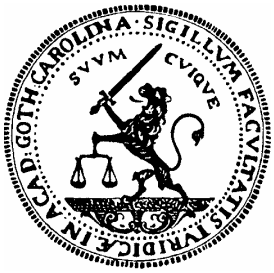

FACULTY OF LAW
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Mandatory Bid Rule
Problems and effects of its implementation

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Contents

Abbreviations

1. Directive, Takeover bid Directive, Takeover Directive - Directive 2004/25/EC of the European parliament and of the council of 21 April 2004 on takeover bids.
2. High level group, Winter Group - High level group of company law experts' on issues related to takeover bids, who published Report of the High level group of company law experts' on issues related to takeover bids", Brussels, 10 January 2002, Chairman: Jaap Winter.

1 Introduction

1.1 Why this subject is important

"Several studies have documented the cyclical pattern of mergers and acquisitions. In the 20th century five waves have been observed: the early 1900s, the 1920s, the 1960s, the 1980s, and the 1990s (Renneboog and Martynova, 2006). The sixth wave can be added: the 2000s (Renneboog and Martynova, 2005). The new deal volume surpasses any level ever reached.
During the first half of 2006 the deal value of the announced mergers and acquisitions exceeded the deal value of 2002 and 2003. Especially in Europe merger activity soared significantly. The deal value in the first half 2006 exceeded $ 700 billion in Europe, even more than in the US."[1].
Due to financial globalization cross-border takeovers are more promoted and easier to be realized, which leads to necessity to protect various constituencies, capital market and market of corporate control. Takeover Directive is supposed to be one of the device which determines, on one hand, how minority shareholders and other vulnerable constituencies must be treated and, on the other hand, prevent inefficient behavior of controlling shareholders and managers in managing corporations and interfering in capital market. Takeover regulations determine a set of economic and social requirements that potential successful bidder should fit in. Such requirements are also indispensable in the light that economic and political power of many listed corporations exceed that of some Member States.
Another reason behind adoption of the Directive is creation of so called level playing field in the area of takeover bids in European Union. According to High Level Group of Corporate Law Experts the extent to which in a given securities market takeover bids can take place and succeed is determined by a number of factors. These factors can be of a general kind, often macroeconomic, or company specific. Currently there are many differences between the various Member States, in terms of such general and company specific factors. As a result, takeover bids cannot be undertaken with the same expectation of success in the different Member States and shareholders in Member States do not have corresponding opportunities to tender their shares. The Winter Group took position of promoting level playing field proceeding from such benefits of takeovers as exploitation of synergy, opportunity for shareholders to sell their shares at a price higher than the market price, disciplining of management[2].
Another reason for harmonization of takeover activity on European Union level is to avoid race-to-the-bottom. "Bebchuk and Cohen (2003) and Bebchuk and Ferrell (2001) show that the real reason to incorporate in another state is that companies are attracted to the states that provide

[1] Christoph Van Der Elst, Lientje Van Den Steen" Opportunities in the M&A aftermarket: squeezing out and selling out", working paper series, September 2006, p.4.
[2] "Report of the High level group of company law experts' on issues related to takeover bids", Brussels, 10 January 2002, Chairman: Jaap Winter.

managers with a wider range of anti-takeover measures. Hence, the competition between states to attract incorporations may actually worsen corporate governance. Similar trends may occur as a result of cross-border mergers and acquisitions. Companies from countries with less friendly takeover regimes are less likely to be taken over (and hence have more opportunities to seek target companies abroad), whereas companies from countries with relatively friendly takeover regimes are more likely to become targets. Since the target usually adopts the acquirer's governance standards, the cross-border market for corporate control may evolve towards a less friendly takeover regime: either a blockholder-based regime or a market-based regime with effective takeover defenses. In turn, this may push countries to adopt takeover regulation resulting in a less friendly takeover regime and hence in less efficient market monitoring of managers"[3].

Despite all the reasons to adopt Takeover regulation, it was not that easy to find a version of the Directive appropriate for all Member States. Earlier versions of Directive were rejected proceeding from the political considerations. As a result in order to be able to pass Directive, the authors of the Directive must create Directive which would be suitable for Member States with opposite political views on major mechanisms and legal techniques of the Directive. Thus, Directive offers rules of harmonization for such critical techniques as mandatory bid rule, transparency, principles of takeover activity, squeezing-out and selling-out. At the same time Directive leaves such issues as board-neutrality rule, breakthrough rule, and threshold for mandatory bid rule to discretion of Member States, which characterizes Directive as flexible in terms of condition of adopting it by Member States.

From the three pillar rules of Takeover Directive only mandatory bid rule is obligatory for Member States. Thus, the author of thesis has decided that the analyses of mandatory bid rule is of primary importance and deserve thorough attention.

1.2 Purpose

The author believes that Directive is a significant step to fulfilling the aims on the basis of which mandatory bid rule is adopted, that is why the main approach of the thesis is to acquit the main provisions of the Directive regulating mandatory bid rule. This thesis identifies fundamental characteristics and rationales of the theories supporting Directive approach to mandatory bid rule. Theories contradicting Directive approach are also examined in order to create complete picture of circumstances and rationales of Directive approach. This rule is discussed in light of different economic and legal theories in order to make it clear which legal circumstances and economic factors are taken into consideration to underpin the rule in the Directive. Thesis also makes possible to understand how Directive itself

[3] Marc Goergen, University of Sheffield and ECGI, Marina Martynova, Tilburg University, Luc Renneboog, Tilburg University and ECGI, "Corporate governance Convergence: Evidence from takeover regulation", Law Working Paper N° 33/2005, April 2005, p.5-6

supports realization of mandatory bid rule in its principles and preamble. Different scenarios of implementation of the rule are offered to describe potential effect of the rule. Also possible derogations from the rules are revealed and possibility and the ways to impair these rules are discussed. Apart from analyzing theoretical effect of mandatory bid rule in different scenarios and different ownership structures, thesis explains the regulatory techniques of core rules of the mandatory bid rule, namely mandatory bid rule threshold, price and means of payment to show complete picture of the way in which shareholders are protected.

1.3 Outline

This chapter shortly introduces different arguments and theories of different scholars with respect to mandatory bid rule and its effect. Such an introduction helps reader to understand the main conflict of viewpoints currently existing in literature regarding mandatory bid rule. Second chapter discusses history toward adoption of Takeover Directive in the light of mandatory bid arguments. This helps reader to understand partly the reason for the particular context and wording of mandatory bid rule in the Takeover Directive. The third chapter clarifies and elaborates justifications for mandatory bid rule both directly accepted by the Directive and theoretical foundations such as necessity to favor distribution of a controlled premium to minority shareholders and necessity to allow minority shareholders to exit on terms that are no less beneficial than those provided for shareholders who sold their controlling position. Then scenarios of different combination of private and security benefits are disclosed and behavior of bidder and shareholders of target company are revealed, on the basis of which implementation of mandatory bid rule in different scenarios are analyzed. Discussing the threshold of mandatory bid rule in forth chapter, attention is paid to different approaches to definition of the control, their shortcomings and virtues, then exemption from obligation to launch mandatory bid rule are discussed and effect of threshold application in dispersed ownership is assessed. Discussing the price of mandatory bid rule in fifth chapter, three major criteria to define price of mandatory bid is introduced, their advantages and disadvantages are presented, and the Directive choice is justified. Also attention is paid to the period of time, during which prices paid for share must be taken into account, and to the means of payment. Sixth chapter is devoted to analyses of behavior of mandatory bid rule in different market and ownership structures. Different market and ownership systems are briefly described, rational for such differences is revealed, potential effects and means of influencing of mandatory bid rule in both systems are analyzed, authors opinion on which system is preferable is described and how mandatory bid rule contribute to such system is explained. Seventh chapter discusses possibility of derogation from mandatory bid rule, which leads to regulative weaknesses of mandatory bid rule. The last chapter concludes.

1.4 Delimitations

The main purpose of the thesis is to analyze policy considerations behind adoption of mandatory bid rule on European level. Mandatory bid effects, especially in different combinations of private benefits and security benefits or in different market and ownership systems, discussed in the thesis, are based on theoretical predispositions of different scholars but not on real empirical evidence. The author of the thesis excluded from her research position of mandatory bid rule in a financial market regulatory framework.

1.5 What is written on the subject

On one hand, authors of different articles appreciate method offered by mandatory bid rule in protecting minority shareholders. They state that, as control premium belongs to all shareholders, the same as other assets of the company, it should be distributed fairly among shareholders who have chosen to tender their shares to the bidder[4]. The same rule has an effect that minority shareholders are prevented from being trapped in company if they disagree with policies of a new controlling shareholder or a group of shareholders. In addition to this, the requirement of mandatory bid rule that exit price be equal to highest price, paid by the bidder in a definite period preceding the announcement of mandatory bid rule, guarantees treatment of minority shareholders no worse than majority shareholders. Without such a guarantee the value of shares of minority shareholder would drop significantly after acquiring by the bidder of control, depriving their possibility to cash their shares at fair price.

Other scholars had question the need for such a right in different scenarios as they think that, the main aim of shareholders is to earn dividends and any new acquire cannot change the right for dividends so that shareholder would be deprived of them. However, some authors disagree with such statements stating that the change of control leads usually not only to the turnover of main directors and management of the company but also to the strategical change of the policy of the company, including the policy toward dividends. Also transfer of control can lead not to the increasing company value and wealth but to maximizing bidder's wealth[5]. With regard to the need to redistribute control premium there are also a range of arguments to whom it must belong: to company, to the controlling shareholders only or to all shareholders in proportion to their shares.

Also scholars who disagree with necessity of the mandatory bid rule explain it by the fact that there are a range of other company law mechanisms of protecting minority shareholders, such as, for example, the presence of many highly liquid capital markets and portfolio diversification which helps to reduce minority shareholders' risks, associated with investments[6].

[4] Simon M. Sepe, "Private sale of corporate control: why the mandatory bid rule is inefficient", http://ssrn.com/abstract=1086321, pp. 15-16.
[5] Ibid, p. 14.
[6] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory

Another widely used argument against mandatory bid rule is that its requirement to offer bid to all outstanding shareholders increases the cost of a takeover, and thereby might discourage some value-maximizing transactions[7]. Discouraging of value-maximizing transactions might lead to protection of inefficient managers of a target firms.

There are also different opinions with respect to the need of mandatory bid rule in concentrated ownership. The major agency conflict in companies with concentrated ownership is between majority shareholders and minority shareholders. According to some authors mandatory bid rule does not solve the problem of such corporations because first there are other ways of transfer of control, which do not trigger mandatory bid rule and, second, even if it is transfer of control covered by Takeover Directive, it is not substantial because the structure of the company does not change: instead of one majority shareholder another majority shareholder appears, leaving agency conflict unresolved[8]. Also these scholars think that it is logically to trust majority shareholders as they invest their money in the same corporation and are interested in its prosperity. However, such authors underestimate arguments of other scholars that the main fear of minority shareholders not the fact of change of owners but their intentions of extracting private benefits at the expense of minority shareholders, which is a characteristic particularly for companies with concentrated ownership, and result in severe majority-minority agency conflict[9]. There are extensive debate among the scholars about the effect of mandatory bid rule on neutralizing behavior of managers and majority shareholders pursuing the aim to exploit minority shareholders and extract private benefits at their cost.

Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, ttp://ssrn.com/abstract=819764.pp.13-14.

[7] William Magnuson, "Takeover regulation in the United States and Europe: an institutional approach", 2009 Pace University School of Law, p.14

[8] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, pp.11-12

[9] William Magnuson, "Takeover regulation in the United States and Europe: an institutional approach", 2009 Pace University School of Law, p.4

2 History of adoption of mandatory bid rule on European Level

2.1 Development of the ideas, assotiated with mandatory bid rule

Mandatory bid rule took its origin from UK self-regulatory City Code on Takeovers and Mergers, which was introduced in 1968 by the Bank of England as a response to perceived abuses in the domestic takeover market. The purpose of the City Code was to guarantee fair and equitable treatment of shareholders, whose companies are involved in takeovers, and to provide framework within which takeovers would be put into effect[10]. Since 1968 the Code was amended. The mandatory bid rule was not introduced in 1968, but in 1972 in response to a defensive acquisition of shares by the shareholder of a corporation target by two rival bids. In response to such actions of shareholder, the Takeover Panel, the self-regulatory body, administrating takeover rules, introduced a rule according to which any bidder purchasing forty or more of corporation' shares must offer to buy from the rest shareholders all the outstanding shares. In 1974 the threshold was lowered to thirty percent[11]. Also the City Code requires the buyer to buy the remaining shares at a highest price paid for the same shares in the preceding year[12]. "During the non-numerical regime which lasted for four years, the control threshold was ascertained by reference to the ability of a shareholder to significantly influence the affairs of the company and conduct them in accordance to his wishes"[13].

