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The Takeover Directive

- and Its Implementation in Germany, UK and Sweden

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Summary

One of the main purposes in EU is increased competiveness on the European market and to achieve the goal; the European Commission made a proposal of a Directive on Takeover Bids which would facilitate the takeover activity in EU. Takeover activities essentially signify when a company purchases shares in another company which occasionally also leads to a takeover of the control of the target company. The proposed Directive was inspired by the UK regulation on Takeover Bids "the Takeover Code" and contained several rules that would obstruct the use of defensive measures applied in relation to impeding an offer. For example, the proposal of the Directive contained a board neutrality rule requiring that the board of the offeree company cannot take any defensive measure in order to frustrate a bid unless it is supported by the shareholders. In addition, the Directive contained a breakthrough rule aimed to neutralize pre-bid measures, e.g., striking out multiple voting rights by using the 'one share - one vote' principle.

Owing to Member States' different regulations on takeovers, the Directive based on Anglo-Saxon regulation, was strongly criticized by the European Parliament and several Continental Member States and especially by Germany. The corporate structure in Germany is, unlike the UK's focus on shareholder value, instead focused on the company and its stakeholders. Several authors have also claimed that the Directive might damage companies in Member States using dual class share system (*i.e.,* companies with shares carrying different amount of votes).

As a reaction to the criticism, the Commission amended the Directive and made the breakthrough rule and the board neutrality rule voluntary. The implementation of the Directive thus varied among the Member States since some States including Germany chose to refrain from the adoption of the board neutrality rule. Moreover, none of the Member States (except for the Baltic States) implemented the breakthrough rule which was a disappointment for the Commission since the rule is significant for the achievement of increased competitive market. Another purpose with the Directive is a mutual regulation on takeover bids in EU but since the Member States have implemented and interpreted the Directive differently; neither is this purpose accomplished.

With this project I intend to illuminate some of the purposes behind the Takeover Directive and to clarify why they have not been able to be achieved. In addition, I will examine the implementation of the Directive by a comparison between Sweden, the UK and Germany and explore whether the implementation of the Directive has affected the Member States' national law. Finally, owing to the Member States' various regulations of corporate governance, legal structure and market economy; I will explain the problems with a mutual regulation on takeover bids in the EU.

Sammanfattning

Ett viktigt syfte inom EU är ökad konkurrens på den Europeiska marknaden och för att målet ska uppnås föreslog den Europeiska Kommissionen ett Direktiv som reglerar uppköpserbjudanden vilket skulle bidra till förenklade förvärv av företag på den gemensamma marknaden. Företagsförvärv innebär huvudsakligen att ett företag köper aktier av ett annat företag vilket även ibland kan leda till övertagande av kontrollen i målbolaget. Det föreslagna Direktivet var inspirerat av den engelska regleringen av uppköpserbjudanden "the Takeover Code" och innehöll vissa regler som försvårar införandet av försvarsåtgärder som i regel används för att försvåra ett bud. Som exempel på sådana regler kan nämnas styrelseneutralitetsregeln som kräver att styrelsen i målbolaget måste ha stöd från aktieägarna för att få lov att införa försvarsåtgärder. Även den s.k. genombrottsregeln är ämnad att neutralisera försvarsåtgärder, bl. a. genom att neutralisera aktier med olika röstvärden så att varje aktie är värd en röst oavsett aktiens tidigare värde.

På grund av medlemstaters olika regleringar av företagsförvärv blev Direktivet som baserats på den anglosaxiska rätten kritiserat av både det Europeiska Parlamentet och medlemsstater med ett kontinentalt rättssystem, speciellt av Tyskland. Den tyska bolagsstrukturen skiljer sig nämligen från den engelska som är inriktat på aktieägarna eftersom Tyskland fokuserar på övriga intressenter i ett bolag samt på bolaget som sådant. Även författare har hävdat att Direktivet riskerar att skada företag i medlemsstater vars bolagsstruktur består av aktier med olika röstvärden. Kommissionen bemötte kritiken genom att modifiera Direktivet och göra genombrottsregeln och styrelseneutralitetsregeln frivilliga. Därav har implementeringen av Direktivet varierat mellan medlemsstaterna eftersom vissa stater inklusive Tyskland har valt att avstå från att implementera styrelseneutralitetsregeln. Vad beträffar implementering av genombrottsregeln så har inga stater (förutom de Baltiska staterna) till Kommissionens stora besvikelse antagit denna regel. Besvikelsen består i att genombrottsregeln med stor sannolikhet skulle ha bidragit till att uppnå syftet om ökad konkurrens på företagsmarknaden. Ett annat syfte med Direktivet är en gemensam reglering av upphandlingserbjudanden inom EU men med anledning av att stater har implementerat och tolkat Direktivet olika har inte heller detta syfte kunnat uppnås med hjälp av Direktivet.

Det är min målsättning att genom detta arbete belysa några av de syften som står bakom Direktivet och redogöra för varför de inte har varit möjliga att uppnå. Jag kommer dessutom att genom en jämförelse av implementeringen av Direktivet mellan Sverige, England och Tyskland undersöka hur införlivandet av Direktivet har påverkat medlemsstaternas nationella lagar. Slutligen, med anledning av medlemsstaters olika regleringar av bolagsstyrning, rättslig struktur samt marknadsekonomi ska jag förklara problemtiken med en gemensam reglering av uppköpserbjudanden inom EU.

