Takeover Directive, or opt for national law.

There are essentially three types of provisions in the Directive that deal with anti-takeover defences: the board neutrality rule, the breakthrough rule and the restrictions on voting rights and on the transfer of shares[51]. Each of these provisions can be waived in whole or in part by the national legislator, leading to considerable diversity among the national regimes. This would prevent the emergence of a market for corporate control. The Commission 2007 inventory of implementation concluded that the neutrality rule remained applicable in most jurisdictions that had introduced it although some had removed it, while the breakthrough rule was almost never[52] adopted by any state and obviously no data are available about the restrictions on voting rights and share transfers[53]. The famous compromise therefore resulted in what could be expected, i.e. a standstill, or even a regression. However, later evolutions in the Member States should be taken into account and the report which the Commission has ordered from Marccus advisors will certainly contain interesting data. Moreover, the economic context has considerably changed with the financial crisis making national governments much more sensitive to takeovers by firms from other jurisdictions, even within the EU, leading some governments to active interventions in the takeover market. Although there are no figures available one would not be astonished to learn that more takeovers have been thwarted by – mostly informal - government intervention than by anti-takeover defences[54]. Moreover, some Member States have adopted formal legislation that would subject takeovers by foreign interests to government authorisation. These actions have divided the market for corporate control much more than any private anti-takeover mechanism. One also expects this evolution to be investigated in the abovementioned Marccus report. Indeed, there is a fear that we are engaged in the wrong discussion, as the real issues are political and do not fit into the present discussion about the reform of the takeover Directive or of company law.

The neutrality rule art.9 (2) as it has been adopted in a considerable number of Member States serves to prevent boards protecting themselves ("entrenchment"), but does not clearly state that its purpose is to protect the shareholders. It only mentions that the board can seek alternative bids as a defensive mechanism. The experience especially from the US indicates that the use of defensive techniques may strongly contribute to improving the position of the shareholders not only in triggering alternative bids, but also and especially in exacting better conditions from the bidder. Therefore it seems logical that the mere exception to 'seeking alternative bids' should be broadened to any other technique allowing the board to take action that is likely to improve the financial condition of the shareholders. This formulation - which is the expression of the fiduciary duty of the board - as is the prevailing view in the US - should make it clear that entrenchment by the incumbent board should be avoided, but not to the point that it would be detrimental to the shareholders.

With respect to the other – especially pre-bid defences - the debate should be repositioned from a market perspective – each shareholder deciding for himself whether or not to tender his shares – to a company perspective, according to which the future of the company is to be decided by a vote of the shareholders, hence a collective decision in the AGM. What seems contrary to one of the fundamental concepts of company law is that decisions about the final destiny of the company are not taken by the shareholders, duly and fully informed. Many will answer that the "shareholders" in a takeover situation are short-term traders, hedge funds and other speculators to whom the

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[51] Respectively art.9 (20, art.11 (4) and art 11(4)
[52] Estonia excepted
[53] See the proportionality study, nt. 38.
[54] see the blocking of the French Sanofi takeover by Swiss Novartis; the attempts to block the takeover of Danone by US Kraft, although no offer was ever launched; more recently the Italian blocking of a Parmalat takeover by French Lactalis, terminated only after a French-Italian political agreement

traditional investors have sold once the bid has been announced. This argument may be true but does not change the fundamental point that the shareholders, whoever they are, should make the final determination. It would change a series of individual decisions whether or not to tender the shares, by a collective one, achieved in the context of a well-established procedure, with full disclosure and if possible with due debate. This approach would also eliminate some of the "anomalies" in company law, according to which a legal merger or – in some jurisdictions - a transfer of a substantial part of the assets is subject to a formal decision of the general meeting after a more or less elaborate procedure has been followed, while in case of a takeover the company's supreme body is not involved.

This proposal is submitted for discussion in the hope that it will avoid a new deadlock on these matters but allow the discussion to be repositioned where it belongs, i.e. that ultimately it is for the shareholders to decide. They should decide about the future development of the company, and this after a transparent and open debate. But some difficult additional questions will be raised to which no ready answer is available. Would the rule apply to all bids, or only to those where defences have come to light? And would mandatory bids also be included? In principle, all bids should be covered as the fundamental issue about the company's future is posed in voluntary bids as well as in mandatory bids.
The subject submitted to the AGM should be on the company's future, and on the basis of that on the defences as these have been put to work. If the motion if adopted, defences will come to an end. Most difficult is the issue of the majorities: if, as proposed, one would admit that pre-bid transactions to the bidder would be unenforceable, or limited to a certain percentage, one could admit that all shareholders, including the bidder would be entitled to vote, and that 75% - or any other qualified majority - of the votes cast should agree with the new orientation of the company. This would bring the decision in line with a merger, or a sale of all assets[55] In case of a mandatory bid, the rules would be the same, which would mean that the controlling shareholder cannot sell the company on his own, but only with the consent of a vast majority of co-shareholders. One will notice that the proposal comes close to the breakthrough rule: indeed there are clear similarities, the main differences being that ultimately the decision is not adopted by shareholders individually, but as part of a collective decision making process.

But anyone who has been engaged in the field of takeover will certainly understand that new ideas may not necessarily receive much attention. The discussion should at least be started.

Conclusion

The Takeover Directive has laid the basis for a better organisation of takeovers in Europe, especially by introducing better coordination of the procedure in cases of multistate takeovers. But the provisions of the Directive dealing with designating the competent authorities have to be updated taking into account the changes in the regulatory system in Europe (ESMA), in the trading patterns and the changed perspectives in company law. Differently from the concepts followed at the end of the previous century, there is more understanding these days as to the role played by stable shareholders. This leads to a better analysis of the issues of private benefits of control that should be avoided on a permanent basis, and not only at the moment of a control acquisition. As a consequence, the obligation to make a bid in case of crossing a certain threshold should be mitigated by ensuring that the new controlling shareholder can obtain no private benefits. For other, open bids, the usefulness of the takeover technique is widely recognised and

[55] At least in certain jurisdictions.

should be supported as the ultimate disciplining instrument. However, the takeover is not the most efficient disciplining mechanism, and other instruments should be supported as well. Finally, the debate on defensive techniques will probably not be avoided. It is proposed that this debate should be repositioned in terms of the overall decision-making mechanism in company law and allow the general meeting to ultimately decide what are the effects of takeover protections and which direction the company should take. Differently from proxy solicitation as a disciplining instrument – with which this proposal is affiliated – here the decisions are adopted in light of a firm offer and the shareholders and with full disclosure will know what will be the financial consequence of their decision.

Dealing with takeovers often results in a dilemma[56], one being obliged to take account on the one hand of the necessary flexibility, the risk of entrenchment, irresponsible conduct and abusive private benefits, and on the other, to create stability and innovation, responsible ownership, supporting the long term growth. This balance will only be struck in an appropriate way by dealing not only with the technical case of takeover bids, but should include the wider legal, financial, social context in which business activity is undertaken. One can hope that the European regulators will be open to take this wider view into consideration.

[56] A similar dilemma but limited to the balance between entrenchment and protection of shareholder rights is mentioned in Becht, Marco, Bolton, Patrick and Röell, Ailsa A., Corporate Governance and Control (October 2002). ECGI - Finance Working Paper No. 02/2002. Available at SSRN: http://ssrn.com/abstract=343461

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