Until the 1980s, United Kingdom was a single country within European Union who strictly regulated mandatory bid rule and takeover regulation as a whole. The main explanation to this phenomenon can be that hostile acquisitions of companies were a rare case and as a consequence there were no need for their specific regulation. As takeover activity increased on Continental Europe during the second half of the 1980s, other countries began to adopt mandatory bid rules, benefiting from experience of United Kingdom and using British City code as a benchmark. At the beginning of introducing mandatory bid rule countries prefer voluntary codes, which

[10] Jeremy Grant, Tom Kirchmaier, Jodie A. Kirshner, "Financial Tunneling and the Mandatory Bid Rule", January 2009.

[11] Marco Ventoruzzo, "Takeover regulation as a wolf in sheep's clothing: taking armour and skeel's thesis to continental Europe", Brocconi University Institute of Comparative Law "Angelo Sraffa" (I.D.C.), pages4

[12] Jeremy Grant, Tom Kirchmaier, Jodie A. Kirshner, "Financial Tunneling and the Mandatory Bid Rule", January 2009.

[13] Lan Luh Luh, Ho Yew Kee, Ng See Leng, "Mandatory Bid Rule: Impact of Control Threshold on Take-Over Premiums", Singapore Journal of Legal Studies December, 2001, p.3.

eventually were superseded by binding rules in the mid of 1990s. First Member States prefer to adopt self-regulatory rules and only later opted for binding legal rules, although some countries have left self-regulatory rules as only ones regulating takeover bids. Here there is a table representing of these national regulations[14].

Country	Form of regulation	Mandatory bid rule condition
Austria	Legislation 1998	Legislation: control
Belgium	1964 Soft Law (rules and guidelines issued by the Banking Commission), legal rules	In the soft law of the 1970s:control, in the legislation 1989:control
Denmark	Self-regulation 1979, amended 1988, legislation 1995	
Finland	Legislation 1989	67%
France	Rudimentary self-regulation early 1970s, full takeover regulation by law 1989, amended 1992	In legislation late 1980s: 33% and 50% and at certain other occasions
Germany	Voluntary code 1995, legislation (the Takeover Act) 2002	Amendment to the voluntary code 1997: control, in the legislation 2002: 30%
Holland	Self-regulation (primary on mergers) in the early 1970s, proposal for takeover legislation envisaged 2002	
Italy	Stock Exchange Code early 1970, Legislation 1992	Legislation 1992:control, later: 30%
Portugal	Legislation 1986	Legislation 1986: 33% and 50%
Spain	Legislation 1984, 1991	Very complex
Sweden	Self-regulation 1971	Amendment to self-regulation 1999:40%
UK	Self-regulation 1968	In 1968 code:30%

Despite the fact that majority of Member States adopted the rule, design of the rule with respect to the threshold and the price, at which the offer must be made, differed across the Member States. The threshold varied between 30 per cent and 50 per cent, with majority of the countries having a

[14] Erik Berglöf, Mike Burkurt ”European takeover regulation” SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.186-187

threshold of one-third of the voting rights. As also can be seen from the table some countries demand a mandatory bid rule once a control has been obtained. Some countries have very complicated rules for triggering mandatory bid rule.

With respect to the price of mandatory bid offer, there were also different rules in different Member States. For example, the United Kingdom and Germany required the price to be equal to the highest price paid for pre-bid purchase. In Italy, the price had to be equal to the average market price over the twelve months prior to the bid announcement[15].

Meanwhile cross-border takeover activities increase its speed. “In 1985, most takeovers were domestic, constituting over 86 per cent of all corporate takeovers, but in 1999, this percentage fell to only 40per cent. During the same time period, the percentage of corporate takeovers involving at least one European party rose from 15 per cent to 43 per cent. Similarly, looking instead to the market value of these transactions, takeovers involving a European party rose from 11 per cent of the world total in 1985, to 47 per cent in 1999. And in 2000, the value of takeover deals in the United Kingdom alone reached an astounding $173.7 billion. Some scholars describe this period as a "First International Merger Wave"[16].

The Commission acknowledged that above described differences in legislation of Member States concerning mandatory bid rule and takeover activities as a whole were too drastic, even though the origin of them can be traced back to national distinctions and varying cultural norms among member states. Such differences often lead to considerable obstacles to takeover bids or uncertainties with regard to implementation of takeover bids regulations. Commission recognized that uniform takeover regulation among the Member States could facilitate development and reorganization of European Countries, which would suit to the aim of further development of single market and competitiveness of European companies. As a result, European Commission appointed Professor Robert Pennington to draw up a draft directive for takeover bids in 1970s. The draft, strongly influenced by United Kingdom City Code, was introduced and was discussed with representatives of Member States for couple of years, however did not yield positive results as interests of Member States was not prominent yet. As a result this first attempt of takeover harmonization was abandoned[17].

One of the influential steps toward harmonization of regulation of takeovers bids on European level began in 1985 upon publication of the "White Paper" by the European Commission, which emphasized the need for cross-border

[15] Marc Goergen, University of Sheffield and ECGI, Marina Martynova, Tilburg University, Luc Renneboog, Tilburg University and ECGI, “Corporate governance Convergence: Evidence from takeover regulation”, Law Working Paper N° 33/2005, April 2005, p.23

[16] Dmitry Tuchinsky, “The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium”, 2006-2007 New York Law School Law Review, p. 4

[17] Erik Berglöf, Mike Burkurt ”European takeover regulation” SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.189

collaboration in order to achieve the goal of a common market[18]. Commission continued its efforts ten years later when at the end of the 1980s the European Commission presented a draft for 13th Company Law Directive. The draft was heavily criticized and majority of states revealed lack of interests to such regulation on European level[19]. However Member States attitude to Commission efforts changed dramatically by the event of January 1988, when Italian entrepreneur Carlo de Benedetti launched hostile takeover of the giant Belgian holding company, Societe Generale de Belgique. The attempt was hindered by an acquisition by a French white knight, but revealed indispensability for uniform European takeover bids regulations as national rules turned out to be void on cross-border takeover bids. Such events encouraged European Commission to pursue its plan and at the urging of the European Parliament Commission developed its draft and on January 19, 1989, the Commission presented an initial proposal to the European Council for the Thirteenth Directive on company law. The next year, on September 10, 1990, the Commission adopted an amended proposal of the Takeover Directive (the "Initial Proposal"). The Initial Proposal reflected the opinions of the Economic Committee, the Social Committee, and the European Parliament and represented a detailed document, containing explicit reporting, timing and conduct limitations, intended to function as the primary takeover law for all Member States. However, Member States were not prepared to such a detailed regulation of takeover bids. Mostly this can be explained that by that time most Member States had not introduced regulations regarding takeover bids to their compulsory legislations even for domestic acquisitions. They were unaware of the nuances of regulation of mandatory bid rule and conduct of offeror and offeree companies. Inspired by similar provisions in the U.K. Takeover Code, this proposal contained a version of the passivity rule as well as a mandatory bid rule pursuant to which any acquirer of a large block position in a target company would be required to bid for all remaining shares at an equitable price. While those rules were (at that time) relatively uncontroversial, a number of member states expressed a general concern that the proposal was too detailed and would intrude too severely upon company law at the national level. The main argument was that Directive should frame basic principles for national rules while leaving details to national legislation. Another argument of Member States majority's was that mandatory bids might be excessively burdensome and deter efficient transfers of control in too many cases. By the end of 1991, the Commission announced its intention to prepare yet another draft proposal with proper reaction of Member States arguments[20].

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[18] Tyler Theobald, "Hostile takeovers and hostile defenses: a comparative look at U.S. board deference and the European effort at harmonization", International Trade Law Journal, Winter, 2006

[19] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.189

[20] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.189 and Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover

A new proposal for a Takeover Directive was presented to the Council and to the European Parliament on February 8, 1996. The main aims of this proposal were to create, on one side, harmonized regulation of takeover activities, that is, to provide level playing field for companies across Europe involved in takeover bids and, on the other side, to guarantee protection of minority shareholders. According to this proposal Commission formulated general principles that Member States would be obliged to follow while implementing their national takeover codes, thus Commission had left considerable amount of matters to the discretion of Member States. However, the crux of new proposal was mandatory bid rule and prohibition against frustrating actions. Taking in consideration criticism of previous mandatory bid rule provisions of 1996, proposal provided that mandatory bids shall "be launched to all shareholders for all or for a substantial part of their holdings at a price which meets the objective of protecting their interests" (Article 10 (1)). The Explanatory Memorandum commented that "there were serious objections to the imposition of the full mandatory bid on all Member States. The requirement for a full mandatory bid was criticized as a burden on business which would undermine market mechanisms and be liable to upset the financial markets". The proposal was amended several times in response to remarks from the first reading in the European Parliament and as a result of negotiations with the Council. Opposition was essentially eliminated by the end of 1999 when the U.K. and Spain reached an agreement over the regulation of Gibraltar[21].

One of pivotal issue, which stimulated work in coordination of efforts to pass Takeover Directive, was an increasing emphasis on maximizing shareholders' value[22]. This issue became apparent among other

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Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 52-53, ttp://ssrn.com/abstract=819764, Dmitry Tuchinsky, "The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium", 2006-2007 New York Law School Law Review, p. 5, Scott Mitnick, "Cross-border mergers and acquisitions in Europe: reforming arriers to takeovers", 2001 Columbia Business Law Review, p.3., John Elofson, "Lie back and think of Europe: American reflections on the EU takeover directive", Wisconsin International Law Journal, Fall 2004, p.3, Guido Ferrarini, "Share Ownership, Takeover Law and the Contestability of Corporate Control' in Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends", Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends. Conference Proceedings, 2009, p.17

[21] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.189 and Dmitry Tuchinsky, "The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium", 2006-2007 New York Law School Law Review, p. 5, Scott Mitnick, "Cross-border mergers and acquisitions in Europe: reforming arriers to takeovers", 2001 Columbia Business Law Review, p.3., John Elofson, "Lie back and think of Europe: American reflections on the EU takeover directive", Wisconsin International Law Journal, Fall 2004, p.3, Guido Ferrarini, "Share Ownership, Takeover Law and the Contestability of Corporate Control' in Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends", Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends. Conference Proceedings, 2009, p.17

[22] Dmitry Tuchinsky, "The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium", 2006-2007 New York Law School Law Review, p. 4

considerations by following international acquisition. In 1999, a United Kingdom telecommunication corporation, Vodafone, successfully completed the hostile takeover of the German colossus Mannesmann. "What was striking about the Mannesmann affair was not simply that Vodafone won, but that the German company's defense was based almost entirely on arguments about shareholder value; the directors claimed that shareholders would be better off sticking with Mannesmann as the independent company than accepting Vodafone's highly valued shares[23]". Also the battle over this important company highlighted importance of harmonization of regulations of takeover activities and attracted significant political attention.

As further details about obstacles to adoption of Takeover Directive are outside mandatory bid issue, to cut the long story short, the main disagreement among the Member States, especially Germany, and Commission with regard to 1996 proposal has left neutrality rule[24]. On July 4 2001 the proposal was presented to the European Parliament but did not pass due to the lack of one vote. The number of votes for each side was 273. One of the contentious and highly politicized area, in which Member States did come to agreement was minority shareholders protection, provided by article 5, according to which successful bidder was obliged to make a fair offer to all shareholders[25]. "What toppled the proposal in the European Parliament after a hard-fought compromise had been achieved was apparently a riot among the parliamentarians instigated mainly by the German members responding to heavy lobbying by German industry. The Germans feared that their unique way of viewing the corporation as an enterprise intended to serve not only shareholders but other stakeholders as well, notably the employees and society in general, was being scrapped in favor of the more simplistic Anglo-Saxon view of the corporation as a vehicle to promote the interests of shareholders[26]".