Preface

First and foremost I would like to thank my mentor Henrik Norinder for his support throughout the project. In addition, I am very grateful for the comments and thoughts made by Jonas Björlin, Rick Fernández, Dennis Andersson, Svante Lifvergren and Magnus Nygren. Finally I want to thank my mum and dad for being the most supportive parents throughout my studies.

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Malin Hamnered

Abbreviations

AMN	Aktiemarknadsnämnden
Art.	Article
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
CEO	Chief Executive Officer
CME	Capital Market Economy
EC	European Community
e.g.	for example
EEA	European Economic Area
et. al.	et alia
EU	European Union
ECJ	European Court of Justice
FI	Finansinspektionen
FSE	Frankfurt Stock Exchange
LME	Liberal Market Economy
LUA	Lagen om Offentliga Uppköps-erbjudanden
M&A	Mergers & Acquisitions
MBO	Management by Objectives
MTF	Multilateral Trading Facility
NBK	Näringslivets Börskommitté
Prop.	Proposition
SOU	Statens Offentliga Utredningar
UK	United Kingdom
US	United States
v.	verses
WpÜG	Wertpapiererwerbs- und Übernahmgesetz

1 Introduction

1.1 Takeover activity

Takeover activities essentially signify when a company purchases shares in another company which occasionally also leads to a takeover of the control of the target company. This action is a growing phenomenon on the business market and the most obvious reason for conducting a takeover is to achieve increased synergies; when the two companies are combined, the individual value of each company will in a long-term perspective increase as a result of the merger. Takeover activities thus play an important role on the business market.[1] However, rules that regulate the process vary significantly among countries. The regulation on takeovers in Germany is for example relatively restrictive. Firstly, the German corporate structure is characterized by a two-tier board system; in addition to supervisors, the board management shall contain representatives of the company's employees in order to protect the workers. Secondly, the board management does not need an approval by the company's shareholders when applying defensive measures in order to frustrate an offer made to the company. While the German corporate structure is based on the principle that decisions shall be made in the best interest of the company the UK on the other hand states that decisions shall be made in the best interest of the shareholders. UK, on the opposite of Germany, supports takeover process for the achievement of a competitive market. Companies in UK belong to a one-tier system where the management board has less influence while the shareholders have a greater power to take decisions concerning the company.

Owing to the differences between the Member States' regulation of corporate governance, legal structure and market economy; this thesis contains a comparison between Sweden, the UK and Germany in order to distinguish the differences thus clarifying current legal position in EU and domestic law. Prior to the comparison however, is a case study presented to demonstrate a hostile takeover of a company. The case is based on the famous takeover of the German telecom company Mannesmann made by the English telecom company Vodafone. The case is famous since the acquisition is the largest and most expensive takeover the world has seen to date.[2] Moreover, this is the first time Germany has faced a hostile takeover substantial to realize that the German law in some aspects are not sufficient.

1.2 Purpose and problem

The Directive on Takeover Bids has been contested by many legal scholars and the aim with this project is to examine whether the allegations are legitimate or if the Directive might be valuable for the corporate market in

[1] Dey, Joy, Efficiency of Takeover Defence Regulations, 2009, p. 2.
[2] Kolla, Peter, The Mannesmann Trial and the Rule of Courts, 2007, p. 829.

EU or if both statements may be supported. In order to take a position, I have three questions set forth to respond within this project:

- Does the Takeover Directive serve its purposes?
- How has the implementation of the Directive affected the Member States' national law?
- Is a mutual regulation on takeover bids in EU reasonable for the Member States?

These questions will be examined throughout Chapter one to four and eventually answered in Chapter five, the analysis.

1.3 Method and material

The methods that I have used for this project are firstly the traditional legal dogmatic method. Thus, the project is based on descriptions of the domestic laws and their preparatory works and national case law from Germany, the UK and Sweden. In addition, secondary Law, the Directive on Takeover Bids and its preparatory work, have been examined as well. Moreover, to answer the questions presented in 1.2; information from legal literature for instance books, doctrines and articles by legal scholars have been critical.

Additionally, for the comparison in Chapter four regarding how the Directive was implemented in Germany, Sweden and UK, I have applied a comparative legal method in order to illuminate differences in implementation of the Directive among the countries.

Besides the area of law, this thesis concerns political science and some economics as well. These areas are presented mainly in Chapter two and three and to some extent in the analysis. Facts and opinions are in this sentence supported by articles by legal scholars.

1.4 Delimitation

The project mainly focuses on the implementation of the Directive on Takeover Bids in the EU and a comparison between three Member States (Sweden, UK and Germany) felt sufficient. Even though a comparison with a non-member state like US would be relevant; that is beyond this scope. In addition, certain defensive measures will be mentioned since one of the Takeover Directive's intentions is to eliminate these defenses. However, defenses like antigreenmail provisions, reincorporation and crown jewel defenses will not be discussed.

In respect of the Directive's many provisions, I will mainly focus on three rules regarding board neutrality, breakthrough and mandatory bid and to some extent the rule of optional arrangements. However, rules governing right to "squeeze-out" in favor of minority shareholders and the requirement to make a public bid transparent are omitted from this thesis.