In spite of the defeat of Commission proposal of Takeover Directive in Parliament, the need for such Directive on the European Level became more and more conspicuous. This need was dictated by the fact that a number of Member States by that time adopted takeover rules, including mandatory bid rule on domestic level, putting them at disadvantage to bidders from the Member Stated, which did not adopt similar rules[27]. Therefore to continue developing a project Commission set up in September 2001 a High Level Group of Company Law Experts chaired by Dutch professor Jaap Winter, to

[23] Dmitry Tuchinsky, "The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium", 2006-2007 New York Law School Law Review, p. 4

[24] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.189

[25] Dmitry Tuchinsky, "The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium", 2006-2007 New York Law School Law Review, p. 5

[26] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.2

[27] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 54, ttp://ssrn.com/abstract=819764

prepare report about subjects, which were the crux of disagreement in Parliament and provide suggestions for appropriate legislative project of harmonization of European corporate law with respect of takeover regulations[28]. Giving essential need to prepare recommendation the task of Winter group was to address problems, raised in previous negotiations, namely how to ensure a level playing field for shareholders in the EU; the definition of the equitable price to be paid in the case of a mandatory bid; and the introduction of a squeeze-out procedure, the latter being suggested directly by the European Parliament. Apparently, the wisdom of a mandatory bid rule was not to be debated[29]. In January 2002 the Winter Group handed over its recommendations[30]. With respect to mandatory bid rule "the Expert Group remarks that by "lack of a level playing field" they mean company specific barriers to takeover bids which are lawful and, in many instances, actually applied in the Member States and which the Expert Group has reviewed. As a result, takeover bids cannot be undertaken with the same expectation of success in the different Member States and shareholders in Member States do not have equivalent opportunities to tender their shares"[31]. Winter Group specified that in some of the Member States that currently apply a mandatory bid rule, the provisions on the consideration to be paid have a binding character, whereas a few Member States provide only recommendations. The provisions also differ widely with respect to both the level and the nature of the consideration to be offered. In a few Member States, the level of the consideration to be offered is determined by reference to general principles only (e.g. equal treatment of shareholders). However, a vast majority of Member States has adopted detailed provisions with respect to the consideration to be offered in a mandatory bid, but they vary considerably as to the nature and the number of the criteria used, and the way in which they are applied[32]. The Group disagreed with the wording of article 5(1) of the Directive. According to Group the effect of the wording of article 5(1) of the Directive is that the issue whether a price is equitable is a matter of European law, ultimately determinable by the European Court of Justice. In the view of the Group, it is not desirable that such a question - which will arise in the midst of a complex transaction where time is of the essence and where the issue will depend very much on particular circumstances if it is left undefined - should be determined by long drawn out court proceedings. The likelihood of such proceedings may well have the effect of deterring transactions altogether,

[28] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.190

[29] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.4

[30] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.190

[31] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.4

[32] "Report of the High level group of company law experts' on issues related to takeover bids", Brussels, 10 January 2002, Chairman : Jaap Winter, p.47

which is undesirable. The Group therefore considers that, at the very least, it should be made clear that it is for the member states to satisfy the directive requirement to provide for one or several equitable price criterion/criteria, within the margin of appreciation laid down by a broad requirement in the Directive that the mandatory bid must be made at an equitable price. According to Group, on one hand, the great diversity of the national regimes applicable to the consideration to be offered in a mandatory bid indicates that it is difficult to conceive one single rule which could be used in all countries and in all situations to achieve an adequate level of protection of minority shareholders. On the other hand, the Group notes that an efficient functioning of the capital markets in the European Union requires a sufficient degree of predictability as to the consideration to be offered in a mandatory bid. It is indeed a major disincentive to the acquisition of control if such acquisition imposes an obligation to bid but the price to be paid is not predictable. As a result The Group holds the view that the principle of equivalent treatment of all holders of securities of the same class requires that the price to be offered in the mandatory bid should, in normal circumstances, be equal to the highest price paid by the offeror for shares in that class, whether on or off the market, during a certain period preceding the date of the acquisition of securities by the offeror, which resulted in the change in the control of the company. Member States should be free to set the length of this period between 6 and 12 months[33].

A new proposal based on recommendations of Winter Group was presented to the European Parliament on 2 October 2002[34]. On December 16, 2003, the European Parliament approved the compromised version. The Council gave final approval on March 30, 2004, and the Takeover Directive came into force on May 20, 2004. The Takeover Directive required that all member states pass legislation implementing the Takeover Directive by May 20, 2006[35].

2.2 Main arguments, regarding mandatory bid rule

At some point majority of Member States agreed on fairness and solid rational for mandatory bid rule. However reasons for this agreement were different. “To the Germans, the rule is all about exit. This is a way to ensure that the minority shareholders can escape the company once control of the

[33] “Report of the High level group of company law experts’ on issues related to takeover bids”, Brussels, 10 January 2002, Chairman : Jaap Winter, p.48-49

[34] Marco Ventoruzzo, “Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends”, Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 55, ttp://ssrn.com/abstract=819764

[35] Dmitry Tuchinsky, “The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium”, 2006-2007 New York Law School Law Review, p. 5

company has been gathered in one hand and the company's independence is likely to be compromised. Similar exit rules exist in German company law on groups. In British company law, the mandatory bid rule dates back to the early days of the City Panel on Takeovers and Mergers. To the British, the rule is about fairly dividing the takeover premium among all shareholders rather than leaving it with a few[36]".

Despite the agreement on necessity of mandatory bid rule it still was difficult to find the wording of mandatory bid rule due to disagreement among Member States on two basic features of the rule: the control threshold, triggering mandatory bid rule, and the price of mandatory bid rule. The definition of control threshold influences the level of free trade of considerable blocks of shares and, as level of ownership concentration differed and differs in Member States, common definition of control threshold was a problem as effect of the same control threshold on level of free trade of block shares can be different in different Member States: the low threshold can have influence on level of free trade of block share in highly concentrated ownership structure while leave unaffected this free trade in dispersed ownership structure. Example of low influence of control threshold on free trade of blocks of shares can be United Kingdom, where ownership structure is highly dispersed, with the median controlling blockholder holds 9,9 per cent of the company's shares. Adoption of 30 per cent control threshold has a limited influence on freedom of control transfer in United Kingdom. Contrary to this example is situation in most continental countries, where median controlling shareholders hold over 30 per cent of company's shares. In half of the listed non-financial firms in Austria, Belgium, Germany and Italy a single shareholder controls more than 50% of the votes. In Dutch, Spanish and Swedish firms the median blockholder holds 43.5, 34.5, and 34.9%, respectively. Therefore, 30 per cent control threshold leads to the fact that in such countries transfer of control block of shares more often associated with triggering mandatory bid rule. It is obvious from this explanation that the higher the control threshold the more transfers of control block shares are unaffected by mandatory bid rule. That is why countries with high concentrated ownership plead for a higher threshold while United Kingdom was satisfied with 30 per cent control threshold[37].

Another controversial issue was the method of determining the price of mandatory bid rule, which highly influences the cost of control transfer. As Winter Group commented that a majority of the Member States refer to the highest price (or a percentage thereof) paid by the offeror, or a person acting in concert, over a certain period (ranging from 3 to 12 months) prior to the offer. However, many other criteria are found in the same or other Member States:

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[36] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.11

[37] Simon M. Sepe, "Private sale of corporate control: why the mandatory bid rule is inefficient", http://ssrn.com/abstract=1086321, p.21.and Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.190

- the average market value over a certain period (ranging from 3 to 12 months) prior to the offer;
- the price paid for a block of shares the acquisition of which led to the modification in control;
- the "net worth" / "theoretical asset value" / "liquidation value" of the company;
- the "objective valuation criteria usually applied" and the characteristics of the company.

A few Member States use only one of these criteria, i.e. the highest price paid by the offeror. The other Member States use more than one (in most cases two or three - including often the highest price paid and the average market value - , but even more in one Member State)[38].

The example of highest price can be practice used by French authorities responsible for the promulgation and enforcement of takeover rules, the French Conseil des Marchés Fiancieres (which replaced the Conseil des Bourses des Valeurs), according to which "the compulsory offer price must be at least as high as the highest target share price during the period over which the share acquisitions giving rise to the compulsory offer requirement were made."[39]

Example of combined practice can be Austria according to 1999 Übernahmegesetz (takeover Statute) the mandatory tender offer had to be launched at a price not lower than the average market price of the relevant securities over a period of six months precedent the acquisition of the controlling interest, and in any case not lower that fifteen percent below the highest price paid or promised by the bidder in the twelve months preceding the triggering event[40]. The Italian Consolidated Financial Services Act of 1998 also provides for a mandatory bid's price to be lower than the highest price paid by the bidder for the acquisition of control. Article 106 (2) of this Act states: "The offer is launched within 30 days at a price not lower than the arithmetic average between the average market price of the last 12 months and the highest price paid by the bidder in the same period of time for the purchase of voting shares"[41].

However European Directive implemented UK approach as to the mechanics of price determination. To be "equitable", in fact, the offer's price must be "the highest price paid for the same securities by the offeror, … , over a period, to be determined by Member States, of not less than six months and not more than 12 before the bid." One of the reason for Member States to agree on such a redaction can be different motivations.

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[38] "Report of the High level group of company law experts' on issues related to takeover bids", Brussels, 10 January 2002, Chairman : Jaap Winter, p.47

[39] Marco Ventoruzzo, "Takeover regulation as a wolf in sheep's clothing: taking armour and skeel's thesis to continental Europe", Brocconi University Institute of Comparative Law "Angelo Sraffa" (I.D.C.), page 9.

[40] Ibid.

[41] Guido Ferrarini, "Share Ownership, Takeover Law and the Contestability of Corporate Control' in Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends", Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends. Conference Proceedings, 2009, p.17

3 Justification of the mandatory bid rule

3.1 Short outline of problems called to be resolved my mandatory bid rule

The cornerstone idea supporting legal mechanism to foster takeover bid is that bidder can organize management of the company in a way that can bring more benefits from operation of the company than benefits produced by incumbent management[42]. As a result of more efficient management of the bidder the value of the company increase, which leads that the value of securities of the company increase, which should benefit shareholders. These benefits called in literature security benefits[43]. But there is another benefit, sometime derivative of increasing security benefits, which takeover regulations aim to extract for minority shareholders. This is so called control premium benefit. To explain this benefit, imagine that a company value under incumbent managements is *v*. The company's value under the bidder's more efficient management is *d*. The difference between the value *v* and value d is called premium[44]. Obviously the price paid to the controlling shareholders must be more than v to convince shareholder to sell but less than *d* to make it attractive for bidder to buy. That is to say, that in the result of takeover bid the premium is distributed between the bidder and shareholders. But this simple structure is complicated by different factors:

1. Existence of private benefits of controlling shareholders obtained from ruling the company which increase the part of premium such shareholders must receive in order to agree to transfer their controlling position[45].
2. As private benefits can be obtained at the expense of minority shareholders there is necessity to protect rights of non-controlling, minority shareholders. Minority shareholders also as the owners of the company must benefit from

[42] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, ttp://ssrn.com/abstract=819764.p.9

[43] Christoph Van der Elst, CCL and Tilec, Tilburg University; FLI, Ghent University Lientje Van den Steen, FLI, Ghent University, "Opportunities in the M&A aftermarket: squeezing out and selling out", working paper series, September 2006, p.11

[44] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, ttp://ssrn.com/abstract=819764.p.13

[45] Erik Berglöf, Mike Burkurt "European takeover regulation" SITE, Stockholm School of Economics and CEPR; SITE and Department of Finance, Economic Policy, April 2003 Printed in Great Britain, p.192

premium, which increase the part of the premium which bidder should share with shareholders[46].

3. Takeover transactions are also subject to agency problems. Transition of the control of the target company to less efficient managers may occur as a result that these managers may know how to extract more private benefits from operating of the company than incumbent managers do. Also new managers may redistribute rather than create value, granting shareholders with wealth received from bondholders and other stakeholders.