1.5 Disposition

This project is based on takeover activities in the EU and a clarification of certain rules and measures associated with the process is thus enclosed in the scope. Notwithstanding, certain knowledge of company law and specifically mergers and acquisitions might be preferable to obtain a better grasp of the thesis. For more information in-depth, I truly recommend the books "the Anatomy of Comparative Company Law" and "Mergers, Acquisitions and Corporate Restructurings".

The project begins with a presentation of the German (and UK to some extent) history in Chapter two where substantial elements of German corporate governance are illuminated. The Chapter continues with a case study of the hostile takeover of the German telecom company Mannesmann exemplifying the consequences of when these elements are set aside. The Chapter moreover defines defensive measures useful for the avoidance of a hostile takeover. Chapter three gives an introduction of the Directive on Takeover Bids and its aim to maintain a level playing field in EU, *inter alia* by hampering the application of defensive measures. The Chapter furthermore sets forth a detailed description of three of the Directive's main rules including the breakthrough rule, the no frustration rule (also recognized as board neutrality rule) and the mandatory bid rule. The section is concluded by a discussion in respect of the three rules and some other comments on the Directive. The subsequent Chapter consists of a comparative study between Sweden, UK and Germany and examines what has been implemented and how it was implemented in the different states. Chapter 5 contains the project's analysis and is thus the project's main core. The three questions set forth in the first Chapter will be examined and also answered. Eventually, the project will be concluded in Chapter 6 with some final remarks.

2 Background

2.1 Introduction

This Chapter begins with an explanation of the German history and briefly about some elements of the history of UK. The reason for focusing mainly of German history depends on the upcoming case study where changes in German history were significant for the outcome; a hostile takeover of a German company made by a foreign company. In order to understand the reasons for why a hostile takeover was possible in Germany, it is appropriate with a presentation of German history and how it has been changed during recent years.

2.2 History

Corporate governance in Germany has long been identified by the German Model (Modell Deutschland). The German Model is distinguished not only by banks' influence on the board's decisions and the allowance of golden shares, it additionally contains certain limited rights for workers to participate and contribute to decisions in the management of a corporation, subject to co-determination.[3] The German Model has lately experienced alterations due to some modifications of its cornerstones banks' influence and co-determination, further explored *infra*. Additionally, the existence of institutional investors may have transformed its guidelines. The German Model had its golden age until the 1970's, when the system faced several harsh difficulties that subsequently caused unemployment and economic restructurings, due to economic crises. Around this time, Germany also underwent several political changes, beginning with the coming to power of a right centered leader in the 1980's who had a vision based on a market-oriented system similar to the Anglo-Saxon model (described *infra*).[4] An important keystone of the German Model is the banks' influence over corporations. Banks typically played a defensive role against hostile takeovers under the system of "Depotstimmrecht", which allows banks to vote on behalf of shareholders at annual shareholder meetings.[5] However, as banks during the 1990's went from being house-banks, *i.e.*, arranging payment transactions within a company, to becoming investment banks, their former activities within the company declined. By contrast, the banking systems prevalent in the US as well as in the UK differ from the German structure on several key points. For example, banks in the US and the UK are divided and separated from the corporation. Additionally, these banks initially operate solely with deposits and credits or securities.[6] In spite

[3] Beck, Stefan et. al., Surviving Globalization? 2005, p. 3.
[4] Beck, S, et. al., p. 6.
[5] Callaghan, Helen et. al., Insiders, Outsiders, and the Politics of Corporate Governance, 2009, pp. 741-742.
[6] Beck, S, et. al., pp. 117-118.

of the fact that bank control has diminished over the recent years, they still possess substantial portions of shares in German companies.

More recently, institutional investors such as insurance companies, pension funds and hedge funds have appeared in German market; this appearance has substantially affected the German Model by leading the Model one step closer to a so-called short term market. Once an investor has obtained a larger block of shares in a company, the termination of such a relationship by selling their block of shares often results in economic losses for the company. Moreover, the more influence investors gain by an increased invested capital, the less opportunity for minority shareholders to have a say in respect of decision rights, controlling the value of shareholders, *etc*. Owing to the increase of investors' decision-making power, the desire to adapt the Anglo-Saxon version in certain legal fields including accounting rules has become more common among investors. This includes disregarding the principle that assets should be valued at cost rather than at market pricing that represented the German doctrine for asset valuation and in its stead focusing on a system ranking disclosure of profits and losses to shareholders.[7]

Another important element of the German Model used to be (and still is, to some extent) 'parity codetermination'.[8] The German corporate system is divided in two parts where workers, trade unions and codetermination represent one of the two parties.[9] The principle requires the supervisory board of a company to be represented by as many workers as there are capital representatives of the business' main area.[10] In the upcoming case study it is declared that the supervisory board has failed to achieve this equality, which facilitated the hostile takeover.[11] The rule may also be identified as the counterpart to shareholder value pursuant to its concerns for stakeholders. Despite its impact on preventing companies from hostile takeovers, its effectiveness has in recent days waned as a result of international mergers and global changes in corporate structures.[12] The Mannesmann-case clearly illustrates a case where co-determination did not serve as a preventive measure against a hostile takeover of a company. The term 'co-determination' is by outside parties (mainly from other countries) associated with hindrance in the investment, thus causing pressure on Germany to alter the German system. The last and maybe one of the most important elements representing the German Model is the usage of golden shares, defined in Section 2.3.1.3. Golden shares are owned by the government and contains a veto right for the holder to deny a hostile takeover. The opportunity for the state to invest in a company is thus