So, as can be seen regulation of takeover bid should take into account two conflicting aims:

1. Aim to foster market for corporate control, allowing bidder to substitute inefficient incumbent management. The mere threat of takeover influences those shareholders who appointed managers and disciplines managers, thus serving as a preventive measure. Takeover bid also serves on curative basis, that is takeover bid is likely to be accepted by shareholders who are not satisfied with incumbent management.
2. Aim to protect minority shareholders or other non-controlling shareholders, which makes substitution of management more expensive.

One of the possible reasoning behind substantiating reconciliation of this two aims can be the following: the more we protect minority shareholders, the more they as investors prefer to invest in our companies, which will lead to liquid capital market with more takeovers. However as will be shown down this is not true for every circumstances. The regulation of takeover bid in respect of discussed problems has different perspective, evolution and outcomes in different structure of ownership and control, that is dispersed ownership and concentrated blockholder ownership.

Further this short outline of the problem must be discussed in more details.

3.2 Justification for necessity of mandatory bid rule

To justify necessity to takeover bid we need to consider two interconnected ways of realizing mandatory bid rule. Takeover bid theory recognized two majour ways of providing equal rights for shareholders and protecting minority shareholders. They are:

1. To favor distribution of a controlled premium to minority shareholders[47],
2. To allow minority shareholders to exit on terms that are no less beneficial than those provided for shareholders who sold their controlling position[48].

[46] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.18

[47] Ibid.

[48] Ibid.

3.2.1 Favouring distribution of control premium to minority shareholders

To address the first way we should consider the following case. Imaging, for example, that particular shareholder hold 40 per cent of company's shares and this amount exceeds threshold, which provide de facto control, that is this particular shareholder is controlling shareholder. If the market price for share is 100 and premium for control may be 30 per cent of the price of controlling shares and if the bidder agrees to pay this 30 per cent extra to 100, then in the result of private transaction only controlling shareholder will receive benefits from controlling premium. Minority shareholders in best case will receive only 100. The question arises whether controlling shareholder somehow deserved this beneficial transaction, whether the controlling shareholder somehow paid for his controlling position. If yes, then mandatory bid rule, which equalizes controlling shareholders and non-controlling ones in a way that it distributes control premium between all shareholders in equal portions, may be recognized as unfairness among shareholders. If not, then transaction, discussed above, is distortion of securities market, which can alienate investors, resulting in weaker equity market. As a result mandatory bid rule, which provides that in any takeover all shareholders can benefit from control premiums, strengthen the financial market by providing a systemic protection against exploitation of minority shareholders. "These provisions may be particularly desirable in a market that is regarded as not particularly "thick" of efficient, meaning a market in which control of listed corporations is often transferred outside the market, through friendly transactions among insiders able to capitalize control premiums to the detriment of minority investors. This risk is particularly high with strong controlling shareholders and concentrated ownership structures, a condition present in most continental European countries."[49]
Coming back to the positive answer that controlling shareholders paid for their controlling position, one of the arguments may be that minority shareholders have chosen their minority position and in order to keep themselves on safe side diversified their investment across several companies as an alternative to going actively into one company. There may be an argument that minority shareholders possess shares of both target and bidder companies. According to Marco Ventoruzzo while coherent in theory, the practical reality of this hypothesized agnosticism is highly doubtful. "First, most bidders are not listed, but are instead empty shells created explicitly for the purpose of conducting the takeover. While it is true that most bidders are not listed, they often participate through listed corporations, which are the ultimate beneficiaries of the successful takeover and which have minority investors. But the mechanisms through which potential gains are transferred from a subsidiary to a parent corporation are not particularly efficient. In addition, most individual investors do not have

[49] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 36, ttp://ssrn.com/abstract=819764.

completely diversified portfolios. Instead, employee-investors, for example, have invested a significant amount of their financial surplus in the corporation for which they work, often through pension funds".[50]

Another line of arguments against mandatory bid rule can be that the cost paid by controlling shareholders are those advantages that company has when company is ruled not by board management but by controlling shareholders. Controlling shareholders are not lured by short term benefits they can bring to minority shareholders to win market prices for shares but bear more risks of their capital by investing in long term beneficial projects. Their heavy investments stimulate them to do it and by doing it they risk their investments. This is one of the costs. The company wins from such strategy by benefits brought by long-term investments[51]. Another cost paid by controlling shareholders is commitment, in the result of which company wins from better planed and realized strategy of the company, and patience, in the result of which company wins trough less heavy director remuneration packages. In both cases of commitment and patience company also wins from less agency cost, as it does not have to organize and finance monitoring and controlling of managers, as controlling shareholders are self-interested in beneficial performance of the company. However, it is possible to argue with this line of reasoning by saying that the cost paid by the controlling shareholders is outweighed by the benefits they can extract from operating of the company. First, if it were not for those benefits the controlling shareholders would not pay cost, described above. Second, controlling shareholders do not share those benefits with other shareholders. Third, those benefits, to addition that they are not redistributed equally among the shareholders, can be extracted at the expense and to detriment to minority shareholders, such as, for example, realizing operations or transactions in the interest of controlling shareholders, which entail cost or risk for the company without benefits to the company, which could offset corresponding cost or risk. Thus, in such theory the mandatory bid rule is seen as interference in the benefit-costs of control balance, since it compels the controlling shareholders not to appropriate the control premium as a kind of compensation for all their past costs. "The response to this theory is that even though it is true that the mandatory bid rule represents a cost for the market of corporate control (for both the acquirer and the seller), it must be considered that the capital markets are, unfortunately, not perfect. There are information asymmetries and different bargaining powers in place, and, hence, regulatory intervention is needed in order to redress the balance between controlling and minority shareholders and to promote investors confidence".[52]

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[50] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 14, ttp://ssrn.com/abstract=819764.

[51] Ibid.p.11

[52] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.21.

Another argument against the appropriating controlling premium by the holders of the control is that privilege to rule the company, even if acquired at some cost, is an intangible asset of the company and the company must benefit from it, not the controlling shareholders[53]. As all assets of the company are owned by the shareholders in the amount proportional to the value of their shareholdings, the asset to rule the company and all derivative benefits from it must be distributed among all shareholders proportionally to the value of their shareholdings. Mandatory bid rule pursues this aim as controlling premium is tired to price of the shares, thus, redistributed proportionally to the value of shareholdings. There are authors, whose positions disagree with such a statement. According to one of them "if the takeover premium is considered as an asset that belongs to the company and thus to all shareholders, then the mandatory bid rule is the best way of making sure that the premium is shared among the shareholders. The problem is that the takeover premium is not an asset of the company**, …** the limited liability company is characterized by an isolation of its internal economic affairs from the external sphere of its shareholders. The shareholders contribute capital and receive shares in return. The shareholders have no direct ownership of the funds contributed to the company"[54]. I think that the author in this case confuses the right of ownership and limits of liability in Joint Stock Companies. First of all, according to company law shareholders own part of the company's assets in proportion to their shares, but in Limited Liability Companies and in Joint Stock companies' liability of shareholders is limited only to the size of their shares. That is, if they invest, they can lose only their investment, however, if company's assets grow, shareholders' part of ownership in company grows too. Apart from the rules stating this directly, this can be exemplified by the fact that if company is liquidated the property of the company is divided among shareholders in proportions to their shares. When company is reorganized shareholders receive shares of a new company in proportion to participation of their part of assets of the reorganized company.

Also the same author believes that "at the root of the fallacy of mandatory bid rule lies the concept of takeover premium, that is, the premium above the market price that the bidder may be willing to pay to get a control block. Most markets for shares in company A will have two different prices for any one share at any given time: the shareholders' asking price at which they would be willing to sell a share (P_a) and interested investors' bidding price at which they would be willing to buy a share (P_b). At equilibrium point, the sellers want a higher price than the buyers are willing to offer ($P_a > P_b$). In any other circumstance ($P_a <= P_b$), there will be transactions until this equilibrium sets in. It is rare that investors share a homogenous opinion of prices. Most often, the sell-side will display different asking prices ($P_{a1} < P_{a2} < P_{a3}$, etc.), and the same would be the case for the buy-side ($P_{b1} > P_{b2} > P_{b3}$, etc.). Transactions will occur first among the bid and ask prices that are,

[53] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.20.

[54] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.12

respectively, the highest or lowest, that is, biding price (P_{b1}) and asking price (P_{a1}) are more likely to be taken up than the other prices set by the other investors. If a bidder wants more shares than the shareholder with the asking price (P_{a1}) offers to sell, the bidder will have to increase his bid to cover the next asking price (P_{a2}) and so on. If the bidder wants to buy up shares to obtain a control block, the offering price must be equal to or higher than the current asking price. If the bidder further wants to ensure that many shareholders take up the offer, the offer has to be substantially higher. This difference between the offering price (P_0) and the prevailing asking price (P_{a1}) is the takeover premium. One would not normally expect that one shareholder should receive the same price that another shareholder was paid in a different transaction"[55]. I disagree. The problem with takeovers is that transactions are not as isolated as it described in the example. On the contrary the bidder must publicly announce about bid and stipulate, at some level, equal conditions to all shareholders, that is, time and information, necessary, for shareholders to reach their decisions, conditions for cash considerations, other minimum requirements set in the Directive. Moreover, Directive requires paying equitable price not just to another shareholder, but to minority shareholders, because as will be described below, after control share block is transferred, minority shareholders can be forced to exit the company on unfair terms, that is, to sell their shares at a price even less than market price.

Another argument in line with previous of the same author is following. "Imagine a bidder who has obtained control of a company by acquiring three blocks of shares in three separate transactions (T_1, T_2 and T_3). For the sake of simplicity, each block of shares represents 10 per cent of the total stock of shares outstanding, and all shares in the target company carry identical voting rights. The prices paid (P_1, P_2 and P_3) were subsequently increased in each new transaction ($P_1 < P_2 < P_3$). Upon reaching 30 per cent of the votes, a mandatory bid obligation may arise, obliging the bidder to make an offer to all of the remaining shareholders for their 70 per cent shares. The offer price would be (P_3), arguably because that price carries a control premium that belongs to all shareholders. One would be inclined to ask, that if this is the case, why is there no obligation on the bidder to offer a similar compensation to the counter-parties of the first two transactions, where the compensation would be ($P_3 - P_1$) for transaction (T_1) and ($P_3 - P_2$) for transaction (T_2)?"[56] I think there is no anomaly in this case and mandatory bid rule did not contribute to any abnormality. Firstly, it was the choice of those who sold their shares at price P_1 and P_2 while minority shareholders do not have a choice, they did not want to tender and as a result they are trapped. Second, those who have sold their shares at price P_1 and P_2 did it because the price include control premium and they are not loosing anything, while minority shareholders can be forced to sell at a price below market price and thus need protection. Mandatory bid rule protects the right of minority shareholder to choose not to tender by promising adequate exit.

[55] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.13
[56] Ibid.

If it were not for mandatory bid rule minority shareholder would be forced to tender at initial price, even if it is unfair, being afraid to get trapped.

3.2.2 Minority shareholders' right to exit and its terms

The indispensability for exit right of minority shareholders is dictated by possibility of majority via minority conflict to occur after implementing control acquisition transaction.
The guarantee of equitable price to be paid for shares of minority shareholders is substantiated by the possibility of such conflict and that this possibility is likely to cause the decrease of value of the shares. Such decrease can occur as a result of, on one hand, increase supply of shares of the company as all minority shareholders is likely to try to avoid minority position by selling their shares and on, the other hand, the fact that the selling shares are shares for minority position, which is likely to decrease their price. The likelihood of such decrease of value of share also explains why it is not acceptable to agree with argument that non controlling shareholders can sell their shares on liquid market[57].
Another argument that was already used against such right is that "it departs from the presumption that the change of control is detrimental to the company's other shareholders being illogical to require the controlling shareholder to extend a mandatory bid until it has been proven that harm has actually being incurred".[58] The counterargument, offered, is that empirical evidence shows that the change of control enhances the target company value[59]. However, this counterargument cannot be accepted because as discussed above and will be discussed below the bidder, who increase target's value may be willing to do so, not on the ground that he can manage the company in more efficient way but because he knows how to extract private benefits from operating of the company at the expense and to detriment of minority shareholders. Such a possibility is only another argument why minority shareholders must have right to exit, that is not to allow such parasitic acquisition and again protection of minorities.
Thus the primary goal of the mandatory bid rule is to protect minority shareholders from the risk that a controlling shareholder will sell his shares without sharing the control premium with the rest of shareholders, or from the risk of becoming trapped in a corporation that has been taken over, without being able to sell their shares at a reasonable price.