[7] Beck, S, et. al., p. 125.
[8] In German terms 'Montan-Mitbestimmung'.
[9] Beck, S, et. al., p. 9.
[10] This area is in general, as in the Mannesmann-case, mining or steel and iron industry.
[11] Höpner, Martin, et. al., Ensteht Ein Markt für Untemehmenskontrolle? 2001, pp. 547-548.
[12] Beck, S. et. al., p. 125.

permitted, which might thereby prevent a hostile takeover, provided that it is not in the best interest of the state.[13]

2.3 Case Study: the Mannesmann Takeover

By way of introduction, an illustration of miscellaneous factors emerging in relation to a cross-border acquisition appears to be appropriate as a case study. Thus, the takeover by the British company, Vodafone Airtouch, of the German company, Mannesmann AG, in 2000 will serve as the framework for this purpose. The takeover was not solely hostile and initiated by a foreign corporation; it was the largest and most expensive acquisition the world had seen to date.[14] Before revealing the relevant details it is vital to set forth three questions in order to acquire a greater understanding of the case, namely: *what* happened, *how* it did happen and *why* it happened. These fundamental questions will be followed by the outcome realized from the hostile takeover.

When studying the corporate structure of German Law at first glance it is almost inconceivable to believe that an acquisition equal to the present one could occur as easily as it did without any red flags. Specifically, the German legal system virtually deters foreign companies from even offer a hostile bid for a company incorporated in Germany due to specific barriers imposed in corporate governance institutions. These obstacles include, for instance, concentrated ownership, bank monitoring, vague disclosure in insider management and co-determination, where the last obstacle was critical in respect of accomplishing the takeover. *What* actually happened was that Mannesmann, founded in 1890 as a producer of seamless tubes, quite soon diversified into coal and steel and automotive products and as a result the company shortly thereafter controlled two-thirds of the telecommunication market in Germany. In October 1999, Mannesmann made a takeover of the British telecom company Orange. Vodafone, a telecommunication company that, like Orange, was based out of the UK perceived the takeover as a competitive threat. For that reason, Vodafone made a proposal to Mannesmann for a friendly merger, which Mannesmann's CEO at that time rejected. Subsequently, Vodafone instead initiated a new public bid to the shareholders worth €124 billion compared to the former offer of €100 billion, a great deal for shareholders and hard to resist.[15] Consequently, when Vodafone held 98.66% of the share capital in the target company, several key factors were revealed throughout the takeover process, including the following three:

From the public point of view, the *ex post* severance package of € 6.9 million distributed to Mannesmann's former CEO Ackerman, supplemented

[13] Angelov, Peter, et. al., Comparison of Takeover Directive in UK and Germany, 2009, p. 21.
[14] Kolla, P, p. 829.
[15] Höpner et. al, 2006, p. 145-148.

by further pension enhancements and awards to some other members of the board, was by far the greatest factor.[16] By that point, Vodafone, which held 98.66% of the share capital in the target company, gave its full support to conduct this allocation to the former board members.[17] The arrangement was brought to court and, pursuant to §266 of the German Criminal Code,[18] the court concluded that Ackerman *et. al.* might be liable for breach of fiduciary duty owing to dissipation of corporate assets. This arrangement was considered a violation of the principle of [economical] duty of care that plays a significant role in the acquisition of a company.[19] Another circumstance that had an impact on the court's reasoning was the fact that there had been no pre-negotiations whatsoever of golden parachutes. That is a contract drafted in advance providing for severance payment and is normally perceived as a fundamental condition for the validity of benefits like the ones involved here (*see* section 2.3.3).[20]Apart from the issue of severance pay and benefits, a further significant incident was the use by another CEO of Mannesmann (Esser) of a white knight, when a board seeks for an alternative bidder (definition set forth under 3.2.3). In connection with the takeover of Mannesmann, the European Union Competition Regime required a divestment of the above mentioned Orange Company in order to prevent a monopoly within the telecom sector market. Therefore, Esser introduced a French company which would participate in the merger. Meanwhile however, Vodafone offered the Orange Company to the potential white knight and when the French company accepted the deal initiated by Vodafone, it became clear that the white knight strategy had failed. Moreover, the total costs of the takeover defense, including expenses for advertisements, investment banks and lawyers, ended up being € 432 million for Mannesmann. Vodafone further invested an amount three times larger than those costs on pure advertising. This illustrates well that takeovers are often costly an it is occasionally hard to be compensated due to miscalculation of synergy effects. With that being said, the next critical issue is: *How* did Vodafone become the owner of 98.66 % of the shares without more objections from the management or other parties affected by the outcome?

To answer that question, those parties that typically have a great influence on a potential takeover will now be enumerated. In Germany, banks are institutions that tend to play a defensive role in respect of takeovers. Lately however, banks have gone from customary house banking, *i.e.,* centralization of cash management in a company, to investment banks focused on selling shares. The moderate passivity of Mannesmann's major bank, Deutsche Bank, during the negotiations may for that reason have had an impact on the final decision.[21] One aspect that otherwise could have been

[16] The total amount of pension enhancements and awards allocated on 18 executives was worth approximately €60 million; *see* Peter Kolla, p. 830.
[17] BGH 3 StR 470/04 – Judgement of 21 December 2005 (LG Düsseldorf), Section 5-6.
[18] Strafgesetzbuch (Criminal Code).
[19] BGH 3 StR 470/04 – Judgement of 21 December 2005 (LG Düsseldorf), Section 86.
[20] Kraakman et. al., p. 77.
[21] Höpner et. al., pp. 145-152.

decisive for the outcome regards the unused poison pills (*see* 3.2.1) and in this context it specifically concerns co-determination (co-determination is defined *infra*, see section 2.1 subsection 3). This defensive strategy has been quite effective within more traditional areas of commerce, such as steel, and it had a powerful effect on Mannesmann's board for several years, since the Supervisory Board appeared to be neutral and because of the board's constituency of labor representatives. Nevertheless, the board contested its influence in the 80's, which led to a dispute in which the Constitutional Court ruled in favor of Mannesmann. Overall, the decreasing utilization of co-determination in Mannesmann over the past years eased the convenience of an acquisition. Additionally, practically none of the foreign investors in the target company opposed the takeover. To the contrary, when the bid rose to €124 billion, so did the value of their shares. Despite warnings from the labor union, employees sold their shares for the same reason. A final aspect that deserves some attention in regard to the ease of the takeover involves contemporary politicians' choice to refrain from participating in debates illuminating the bid, which instead was shareholder-oriented. The remaining and probably most vital question, *why* the takeover occurred in the first place, carries fairly obvious answers.

From Vodafone's point of view, the acquisition of Mannesmann was necessary as the target company was considered as a threat; especially after Mannesmann's acquisition the British Orange Company. Additionally, Mannesmann had a turnover of €23 000 million compared to Vodafone's € 13 000 million. While a company with 130 000 employees may be attractive for a company like Vodafone with only 30 000 workers, the transaction most certainly was aimed for making long-term profits for Vodafone. Vodafone's market value was at that point estimated to €150 000 million whereas Mannesmann held €120 000 and as the bid rose from €100 billion to €124 billion, minority shareholders simply saw an opportunity to make a good deal, which answers why they repurchased their shares.[22] Additionally, the former CEO Esser was offered a severance payment estimated to €60 million, which could be a reason for Esser's passivity in not using more defensive measures than the white knight. Despite the bonus, it is nowadays quite common for managers to switch boards occasionally.

The present case study is about to be concluded and a further treatment of the Mannesmann case within this project, with a deeper analysis of its affections, significance etc. on German Law is therefore not included in this section. Nonetheless, a final comment is warranted regarding Vodafone's unwillingness to keep a promise. When signing the agreement, Vodafone undertook several guarantees, including the promises of maintaining certain subsidiaries of Mannesmann and that other business within the corporation would remain undivided. Neither of this promises was kept, a circumstance that might have an impact on the company's insiders, such as the employees. Employees are in relation to takeovers quite vulnerable and are likely to obtain less protection after a takeover. On the other hand, Vodafone

[22] Höpner et. al., pp. 148-150.

simultaneously employed 10 000 people in Germany during 2006 owing to acquisitions of other companies. On the whole, this hostile takeover had a substantial impact on the attitude towards corporate control in Germany, an issue elaborated later in this project.[23]

2.4 Defensive measures

This section contains a presentation of defensive measures taken in connection with a takeover bid. They are divided into pre-bid measures which are present before a bid is made public and post-bid measures which are applicable once a bid has been public. The presentation is followed by a discussion in Chapter 3 illuminating consequences that may occur pursuant to the Directive's opinion against these measures. That is because Member States' regulation in respect of the measures vary widely.

2.4.1 Pre-bid defensive measures

In order to protect a company from being inappropriately acquired either by disreputable bidders or at an undervalued amount, the usage of defensive measures in connection with a hostile bid enables the management board of the target company to reduce the occurrence of undesirable risks. While most companies in continental EU countries apply such measures frequently, those in the UK rarely use them despite their opportunity to do so.[24] The measures are divided into two categories: pre-offer defenses and post-offer defenses. The former is aimed to prevent a company from taking control over a target company in a situation where the management in the target company must value the offer accurately.[25] Therefore, pre-offer strategies apparently delay the whole process, resulting in more time for the target board to evaluate whether the takeover proposal is positive for the target company or not. Too many defenses however, could turn an initially good deal into a worthless one. Courts therefore generally have the authority to forbid defenses barely utilized that interfere with the firm's management.[26] The most common pre-offer defenses are poison pills, shark repellents and golden shares.[27]

2.4.1.1 Poison Pills

Poison pills are used either before or at the time that the takeover bid has been announced. As the transferee actually acquires a specific percentage of the target company (most commonly at least ten percent), the board of the target company replies by issuing additional dividends to its shareholders.