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[57] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.27
[58] Ibid.
[59] Marina Martynova and Luc Renneboog, " The Performance of the European Market for Corporate Control: Evidence from the 5th Takeover Wave", ECGI - Finance Working Paper No. 135/2006, CentER Discussion Paper No. 2006-118, University of Sheffield Management School and Tilburg University - Department of Finance, p.4, Marc Goergen and Luc Renneboog, "Shareholder Wealth Effects of European Domestic and Cross-border Takeover Bids", European Financial Management, Vol. 10, pp. 9-45, March 2004, p.11

3.3 Reflection of justifications of mandatory bid rule in reasoning by the Directive of necessity of mandatory bid rule

The need to protect minority shareholders through mandatory bid rule was acknowledged in the preamble of the Directive in section 9 where it was said that Member States should take the necessary steps to protect the holders of securities, in particular those with minority holdings, when control of their companies has been acquired. The Member States should ensure such protection by obliging the person who has acquired control of a company to make an offer to all the holders of that company's securities for all of their holdings at an equitable price in accordance with a common definition. The protection of minority shareholders and guarantee of equal rights to shareholders was recognized in Directive as one of the paramount principles of the Takeover bid Regulations. Article 3 of the Directive states that for the purpose of implementing Directive, Member States shall ensure that the following principles are complied with (a) all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected. As the collateral principle of equal treatment principle section (e) of Article 3 states that an offeror must announce a bid only after ensuring that he/she can fulfill in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration. In other words the offeror must calculate amount of financial support he needs to fulfill among other considerations, mandatory bid rule, that is considerations to minority shareholders who will sell their shares at equitable price. Without taking into considerations expenses for mandatory bid rule takeover bid cannot take place. The name of the article of Directive where mandatory bid rule is stated and the wording of mandatory bid rule "such a person is required to make a bid as a means of protecting the minority shareholders of that company" further reveal the aim of mandatory bid rule, which is protecting minority shareholders of the company.

The main rule that mandatory bid rule provides is stated in article 5 of Directive and is following: "Where a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company as referred to in Article 1(1) which, added to any existing holdings of those securities of his/hers and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price".

3.4 Scenarios of mandatory bid rule implementation

As was discussed above, due to mandatory bid rule the distribution of gains from takeover takes place not only between the bidding firm and target firm, but between controlling and minority shareholders in the target firm. Thus, if more premium is allotted to bidder, the incentive to make a bid is stronger. However, if more premium accrues to minority shareholders, it is less attractive to hold controlling blocks in takeover target. Some authors think that takeover will succeed if the bidder, who is able to generate more value from the company than the incumbent management, receives the entire surplus[60]. However it is possible to argue with this statement on the ground that mandatory bid rule does not exclude all bid, but excludes inefficient bids. In other words mandatory bid rule provides that only bidder, who can create sufficient added value of the company that enables him to pay the control premium not only to controlling shareholders but also to the small shareholders, will succeed in takeover bid, that is, the most efficient management will take place in the result of mandatory bid rule.

However this scenario can be distorted by private benefits, which bidder can extract at the expense of minority shareholders, if these private benefits exceed jointly private benefits and security benefits of the incumbent management. Private benefits are usually considered benefits that can be accrued from controlling a firm. They may be of different nature, some of them can be written in contract and enforced through the court, and some are not. They can be in line with company's and minority shareholders' interests and can be at odd with them. In latter case private benefits can come, for example, from making decisions that benefit a particular investor (or management) at the expense of other investors[61], in cases, which I am going to discuss such most private benefits come at the expense of minority shareholders. Again mandatory bid rule, which enables minority shareholders to exit, is likely to eliminate scenario when bidder acquires company and pay control premium at the expense of private benefits built at the expense of minority shareholders.

Next analysis of the dynamics of control allocation is worth mentioning as it substantiates the necessity for mandatory bid rule. When bidder approaches target firm with the purpose of acquisition, he has at least to pay market price of the company. Market price of the company is dictated by the wellbeing of the company that is the benefits the company produces. Every shareholder may think that if a bidder is willing to pay market price of the company he can create more benefits of the company to compensate his

[60] Mike Burkart, Fausto Panunzi, "Mandatory bids, Squeeze-out, Sell-out and the dynamics of the tender offer process", Law Working paper N 10/2003, June 2003, page.6-7.

[61] Mike Burkart, Stockholm Institute of Transition Economics (SITE) & Department of Finance, Stockholm School of Economics and CEPR, Fausto Panunzi, University of Bologna, ECGI and CEPR, "Mandatory bids, Squeeze-out, Sell-out and the dynamics of the tender offer process", Law Working paper N 10/2003, June 2003, p.192

cost. Thus every shareholder anticipates that value of the company will rise as well as the value of their shares. As a result every shareholder may withhold from the selling their shares to the bidder in order to maximize their profits – the profits is bigger if they don't tender: if they don't tender they will capture the whole value improvement that the bidder can generate (post-takeover value), if they tender they will receive the bidder price of shares which cannot be higher than or equal to post-takeover share value, because the bidder cannot pay all his benefits from acquisition to shareholders, otherwise there is not economic incentive for him to bid. If every shareholder expects other shareholders to tender, which would result in acquisition of controlling position of the company, and think that their refusal to tender is negligible to the outcome of the tender offer, transaction of controlling position of the company will never take place. To overcome this obstacle bidder can offer shareholders the share price higher than the value of share, obtained as a result of more efficient post-takeover management. However, using his controlling position the bidder can withhold part of the post-takeover share value from the minority shareholders after takeover takes place. One of the ways to do this is to divert a part of the dividends he collects. This redistribution of company's value to the benefit of controlling shareholder is known as private benefits[62]. "If the security benefits of the bidder are smaller than the security benefits of the incumbent controlling shareholder but the private benefits of the bidder are larger than the private benefits of the incumbent shareholder including the difference between the higher security benefits of the incumbent controlling shareholder and the security benefits of the bidder, the transaction will take place but the remaining minority shareholders will be worse off."[63] "Empirical evidence shows that controlling shareholders can allocate to itself a disproportionate part of the gains of the company."[64] However, minority shareholders can escape situation where their benefits are appropriated by exiting the company on fair terms, which is guaranteed by mandatory bid rule. If it were not for this exit rule controlling shareholders could allocate to themselves a disproportionate part of the gains of the company. Another virtue of mandatory bid rule is that if due to mandatory bid rule the bidder cannot compensate the cost he paid for controlling shares at the expense of minority shareholders the bidder approaching a target will rely only on maximizing profit by his efficient management. As a result bids which are launched after adoption of mandatory bid rule are efficient as the price the bidder is willing to pay will exceed the sum of private and security benefits of the incumbent controlling shareholders.

However, scenario of free-riding behavior described above assumes that shareholders, first, are sure that the takeover transaction will take place,

[62] Christoph Van Der Elst, Lientje Van Den Steen" Opportunities in the M&A aftermarket: squeezing out and selling out", working paper series, September 2006, p.7.

[63] Christoph Van Der Elst, Lientje Van Den Steen" Opportunities in the M&A aftermarket: squeezing out and selling out", working paper series, September 2006, p.11.

[64] Christoph Van Der Elst, Lientje Van Den Steen" Opportunities in the M&A aftermarket: squeezing out and selling out", working paper series, September 2006, p.7.

second, are aware of the market and post-takeover price of the shares. However it is not always the case.

Another situation when exit rule precludes unfair redistribution of premium is when dispersed shareholders are uncertain about the success of the proposed bid. Even if the bid price of shares is below current value of the shares of target firm, it is possible that dispersed shareholders are under pressure to tender as they expect other shareholders to tender and they don't want to become minority shareholders under unknown regime of new controlling shareholder. As a result they may accept price lower than value of the company. However, when such shareholders are guaranteed fair exit, their behavior may radically change. If they reject the bid, they either become a holder of shares, which are more valuable under new controlling shareholder, or will have the right to sell their shares at a price which include premium from the new value of the company.

Now I have to discuss cases when bidder's private benefits are low or absent. First, it is possible to argue that if incumbent's private benefits are high, incumbent controlling shareholders and the bidder may not want to trade the block even though a control transfer would be value increasing. There is an argument that "regulatory provisions that reduce the private benefits of control may discourage not only holding controlling blocks of ownership, but also efficient corporate restructuring as private gains to a bidder are often an incentive for a takeover bid. As a result, control may remain in the hands of inefficient blockholder"[65]. Under some circumstances it is possible to agree with such statement but there are some counterarguments. First, is that if it were not for mandatory bid rule, even if the efficient corporate restructuring in the result of acquisition increase the value of the company and company's shares, but minority shareholders are not protected from appropriation of their part of the increased value of the company, they would not get anything from such efficient restructuring, which cannot be tolerated and must be regulated. Second, as empirical evidence show on average sellers of controlling blocks are usually capture a high value of security, not private, benefits, produced by the buyer. "Dyck and Zingales (2004) discovered for 39 countries and 393 bids a mean premium of 14 per cent, going as high as 65 per cent in Brazil and -4 per cent in Japan. The maximum premium that has been paid was 299 per cent in Brazil and 217 per cent in the Czech Republic. In the Philippines one case was found with a negative bid price of 40 per cent".[66] This shows that in most cases takeover bids took place as a result of opportunity to increase security benefits and not to exploit minority shareholders' rights. In its turn this proves that protection of minority shareholders' rights does not discourage transfer of company management to more efficient controlling shareholders. Third, mandatory bid rule eliminate only private benefits, obtained at the expense of the minority shareholders, but there are also other

[65] Marc Goergen, University of Sheffield and ECGI, Marina Martynova, Tilburg University, Luc Renneboog, Tilburg University and ECGI, "Corporate governance Convergence: Evidence from takeover regulation", Law Working Paper N° 33/2005, April 2005, p.9.

[66] Christoph Van Der Elst, Lientje Van Den Steen" Opportunities in the M&A aftermarket: squeezing out and selling out", working paper series, September 2006, p.8.

private benefits, which controlling shareholders can enjoy, such as, for example, psychological benefits from running the company.

Now I will discuss a case when I can agree with the statement that regulatory provisions that reduce the private benefits of control may discourage efficient corporate restructuring. If the security benefits of the bidder are higher than those of incumbent controlling shareholder, the value increasing takeover will take place only if security benefits of the bidder exceed the joint security and private benefits of incumbent shareholder. If it is not mostly due to comparatively high private benefits of the incumbent controlling shareholder, mandatory bid rule double the price of premium the bidder should pay, as the cost of the bidder will include private benefits, obtained by the blockholder at the expense of minority shareholders and the same value to those minority shareholders. Thus he must pay private benefits twice, and as there is exit rule, which eliminates private benefits (at the expense of minority shareholders) to bidder, he does not gain anything from second part of payment. As a result, even if security benefits of the bidder exceed security benefits of the incumbent blockholder the bidder can be discouraged to offer takeover bid because of inability to pay the cost of private benefits, doubled due to mandatory bid rule. In this scenario mandatory bid rule intensify agency problem, not resolve it. This model was reason for some scholars to doubt that the main aim of mandatory bid rule is to protect minority shareholders, their explanation lies in the "lobbyism of persons in control in companies (powerful managers or directors, or controlling shareholders) against national legislators for a mandatory bid rule, to make competing acquisitions of control more expensive and thereby less likely to happen"[67]. However, one of argument to such reasoning can be that heavy private benefits, obtained at the expense of shareholders is not a problem of Takeover Bid Directive, but corporate governance problem, which must be addressed on company law level.

However, by adopting mandatory bid rule, the regulator acknowledged that to some extent there is a trade-off between the protection of minority shareholders and efficient control transfer.

[67] Beate Sjåfjell, "The Golden mean or a dead end? The Takeover directive in a shareholder versus shareholder perspective", http://ssrn.com/abstract=866184, p.22.