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[23] Höpner et. al., pp. 151-152.
[24] Ipekel, Ferna, Defensive Measures under the Directive on Takeover Bids and their Effect on the UK and French Takeover Regimes, 2005, p. 341.
[25] DePamphilis, Donald, Mergers and Acquisition Basis: All You Need To Know, 2011, p. 73.
[26] DePamphilis, D., p. 94.
[27] DePamphilis, D., pp. 84-85. Due to this project's limitation, other pre-offer defenses like measures of antigreen-mail provision and reincorporation will not be scrutinized in the upcoming.

The poison pills are either flip-in pills or flip-over pills, where the prior permits shareholders in a target company to purchase shares in the target company's common stock at a price lower than market value. From an acquirer's perspective, this method is disadvantageous due to the expansion of shares that have to be purchased by no one but the acquirer through an exchange of cash or share for each additional share that has been issued. The latter pill authorizes shareholders in the target company affected by the acquisition the priority to purchase shares either in the acquirer's firm or in the company emerging from the acquisition. As a consequence, the acquirer has to compensate its shareholders because of the dilution occurring as a result of the newly issued shares. Subsequently, irrespective of which of the flip-in pills (shares purchased in the target company) or flip-over pills (purchasing shares in the firm of the acquirer) is used; the acquirer nevertheless has to generate more shares in either case. What differentiates the two poison pills from each other is a matter of generating shares in the target company or in the transferee's firm, respectively. As there are always two sides to a coin, these defensive measures likewise have their pros and cons. On the one hand, poison pills may protect a firm from losing all its stock without the endorsement by the management board. The board's authority to stop using the pills increases the chances of remaining independent despite a substantial acquisition. On the other hand, the pills might be an initial opportunity for unsatisfied shareholders in the target company to entrench the management and conduct litigation. As a result, boards occasionally struggle between offering rights for shareholders by exerting poison pills and simultaneously withdrawing pills that are present.[28]

2.4.1.2 Shark repellents

Shark repellents are a measure that impedes a takeover by requiring that the board shall be reelected several times or that only cash offers are permitted.[29] The main purpose of shark repellents is the maintenance of board members' control in a company by proposing amendments in the corporate charter, which is; a covenant identifying a company's name, purpose, and board members, *etc.* Amendments in the corporate charter require approval at shareholders' meeting and the measure therefore affects a takeover economically and in time. Recently, the measure is used in combination with poison pills in order to prevent unnecessary expenses and the loss of time.[30] Shark repellents are furthermore allocated in staggered and classified board elections. By dividing the board members' seats into different classes where each class is reelected in different years, the risk of having an entire board replaced over a shorter period is reduced markedly. Therefore, a stockholder who may hold the majority of the shares, still needs to wait as many years as there are classes until obtaining the control of the board. Additionally, the charter usually contains restrictions, such as

[28] DePamphilis, D., pp. 75-78.
[29] Stattin, Daniel, et. al., Bolagsorgan och Bolagsstyrning, 2009, p. 138.
[30] DePamphilis, D., p. 78.

banning the addition of more board seats with the goal of gaining more control of the board.[31]

2.4.1.3 Golden Shares

When looking into the history of golden shares it is obvious that their significance has been modified over time. Perhaps the fact of being subject to certain disputes in the EU may be the reason for their variable meaning.[32] The current definition, however is that 'golden shares' provide special rights to maintain control over companies that are embedded with this type of shares. The shares are typically owned by the government and provide it a veto to deny hostile takeovers even though the shares may not correspond to a larger percentage of the total shares. The use of such preventive action is usually argued for as being in the public's interest, to decrease the risk of having the firm end up in wrong hands and for maintenance of public health, public security and national defense. The EU since the end of 1990 has been an opponent of golden shares based on the opinion that golden shares hamper cross-border investment and remove managers from the market of corporate control. Since holders of golden shares in general have a great influence on the economy, the EU proposes that States using golden shares instead should impose principles that derive from public law, such as regulation of corporate activity. By doing so, the measures would become more transparent than before, thus enabling a legal review by courts.[33] Disputes concerning golden shares have occasionally been the subject of EC case law. In the *Volkswagen-case,*[34] the ECJ deemed that the golden shares interfered with the provisions of Art. 56 EC Treaty regarding free establishment and movement, and that the golden shares interfered with foreign investors' opportunity to invest in that company. More precisely, it was the Volkswagen's Act, an agreement between Germany, Lower Saxony,[35] the trade unions and employees of the car company Volkswagen, which conflicted with the provision in Art. 56, partially because of Lower Saxony's great influence over Volkswagen. Notwithstanding this, the ECJ concluded that restricting free movement of capital through golden shares should not be deemed impermissible in general European Law.[36]

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[31] DePamphilis, D., pp. 81-82.

[32] For other cases regarding golden shares, see ECJ 26 Mar. 2009, Commission of the European Communities v. Italian Republic, C-326/07, ECR [NYR], ECJ 23 May 2000, Commission of the European Communities v. Italian Republic C-58/99, ECR [2000] I-3811; and ECJ 2 Jun. 2005, Commission of the European Communities v. Italian Republic C-174/04 ECR [2005] I-4933.

[33] van Bekkum, Jaroon, et. al., Golden Shares and European Company Law: The Implications of *Volkswagen*, 2008, p. 6-7.

[34] Case C-112-05, 23 October 2007, Commission of the European Communities v. Federal Republic of Germany, [n.y.r.].

[35] Lower Saxony is a state in Germany holding a stake in the Volkswagen Company.