4 Threshold of mandatory bid rule

The mandatory bid rule ensures that the acquirer shall make an offer at an equitable price to all holders of securities for all their holdings once he reaches a certain percentage of the voting rights in the target company which gives him control of the company. Such percentage and the method of calculation are left to be determined by the Member States. Paragraph 3 Art. 5 of Directive says that the percentage of voting rights which confers control for the purposes of mandatory bid rule and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office. Thus some protection of minority rights are guaranteed, while room remains for differences among Member States due to the different ownership and company law features of each Member State.

The first question, which such provisions triggers is what method of calculating control the Member States should apply. For the purpose of understanding this method we should discuss different approaches to define control. There are two of them:

1. The first approach to define control is to acknowledge de facto control, in which control is factually exercised by shareholder or a group of shareholders who keep or represent majority of votes, which grant them the right to operate the company. There are two types of this control. First type is when control is exercised only during a definite period of time, for example where shareholder or a group of shareholders represent majority of shareholders present at the definite general meeting, which is gathered in order to make a decision indispensable for the company. Second type of de facto control is when a shareholder or a group of shareholders owes majority of company's shares. While first type of defector control can easily be transmitted if some other shareholders, owing substantial part of shares attend the meeting, second type of control does not depend on actions of others[68].
2. Second approach to define control is legislatively defined control, according to which, if a person owes definite percentage of votes he is supposed to hold a controlling block of company's shares.

First European takeover statutes followed first approach of defining control. For example, "historically mandatory bids in the UK were limited to situations in which the acquirer obtained effective control by buying shares from the company's officers, being provided that the Panel on Takeovers and Mergers determined in a case by case basis what constituted effective

[68] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.12.

control"[69]. However, in spite of purpose to be precise in defining control this approached appeared to be bulky and cumbersome in regulation. First of all, controlling block of shares is different for almost every corporation, which annihilates possibility of reliable definition of control on legislative level. Second, controlling block could change without any transaction or consideration over a short period of time, if for instance some shareholders decide to participate in operation of the company, if they previously did not do it. Hence, following de facto control approach, it must be obligatory for each corporation to determine, for each circumstances, under which decisions, vital for company, are taken, the threshold of control, which trigger mandatory bid rule. This would impede efficient operation of the company because of extensive litigation and possible uncertainty of cumbersome rules. As a result of above considerations in 1972 and the City Code on Takeovers and Mergers (the "City Code") was established in the 1950s and '60s a presumed concept of control was established, which is still in force these days[70]. As a consequence majority of countries implementing Directive have adopted predetermined fixed threshold that is presumed to represent controlling block of shares and trigger mandatory bid rule. For example, according to Commission Report on the implementation of the Directive on Takeover Bids Member States determined conditions triggering the obligation to make a mandatory bid as following:

1. Germany as indirect or direct acquisition of control, which is defined as 30% of the voting rights of the target company.
2. Greece as
   - Acquisition of more than one-third of the voting rights or
   - Acquisition of further 30% or more of the voting rights within one year in addition to holding between one third and 50% of the voting right
3. Finland as acquisition of 30% and 50% of the voting rights.
4. France as
   - Acquisition of more than 33,33% of the voting capital or of voting rights and
   - Acquisition of at least 2% more of the voting capital or voting rights within less than one year by persons holding between 33% and 50% of the voting capital or voting rights.
5. UK as
   - Acquisition of an interest in shares which carry 30% or more of the voting rights of a company. An interest in shares arises: through ownership of the shares; through having the right to exercise or direct the exercise of the voting rights attaching to the shares; through having the right or option to acquire the shares or call for their delivery or being under an obligation to take delivery of them by virtue of any agreement to purchase, option

[69] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.12.

[70] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.12.

or derivative; and being party to a derivative whose value is determined by reference to the price of the shares and which results, or may result in, his having a long position in them.

- A person (together with persons acting in concert) has an interest in shares carrying between 30% and 50% of the voting rights of a company and acquires an interest in other shares which increase the percentage of voting rights in which he is interested

It is possible to conclude that it is not necessary to exercise the voting rights attached to the shares; it is an exclusively ownership requirement, being presumed that the holders of a minimum percentage of voting rights can control the company.

However, acquiring determined by legislation amount of shares, which trigger mandatory bid rule but less than absolute majority does not always grant to such acquirer the possibility to control corporation. This obviously happens when someone else holds the absolute majority of the voting shares. As a consequence in the majority of Member States it is provided that if another shareholder holds controlling block of shares mandatory bid rule is not obligatory even if the acquirer has bought shares in quantity normally sufficient to trigger mandatory bid rule[71].

Applying chosen by majority of Member States approach to define threshold might have very different effects in different types of ownership and control. For example, there may be following case in dispersed ownership. In order to exercise de facto control of a particular company it is sufficient that shareholder or a group of shareholders hold ten percent of voting rights. Under such conditions any number of voting rights fewer than legislatively determined threshold and more than ten percent grant a chance to become a controlling shareholder without triggering mandatory bid rule. As such this possible practice, which is not prohibited by Directive, can impair efficient minority shareholder protection. “The important implication is that, in a system with widespread ownership, the real goal of the mandatory bid is not so much the one of protecting minority investors from *any* change in control, but rather from a change in control *when* the resulting ownership structure of the corporation is characterized by the presence of a large block-holder. Compare the same rule in a system in which the ownership structure is concentrated, and the largest shareholders typically hold participation higher than the threshold triggering the mandatory bid. In that context, the practical effect of the rule is that whoever aims at obtaining control must be ready to buy all the outstanding shares. Needless to say, rendering the acquisition more expensive might help the controlling shareholder to fend off an undesired suitor”[72].

In addition to possibility to avoid mandatory bid rule by acquiring de facto control without triggering it, different Member States provide for a barrage

[71] Marco Ventoruzzo, “Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends”, Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 43, ttp://ssrn.com/abstract=819764.,

[72] Marco Ventoruzzo, “Takeover regulation as a wolf in sheep’s clothing: taking armour and skeel’s thesis to continental Europe”, Brocconi University Institute of Comparative Law “Angelo Sraffa” (I.D.C.), pages4-5.

of exemption from obligation to launch mandatory bid rule. "There are exemptions for when the acquisition is temporary, or when the acquisition is part of an effort to turn around a corporation in financial distress, for example if creditor banks agree to convert their loans in shares. Other exemptions exist for when the threshold acquisition is simply the side effect of a merger or consolidation. In all these instances, in which usually some discretionary power is given to the agency or self-regulated body administering takeover regulation, imposing the takeover would hinder other economic goals deemed desirable by the legal system. Such goals might include turning around a corporation in dire straits, or allowing external growth, and possible efficiency gains, through a merger"[73].

[73] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 43-44, ttp://ssrn.com/abstract=819764.

5 Price of mandatory bid rule and means of payment

As was discussed above the majour purpose of mandatory bid rule is to guarantee minority shareholders treatment no less advantageous than that of blockholders by providing exit on fair terms. However, if the price offered to minority shareholders is not attractive such guarantee cannot fulfill its purpose. The same as with mandatory bid as such, the task in defining the price is to find a balance between bestowing some control premium to controlling shareholders in order to give them incentive to sell their shares and guarantee fair treatment of minority shareholders. Another condition of defining price of mandatory bid, which must be allowed for is that efficient functioning of capital market in European Union demands a sufficient degree of predictability as to the consideration paid by the bidder for acquiring a company.

There may be three majour criteria to define price of mandatory bid. They are:

1. The price paid for a block for shares, the selling of which transmitted the control position of the company,
2. The average market price paid over a certain period of time prior to the offer[74],
3. The highest price paid over a certain period of time prior to the offer.

The justification for the controlling block price can be that if controlling shareholder has sold his controlling position for this price this means that such a price comprises premium for security and private benefits. The shortcoming of such a method is that as discussed above it can avert some value increasing acquisitions because the bidder carries the high burden to pay high control premiums to minority shareholders. On the other side, it is possible to argue that such method promotes investment in minority shareholdings in companies with controlling shareholders. The drawback of the average market price is that it is virtually impossible to predict the exact amount of expenses of the bidder before launching the bid, which contradicts to the requirements of Article 3 (e) of the Directive, according to which an offeror must announce a bid only after ensuring that he/she can fulfill in full any cash consideration.

The Directive has chosen the third criteria of calculating the price. Thus the bid must be made at an equitable price which according to the Directive is the highest price paid for the same securities by the offeror, over a period determined by the Member States. Such a period, however, cannot be less than six months and not more than twelve months prior to the launch of the bid. The justification for this method can be found in Winter Report, according to section 2.2 of which the highest price paid rule offers the double benefit of allowing the minority shareholders to fully share the

[74] Pedro Testa, "The mandatory bid rule in the European Community and in Brazil: a critical view", London School of Economics & Political Science (LSE) - London School of Economics, November 9, 2006, p.34.

premium paid by the acquirer at any time in the period under consideration, while at the same time giving the offeror the certainty that he will not have to pay more in the mandatory bid than he has been willing to pay in the preceding period and as a result permitting him to determine himself at which maximum price he is prepared to acquire all securities of the company.

However such method can lead to situation where shareholders, whose selling of shares brought a change in the controlling shareholders, are paid less for their shares then shareholders of consecutive transactions. To illustrate one example of such situation imagine that de facto control of the company is 45 percent of the voting shares. The market price at the beginning of acquisition of shares of such a company is obviously less then after acquisition of substantial amount of shares. For instance, the price at the beginning is 15 euro per share. The bidder is ready to buy them at a price 17 euro per share. After buying, for instance 25 per cent of shares the market price of shares grows to 18 euro per share. The bidder is ready to buy at a price 20 euro per share. After buying another 20 per cent of shares the bidder is supposed to launch mandatory offer to buy shares from other shareholders at price no less than 20 euro per share[75]. It does not look fair in relation to the shareholders, who has sold controlling block as each minority shareholder will sell his shares at a price higher not only than initial market price but also average price per share paid for the controlling block.

It is worth noting that the highest price applies on class of shares by class basis, as it is said in Directive the highest price paid for the same securities.

Another aspect worth noting is declared in paragraph 4 Article 5 of Directive, which provide that if, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired. An additional benefit for minority shareholders from such regulation is that it provides incentive for the offeror to set the price offered in the mandatory bid at a reasonable high level.

Another important condition, which must be regulated by Member States is period of time, during which prices paid for share must be taken into account. “In this respect, the longer the time framework taken into account, the higher the risk of prices unrelated to the current situation of the corporation will be included in the calculation. On the other hand, an average calculated based on a too short period of time is subject to speculation bubbles, which distort the real value of the shares and which could be averaged out if a more extended timeline is used”[76]. The Directive

[75] Marco Ventoruzzo, “Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends”, Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, p. 59, ttp://ssrn.com/abstract=819764.

[76] Marco Ventoruzzo, “Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends”, Bocconi University, Institutes of

stipulated that this period must not be less than six months and not more than twelve months prior to the launch of the bid. The exact period must be regulated by Member States.

Under the Directive, the bidder may offer cash, securities, or a combination of both. However, the Directive imposes certain types of consideration in the circumstances described below.

If securities are offered as consideration without a cash alternative, such securities must be "liquid" and admitted to trading on a Member State's regulated market. As a consequence, a bidder with shares exclusively listed in non European country must obtain a secondary listing for its shares on a regulated market within the European Union prior to offering such shares as consideration in a share-for-share transaction with European Union target. Obviously, this requirement will put non European bidders that do not have secondary listings in the European Union at a serious disadvantage vis-à-vis other bidders that have listings in the European Union.

The Directive also mandates a cash alternative in certain circumstances. A bidder must offer cash as an alternative to securities if it has paid cash for shares representing at least 5 percent of the voting rights in the target over a six- to 12-month period prior to the offer or during the offer. The exact length of this period will be defined by each Member State.

Finally, the Directive mandates a bidder to ensure that it can pay in full any cash consideration prior to announcing cash bid. If the bidder intends to offer securities, it must take all reasonable measures prior to the announcement of the offer to secure the implementation of such consideration.

Comparative Law (IDC), Research Paper No. 06-07, p. 43-44, ttp://ssrn.com/abstract=819764.