[36] van Bekkum, J., et. al., pp. 6-8.

2.4.2 Post-bid defensive measures

Pre-bid defensive measures are accompanied by post-bid defenses, which are present once a company is subjected to a takeover bid.[37] White knight, mandatory bid rule and frustrating actions are all examples of such measures. Post-bid measures are critical for this project and owing to their connection with the Directive on Takeover Bids; an additional examination in depth in this context appears superfluous. The reader is referred to Sections 3.2.2-3.2.3 for further information. In any case, the determination of when the pre-bid period is superseded by the post-bid period does not have a uniform definition in law, although the differences among legal systems are not remarkably large. Pursuant to the UK's City Code, for instance, a post-bid is current once the board 'has reason to believe that a bona fide offer might be imminent', Rule 21.1. That is also the time when the 'no frustration rule' becomes applicable.[38] The EU, on the other hand, has determined the period by the 'breakthrough rule', which is applicable "when the board is informed by the bidder of its decision to make an offer", Arts 9.2 and 6.1.[39] The UK City Code, the 'no frustration rule' and the 'breakthrough rule', together with the aforementioned mandatory bid rule, hold substantial significance for this project. A deeper examination of the rules and the City Code is thus set forth at a later stage in this thesis.

2.4.2.1 The impact of defensive measures

The absence of defensive measures in a company makes it more vulnerable in case of a hostile takeover. It has been shown in circumstances[40] where the measures were present that conducting them before the takeover attempt motivated employees and the management to improve their performance in the target company. Simultaneously, the new firm obtains more time for organizing, including the establishment of a new business plan and, if necessary, recruitment of additional workers. Nonetheless, there are always two sides to the same coin and according to certain studies in connection with takeovers, the outcome of applying takeover measures appears to be negative for, and may even destroy, the shareholder value of the acquirer firm. This impact is most visible in firms protected by takeover defenses, *e.g.,* governed by entrenched management, whereas management boards acting in the best interests of shareholders, obviously results in better opportunities for increased returns. However, if the takeover increases the leverage, which is not unusual in leveraged buyouts, the risk of reduction of the present remaining debt is unlikely, representing a negative outcome, especially for bondholders.[41]

Beyond the defensive measures described above there are additional alternatives that might have substantial influence on a potential hostile

[37] Commission of the European Communities, Report on the Implementation of the Directive on Takeover Bids, SEC(2007) 268, Brussels, 21.02.2007, p. 4.
[38] Kraakman, R., et. al., p. 232.
[39] The Directive 2004/25/EC on Takeover Bids.
[40] DePamphilis, D., p. 91.
[41] DePamphilis, D., pp. 92-93.

takeover. One that is widely used in Germany, for example, is ’co-determination’, defined in the section 2.1. Another valuable method, among several, for the maintenance of control in a company is about to be introduced, namely “joint decision-making”.

2.4.3 Joint decision-making

As mentioned *supra* in the summary, board members may have a negative attitude towards control amendments and takeovers owing to the risk of replacement of the board. The system of joint decision-making might save their position. A company monitored by joint decision-making features a constellation of both management and shareholders engaged in mutual decision-making, where the incumbent management has the authority to act on behalf of the shareholders and their interests. The power extends to certain decisions, including consideration of a bid and whether to reject or accept the offer. Another fundamental prerequisite for this system is “the duty to act in the best interest of the company”.[42] In practice however, decision-making may lead to decisions taken by the incumbent board for reasons of self-interest, raising the precarious subject of agency-principal problems.[43] There are various strategies that can be taken to prevent a decision being made on improper grounds, the most obvious of which is to allow authorized courts to review the decision.[44] Another important strategy is the condition that any decision of importance be required to receive the endorsement of the firm’s independent directors, *i.e.,* members of the board assigned to deal with matters of ethical and reputational interests.[45] Removal rights are another alternative, whereby shareholders mutually decide at a general meeting to replace the current management for not sharing the same opinions as the shareholders. In any case, provided that a company has a staggered board (compare with shark repellants, section 2.3.1.2), only a certain number of board members can be removed at an annual meeting (usually one-third at a time). The fourth and last strategy regarding rewards to the management board is triggered when the control rights are conveyed into the hands of an acquirer. Remuneration is often available when a contract drafted in advance provides for severance payment, *e.g.,* golden parachutes. Most legal systems require a remuneration to be motivated by such factors as compensation for monetary, reputational and psychological losses and to be approved by the shareholders.[46]

[42] Kraakman, R., et. al., p. 242.
[43] Kraakman, R., et. al., pp. 238-240. The problem of agency-principal responsible is beyond this scope. For additional information, see “The Anatomy of Corporate Law, Chapters 2 and 8.
[44] Kraakman, R., et. al., p. 242.
[45] Kraakman, R., et. al., p. 65.
[46] Kraakman, R., et. al., pp. 244-245.