6 Different market and onweship structure in member states and its interaction with mandatory bid rule

6.1 Description of different market and ownership structure

There are two different systems of company laws: company law promoting market based system and company law promoting blockholder based system. The company law promoting market based system prevails in protection of shareholders. Company law promoting blockholder based system not only protects shareholders but also heavily respects interests of other stakeholders of the company.

"The blockholder-based regime prevails in most of Continental Europe and is characterized by majority or near-majority holdings of stock held in the hands of one, two, or a small group of investors. In contrast, the market-based system, which is found in the UK and the Republic of Ireland, is characterized by dispersed equity. Although the difference in ownership between Continental Europe and the UK-Ireland is remarkable, there is also some variation in the percentage of companies under majority or blocking minority control across the Continental European countries. Thus, countries of Scandinavian legal origin have the lowest percentage of companies controlled by a majority blockholder whereas countries of German legal origin and recent EU accession countries (except for Slovenia) have the highest percentage. The percentage varies from just above 10 percent in Slovenia to more than 60 percent in Estonia and Latvia. Percentage of Continental European companies controlled by investors with blocking minorities of at least 25 percent is very high. The difference across countries is less pronounced though, as in almost all more than 50 percent of listed companies have a controlling blockholder"[77]. "In Austria, Belgium, Germany, and Italy, half of the listed corporations that are not financial institutions have a single shareholder holding more than 50% of the total voting rights. Conversely, only 9.9% of the non-financial listed corporations have such a large shareholder in the United Kingdom. In the average Dutch, Spanish or Swedish firm, a large shareholder holds 43.5%, 34.5%, and 34.9%, respectively, of the total voting rights of non-financial listed

[77] Marc Goergen, University of Sheffield and ECGI, Marina Martynova, Tilburg University, Luc Renneboog, Tilburg University and ECGI, "Corporate governance Convergence: Evidence from takeover regulation", Law Working Paper N° 33/2005, April 2005, p.22.

corporations"[78]. In other words in continental Europe significantly larger number of listed companies is under control of large shareholders, who has a greater influence on the development and realization of companies business and policy. These large shareholders can be founders, families, parent companies or shareholder groups.

6.2 Rationals for different market and ownership structure

This drastic difference in ownership structure between United Kingdom and Ireland, on one side, and mostly other Europe, on the other side, is the result of market structure, which is dictated by different attitudes to role and purpose of the companies and company law. The primary role of companies in United Kingdom and Ireland is allocated to the enhancement of shareholders' investment and protection of shareholders' rights associated with such investment. Some authors even argue that enhancement of shareholder investment and protection of their rights is a single objective shared by all listed companies in United Kingdom. The obvious problem arising from such an aim is to find balance between protection of minority shareholders and promotion of majorities investments. Other constituencies involved in companies' performance are considered must be protected by other branches of law. Company law is only reserved to serve shareholders needs because without shareholders there would not be companies at all and existence of companies benefit the whole society including constituencies which are not protected by company law. Distractions of company law for protection of other constituencies could intervene in shareholders-company relationships to the detriment of companies.
In member states of Continental Europe company law aims are diluted with aim of communities and protection of shareholders is diluted with protection of other constituencies of community. The sharpest example is Germany with its strong bestowal a range of rights to employees. The reason for such guarantees is the recognition by Continental Europe countries that companies could not function properly without contribution of other participants of their time, money and efforts in the running of the companies[79]. However I am inclined to accept English attitude more than Continental Europe attitude. Other constituencies – not shareholders, invest their contribution to the companies welfare because without doing so they would not receive their primary needs, which connected to company only indirectly. In other words they participate in contribution not because they care about welfare of the companies but because they care about their own welfare. Their contributions directly lead to satisfaction of their reasons to contribute. For example, banks give loans to earn interests, not provide companies welfare. Otherwise, they would not check all pros and cons of

[78] Katsumaza Suzuki, "Future prospects of takeover in Japan analyzed from the view of shareownership structures and laws in comparison with United states and the European Union", 2004 Columbia Journal of transformational law association.
[79] Beate Sjåfjell, "The Golden mean or a dead end? The Takeover directive in a shareholder versus shareholder perspective", http://ssrn.com/abstract=866184, pp.7-8.

the projects for which they grant loans. Employees give their time, knowledge and expertise to earn salaries. Even if welfare of the company is not the best employees are guaranteed their salaries. In other words what is important to recognize is whose contributions is directly allocated with the aim of the certain company to enhance its value and benefit from this enhancement. Only shareholders fit answer to this question. It does not mean that other constituencies are not supposed to be protected. Other constituencies are protected, on one hand, by the company law, the main principle of which, as the principle for each branch of law, to function without violation of others rights and, on the other hand, by other branches of law, which as specified law, could better regulate specific nuances, associated with protection of certain constituencies.
It is obvious that in the companies with diffused ownership, characterized by shareholders coordination problem, the core agency conflict is between shareholders and management whereas the core agency problem in the companies with concentrated ownership is between minority shareholders and majority shareholders.

6.3 The interdependancy of mandatory bid rule and ownership

Mandatory bid rule requirement to share control premium with minority shareholders has different way of influencing on corporate control market in different ownership structures. In concentrated ownership the mandatory bid realizes its effect mostly through eliminating possibility to acquire company with the aim of not enhancing company's value but with the aim of extracting private benefits at the expense of minority shareholders in the size bigger than it is being done by incumbent blockholder. If it were not for that rule the bidder would be able to pay to the controlling blockholder the price consisted of market price of blockholder's shares plus incumbents blockholder's private benefits plus potential bidders private benefits, which he would get by exploiting minority shareholders. Mandatory bid rule requirement to pay the same price to minority shareholder deprives the bidder of maneuver to enhance his benefits at expense of minority shareholders, thus lowering the number of acquisition of control with the aim of exploiting minority shareholders. The other way of influencing of mandatory bid rule on market of corporate control is found in dispersed ownership systems. "In companies with widely diffused shares and with control contestable in the market, the MBR represents an obstacle to partial bids and creeping acquisitions through so-called street sweeps on the market"[80]. In both cases the main purpose of the rule is to prevent acquisition of the company, which would not enhance companies' value but would exploit shareholders.

[80] Luca Enriques, Matteo Gatti, "EC reforms of corporate governance and capital markets law: do they tackle insiders' opportunism?" Stanford Journal of Law, Business and Finance, Fall 2007

There is an argument that mandatory bid rule can be justified only “in the case in which a new shareholder is building up a controlling position in a widely held firm. In this case it could be argued that the minority shareholders are faced with a hitherto unknown controlling shareholder and the risk that he will extract improper "internal" private benefits of control. They might therefore be given an option to exit or to stay on, depending on whether they anticipate net benefits for themselves in the new constellation. If applied to companies that already have a controlling shareholder, the rule seems over-inclusive, since it interferes with a market-mechanism that balances external private costs with external private benefits of control”[81]. However this way of reasoning is inadequate because as was widely discussed above mandatory bid rule does not eliminate all private benefits but aims at eliminating private benefits extracted to the detriment of shareholders’ interests and rights.

Effect of mandatory bid rule in different ownership structures also differs in the sense that mandatory bid rule in concentrated ownership system substitutes market for corporate control, which protects minority shareholders in dispersed ownership. This can be explained as following. As was said before dispersed ownership structures have coordination problems of shareholders, which lead to the difficulties for them to monitor management, which at its turn leads to aggravated agency conflict between management and shareholders. If takeover bids are facilitated in such a market, they would lead that unsuccessful managers or manager who exploit shareholders’ interests will be superseded by managers, appointed by new controlling shareholders, who appear as a consequent of successful takeover bids. In other word hostile takeovers promote market of corporate control, which replace managers, whose performance does not suit shareholders’ interests. In concentrated ownership system, where majority shareholders can monitor management, the agency problem is displaced to between majority shareholders and minority shareholders, as a result, effect of market for corporate control is neutralized to large extant as it cannot restrain opportunistic behavior of majority shareholders as it can restrain opportunistic behavior of managers in dispersed ownership. In such a case mandatory bid rule requirement, providing opportunity for shareholders to exit on fair terms, mitigates majority-minority conflict.

6.4 Optimal ownership structure

There is an instance debate about what type of ownership structure, dispersed or concentrated, is preferable. Two main objects of Takeover Directive are to facilitate takeover bids, which would improve market for corporate control, and to protect minority shareholders rights. “Commentators on corporate governance have implicitly agreed on one theme: Deep, liquid securities markets arise only under special conditions, which include dispersed ownership structure. In their view, dispersed

[81] Karl Hofstetter, “One size does not fit all: corporate governance for "controlled companies”, 2006 North Carolina Journal of International Law and Commercial Regulation, Inc, p.22

ownership is possible only when the legal system provides adequate protection for minority shareholders"[82].

There are authors who disagree with such a statement. "Not only should concentrated ownership not be seen as an obstacle to takeovers, it could even be argued that it would facilitate them because the presence of a ready control block would reduce search costs and other transaction costs"[83]. I disagree. It is true that in concentrated ownership the control block is ready, because it is kept by one person or group of person whose actions are concerted.

However, this fact makes it virtually impossible to buy this block through hostile takeover and it can be unattractive for the bidder to buy other shares of that company on open market as the rest of shares might be less than is needed to acquire control. Thus, it can be seen that in such a case the only way to acquire control is to convince controlling group of person to sell their block. In order to fulfill this, the bidder has to offer the price which would be enough to cover, among other costs, the private benefits of the incumbent shareholders, extracted at the expense of minority shareholders. However, due to exit opportunities of mandatory bid rule, the bidder will not be able to extract private benefits from minority shareholders, which incumbent majority shareholders were able to do, thus he will not be able to cover the cost of control shares. This is not a negative characteristic of mandatory bid rule, as it would serve to facilitate structural change when the bidder are ready to create enough company's value in order to cover all expenses needed to buy control block, which contrary to the instances when structural changes does not bring considerable positive results but only overburdens the company with the cost, associated with structural changes. However this example shows that the fact of existing a ready control block does not serve to facilitating takeovers.

The same author argues that "the prevalence of concentrated ownership does not necessarily imply that the dominant shareholders enrich themselves at the expense of the minority, as is sometimes suggested in some mainly Anglo-Saxon literature. On the contrary, the stability of concentrated ownership would suggest that there is no scarcity of minority investors, as one would expect if they found themselves regularly abused. As argued by Mark Roe, the precondition for concentrated ownership could be an effective system of minority protection without which it would be difficult to attract minority investors"[84]. Again I disagree. Empirical evidence suggests completely different picture. In United States, where dispersed ownership is prevailing, values expropriated at the expense of minority shareholders amounts, on average, to 1 per cent of the purchase price paid by the buyer to the controlling shareholders. In the United Kingdom, where dispersed ownership is also prevailing, values expropriated at the expense of minority shareholders amounts to 2 per cents of the price paid by the buyer.

[82] Dmitry Tuchinsky, "The takeover directive and inspire art: reevaluating the European Union's market for corporate control in the new millennium", 2006-2007 New York Law School Law Review, p. 6

[83] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.9

[84] Ibid.

The picture in countries with concentrated ownership is completely different. For example, the values expropriated at the expense of minority shareholders in Austria, Check republic, Italy, and Portugal, characterized by concentrated ownership structure, tend to account for significantly larger amount, which are 38 per cents, 58 per cent, 37 per cent, and 20 per cent respectfully of the purchase price paid by the buyer to the controlling shareholders. The picture is less aggravated in Finland, Germany, Spain and Sweden where values expropriated at the expense of minority shareholders amounts to 8 per cents, 10 per cents, 4 per cents and 7 per cents respectfully[85]. As can be seen, contrary to what some authors argue minority shareholders are heavier exploited in concentrated ownership companies than in dispersed ownership companies.

Another argument of the same author with respect of concentrated ownership is that in order "to understand why concentrated ownership occurs, we should again turn to the analytical framework of the limited liability company and its relationship with its capital contributors. Limited liability is not just a limitation of risk; it also has important influence on control. Limited liability enables the individual shareholder to give up control and be a free rider. Freed of control and the costs associated with maintaining control of the business enterprise, the shareholder can settle with a small stake that in turn enables her to diversify her risks by investing similar small stakes in other companies. However, being a free rider is risky, although the risk is limited. It may be profitable to take control of the company if you believe that the costs associated with exercising control would be less than the additional profitability of the company after you acquired control. So the choice of the individual shareholder is between free riding and taking charge"[86]. Again I disagree. In most cases shareholders may not prefer to be minority but they just cannot afford to buy control block shares. Most individual investors do not have completely diversified portfolio. On the contrary, employee-investors, for example, have invested a significant amount of their financial surplus in the corporation for which they work[87]. Also minority shareholders carry cost of monitoring controlling shareholders.

Also there is an opinion that agency problem in concentrated ownership systems, is as not aggravated as in dispersed ownership systems. This is because monitoring managers in concentrated ownership systems proved easier than in dispersed ownership systems. However, as has already been discussed above, existence blockholders in concentrated ownership systems creates agency conflict between majority shareholders and minority shareholders. The author of the opinion, that agency problem in concentrated ownership systems, is as not aggravated as in dispersed ownership systems, agrees by himself that preference of the ownership

[85] Simon M. Sepe, "Private sale of corporate control: why the mandatory bid rule is inefficient", http://ssrn.com/abstract=1086321, p. 12.

[86] Jesper Lau Hansen, "When less would be more: the EU takeover directive in its latest apparition", Columbia Journal of European Law, Spring, 2003, p.9-10

[87] Marco Ventoruzzo, "Legal Studies Research Paper Series The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends", Bocconi University, Institutes of Comparative Law (IDC), Research Paper No. 06-07, ttp://ssrn.com/abstract=819764.p.14

system, dispersed or concentrated, depends on the cost of value expropriated at the cost of minority shareholders in concentrated ownership. If this cost is high dispersed ownership is preferable[88]. According to one author the stream of neo-classical thinkers considers that this majority via minority agency problem is rather difficult to resolve. No legal or economic devices exist to provide minority shareholders with wealth-maximization and protection[89]. According to another author there was following significant research. Rafael La Porta and other researchers looked at ownership data in twenty-seven wealthy economies. “A regression analysis showed a correlation between the degree of concentration and the so-called "Anti-Director Index," which was intended to capture the quality of the minority shareholder protection in the various jurisdictions. Countries with a common law history fared better on average in the "Anti-Director Index" and had significantly higher ownership dispersion. Countries with a civil law background scored comparatively lower on the "Anti-Director Index" and showed higher concentrations of ownership. The author therefore concluded that since common law countries protect minority shareholders better than civil law countries, dispersed ownership could develop in the United States and the United Kingdom, but has been lagging in the civil law countries of Continental Europe. The logical implication was that if minority shareholder protection could be improved in civil law countries, ownership structures would develop in the direction of the United States and the United Kingdom”[90].

6.5 Toward a more liquid security market

It looks like not only minority shareholders but also security market will benefit from mandatory bid rule as mandatory bid rule is likely to transform security market to become more liquid. This is because purchasers of the securities will buy in future smaller blocks of shares than they are used to do. This practice will be caused by the fact that such purchases will try to avoid mandatory bid rule. As a result blocks of shares kept now will be split into smaller ones, driving the whole system of ownership into more dispersed. “Since the control premium received in the sale of smaller blocks will be reduced or eliminated, the willingness of large shareholders to engage in these transactions will depend on: (1) the size of the premium associated with smaller blocks, (2) the extent to which the sale affects the shareholder's ability to receive private benefits, and (3) the increased share value caused by a reduction in the liquidity discount. It is far from certain, but adoption of the mandatory bid rule may therefore encourage wider distribution of shares and promote greater development of capital markets

[88] Simon M. Sepe, “Private sale of corporate control: why the mandatory bid rule is inefficient”, http://ssrn.com/abstract=1086321, pp.11- 12.
[89] Giovani Tamburrini Sr., “Harmonization of Takeover Discipline: a Comparative Law and Economic Overview”, La Sapienza, June, 22, 2009, p. 9
[90] Karl Hofstetter, “ One size does not fit all: corporate governance for "controlled companies”, 2006 North Carolina Journal of International Law and Commercial Regulation, Inc, pp.4-5

along the Anglo-Saxon model"[91]. Also apart from redistribution of control premium to minority shareholders and exit right, provided by mandatory bid rule, minority shareholders has another decisive role. By deciding whether to tender their shares or not, they make a conclusive decision of the size of the block the bidder should acquire and, if the bidder want to avoid of buying more, he will be interested to provide to shareholders fair treatment and guarantee from abuse of their rights. Such guarantee, given by mandatory bid rule that shields minority shareholder's interests might lead to the higher rate of participation of minority shareholders in financing companies through investment, which would again lead to smaller blocks of shares kept by individual shareholders, which is characteristic of dispersed ownership system.

[91] Scott Mitnick, "Cross-border mergers and acquisitions in Europe: reforming arriers to takeovers", 2001 Columbia Business Law Review, p.12

7 The regulatory weakness of mandatory bid rule

Mandatory bid rule, as opposed to board neutrality rule and breakthrough rule, is binding for all the Member States. However, there is general provision of Directive which impairs the binding force of mandatory bid rules, by providing a wide range of discretion of Member States to implementation of mandatory bid rule. One of them is declared by article 4, paragraph 5:

> Provided that the general principles laid down in Article 3(1) are respected, Member States may provide in the rules that they make or introduce pursuant to this Directive for derogations from those rules:
>
> (i) by including such derogations in their national rules, in order to take account of circumstances determined at national level
>
> and/or
>
> (ii) by granting their supervisory authorities, where they are competent, powers to waive such national rules, to take account of the circumstances referred to in (i) or in other specific circumstances, in which case a reasoned decision must be required.

In addition to this rule, there is specific provision permitting deviation from the mandatory bid rule in article 5, paragraph 4, which states:

> Provided that the general principles laid down in Article 3(1) are respected, Member States may authorize their supervisory authorities to adjust the price referred to in the first subparagraph in circumstances and in accordance with criteria that are clearly determined. To that end, they may draw up a list of circumstances in which the highest price may be adjusted either upwards or downwards, for example where the highest price was set by agreement between the purchaser and a seller, where the market prices of the securities in question have been manipulated, where market prices in general or certain market prices in particular have been affected by exceptional occurrences, or in order to enable a firm in difficulty to be rescued. They may also determine the criteria to be applied in such cases, for example the average market value over a particular period, the break-up value of the company or other objective valuation criteria generally used in financial analysis.
>
> Any decision by a supervisory authority to adjust the equitable price shall be substantiated and made public.

In other words, Member States may provide rules to derogate from the mandatory bid rule or grant supervisory authorities the power to decide about the possibility of such derogation on case-by-case basis. However, both this provisions starts with the requirement that the general principles laid down in Article 3(1) are respected. “It seems that an exemption from

the Mandatory Bid Rule will still leave some conduct caught by Article 5 prohibited by the Directive because it would place the national competent authority in default of Article 3, paragraph 1 of the Directive"[92].

As commission report on the implementation of the Directive on Takeover Bids Member States have widely used the flexibility provided by the Directive to derogate from the Directive's provisions in order to maintain their exceptions from the mandatory bid rule. Some of these exceptions are necessary to ensure that this obligation applies only where the holding actually confers control, while others are more far-reaching. Furthermore, in some Member States, supervisory authorities seem to have extensive powers to grant exceptions from the rule. Exceptions and wide-ranging discretionary power can undermine the effectiveness of the protection provided by such a rule[93].

[92] Thomas Papadopolous, "The mandatory provisions of the EU Takeover Bid Directive and their deficiency", Law and Financial market review, November 2007, http://ssrn.com/abstract=1088894
p.3.

[93] Commission report on the implementation of the Directive on Takeover Bids, Brussels, 21.02.2007, SEC(2007) 268 page.10

8 Conclusion

Takeover Directive was adopted with the assumption that its provisions are highly beneficial for companies, companies' different constituencies, including minority shareholders and for European economy as a whole. However, there are different contradicting opinions and research results which doubt positive effects of mandatory bid rule.

Passage of mandatory bid rule has successfully overcome a considerable antipathy of member states toward uniform regulation of takeover bids. However, some political controversies remain strong, which has lead that some aspects of the mandatory bid rule regulations represent a significant compromise, which is apparent in flexibility that Directive affords to member states in adopting mandatory bid threshold and period for calculating equitable price. However, the whole effect of adopting mandatory bid rule represent a significant legislative achievement in both as a step toward more harmonized regulation of takeover bids on European level and in substantive effect of mandatory bid rule.

Extensive debate exists regarding the necessity and fairness of mandatory bid rule, with particular attention focused on two possible justifications for mandatory bid rule. They are:

1. The necessity to favor distribution of a controlled premium to minority shareholders,
2. Necessity to allow minority shareholders to exit on terms that are no less beneficial than those provided for shareholders who sold their controlling position.

Although there are theories favoring disproportionate redistribution of control premium between controlling shareholders and minority shareholders, based on the hypothesis that controlling shareholders have paid for their privileges, there are strong counterarguments. One of them is that cost paid by controlling shareholders is outweighed by benefits they derive from controlling position, including benefits derived at the detriment to minority shareholders. Thus it would be too much to grant to controlling shareholders additional privileges in the term of disproportionately high control premium. Also the author of the thesis has come to conclusion that control premium belongs not purely to the company or majority shareholders but, as all other assets of the company, to all shareholders in proportion to their shares. That is why control premium must be redistributed among all shareholders of the company, including minority shareholders.

The necessity for exit is dictated by the fact that without mandatory bid rule minority shareholders would be deprived of possibilities to exit on fair terms and thus would either be trapped as minority shareholders, whose rights can easily be violated by majority shareholders, or be forced to sell their shares at unfair low price.

The general conclusion about mandatory bid rule can be that it aims at protecting minority shareholders interests and, as different theories and scenarios such as free-riding and pressure to tender show, minority

shareholders need such protection. However, such a protection of minority shareholders in some cases leads to the trade-off between protection of minority shareholders and efficient control transfer. Although a mandatory bid rule eliminate some value reducing takeover bids, the mechanism of mandatory bid rule, adjusted for minority shareholder protection, excludes some value increasing takeover bids. Because of possibility of mandatory bid rule to exclude some value increasing bids Directive took a cautious position in article 4 paragraph 5 and article 5 paragraph 4, which provide rules for Member States to derogate from mandatory bid rule or grant supervisory authorities the power to decide about possibility of such derogation on case-by-case basis. The rules significantly impair the effects of mandatory bid rule, especially because Member States have widely used this flexibility to derogate from the directive provisions.

Regarding threshold of acquired voting rights or voting capital, which triggers mandatory bid rule, legislatively defined control proved to be more reliable and operative than other methods of defining control. Takeover Directive adopted this legislative approach. However, such method of defining threshold might have different effects in different types of ownership and control, some of which can lead to possibility to avoid mandatory bid rule while having de-facto control. Due to this, Directive does not specify the threshold that qualifies control but leaves it open for each Member State to decide their own specified percentages of voting rights, taking in consideration their specific market and ownership structure.

Also the obligation to make an offer in mandatory bid at an equitable price is indeed a big step on European level, especially in fact that it expands to Member States that did not have mandatory bid rule before. On one hand, equitable price provides equivalent treatment of holders of security of the same class, and serves as incentive for the bidder to set the price offered in the mandatory bid at a reasonably high level. Also the definition of price in mandatory bid rule prevents long drawn proceeding of determining the price. On the other hand, some flexibility allowed by mandatory bid rule in defining period, on the basis of which equitable price is to be defined, allows to consider diversity of national regime toward the application of consideration for shares.

With respect to effect of mandatory bid rule in different market and ownership structure it seems that, although sometimes through different means, mandatory bid rule effectively fulfils its task in both type of systems. Moreover, mandatory bid rule has the potential to facilitate restructuring of concentrated ownership into more dispersed one, which suits both protection of shareholders and creating more liquid market, which at its turn will bring countries with concentrated ownership closer to systems of countries with dispersed ownership, which is positive effect.

In sum, then, the European mandatory bid rule seems to fit quite closely with the purposes of the legislation: encouraging takeovers while protecting shareholders, especially minority shareholders.

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