3 The Directive on Takeover Bids in the EU

3.1 Introduction of the Directive

The European Commission's vision of a Directive defining common rules for takeover bids and thus offering companies within the EU a greater legal certainty for cross-border takeover bids was an issue already in 1989. At this time, the Commission presented a proposal for a Thirteenth Directive on company law. The proposal was addressed to the Council and included takeover and general bids.[47] Nonetheless, the draft was claimed to be ambiguous and was owing to changes in the European economy additionally refused by several Member States. Hereby, the proposal was subject to more amendments up until 1996 when it was presented to the Council and to the European Parliament.[48] The Parliament suggested certain amendments but due to diversity of opinion in 2001, the proposal was not enacted at this point. The disagreement concerned the condition requiring the board of a target company to be supported by its shareholders in connection to the usage of a defensive measure (compare with the forthcoming board neutrality rule). The reluctance was based on the target company's vulnerability in the occasion of being subject to a hostile takeover, which indeed is a common misconception according to the Commission.

As a result of the Parliament's rejection, the Commission founded a Group of High-Level Company Law Experts charged with altering the points questioned by the Parliament. The next proposal in 2002 contained several principles including equal treatment in identical situations for all holders of securities in the offeree company. Specifically, the company to which the bid is made must have sufficient information and time to reach a properly informed decision on the bid. Additionally, the board of the target company must act in the interests of the company as a whole. Moreover, the Commission stressed the importance of satisfactory protection for employees and minority shareholders in the event of a control shift, which is why actions at Union level were considered necessary to enable progress.[49] The press release in connection with the proposal contained a statement from Commissioner Bolkenstein asserting that the Directive is critical for the achievement of "…fully integrating European capital markets by 2005 (…) [making] Europe the most competitive economy in the world by 2010."[50] The statement is furthermore supported by the Group of High-Level Company Law Experts advocating a level playing field for takeover bids in the EU by declaring that regulation of takeover bids is a key element

[47] OJ C 64, 14.3.1989, p. 8.
[48] COM (2002) 534 final, 2002/0240(COD), p. 2.
[49] To date, the conditions represent the general principles set out in Art. 3 of the Directive.
[50] IP/02/1402, Commission proposes a transparent framework for takeover bids, 02.10.2002.

for such an integrated market.[51] In 2003, the Directive was finally enacted and contained a requirement for the Member States to implement the Directive into national law no later than 2007. A subsequent section dealing with the implementation of the Directive will present certain rules from the Directive which have relevance for this project. The rules will be treated individually, followed by a discussion concerning the Directive. Apparently, authors in general are not as enthusiastic as the Commission in respect of the Directive.

3.2 Implementation of the Directive

3.2.1 Introduction

The main purpose was primarily to obtain equal protection by harmonizing national rules on takeover bids in every Member State. Furthermore, the insertion of minimum guidelines for the takeover process combined with transparency was necessary to accomplish this goal.[52] The adoption of the Takeover Directive[53] in turn would result in increased competiveness on the European market. To facilitate the takeover activities, the Commission asserted that the establishment of provisions serving as obstacles against certain defensive measures was crucial. For this purpose the 'breakthrough rule' and the 'board neutrality rule' defined and discussed below were considered as vital pursuant to their ability to restrict defensive measures used to frustrate a takeover. As we know, the Directive was rejected at first, but the revised version, containing a right to deviate from these rules by 'optional arrangements', was eventually adopted by the Parliament in 2003.[54]

The two most critical obstacles when acquiring a company are the aforementioned pre-bid defenses (barriers designed to impede the acquisition of shares e.g. share transfer restrictions, voting restrictions or votes with multiple voting rights) and post-bid defenses (e.g. decreasing the amount of shares available to the bidder thus making the takeover more costly, so called share buybacks). These defenses had to be restricted according to the Commission. Hence the suggestions to impose 'the breakthrough rule' which neutralizes pre-bid defenses as well as 'the board neutrality rule' in relation to post-bid defenses. Moreover, as a result of several Member States' and the Parliament's reluctance to facilitate takeovers, the Commission was obliged to offer optional arrangements regarding these rules set forth in Art. 12 of the Directive. Specifically, each Member State is allowed to disregard any or both rules (board neutrality and breakthrough) when implementing the Directive into national law. On the

[51] Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, 2002, p. 18.
[52] IP/97/1022, Brussels 20.11.1997, p. 1.
[53] The term 'Takeover Directive' continuously refers to the Directive on Takeover Bids, 2004/25/EC.
[54] Report on the implementation of the Directive on Takeover Bids, SEC(2007) 268, 21.02.2007, p. 3.

contrary, a Member State cannot prohibit a company from enacting the rules on a voluntary basis by adopting them at a shareholder meeting.[55] Lastly, the Directive contains a reciprocity exception in Art. 12.3, meaning that a company from a legal system governed by the breakthrough rule and/or board neutrality rule may disregard the rules when confronting a bidder belonging to a system where the rules are not in force.[56]

The following section contains a presentation of the breakthrough rule, the board neutrality rule together with the mandatory bid rule, followed by several comments made in miscellaneous legal articles. Whether these rules have been implemented in the UK, Sweden and Germany or not is also a subject for the next section. However, a more in-depth explanation of their function in either national system is a matter for the comparison in Chapter 4.

3.2.2 The breakthrough rule

During and following a takeover bid, Art. 11 basically aims to neutralize defensive measures corresponding to pre-bid defenses, like restrictions on transfer of securities and restrictions on voting rights.[57] The purpose is thus to strike out pre-bid measures and, pursuant to Art. 11.1, the rule is applicable once a bid has been made public. The rule especially discourages obstacles like systems of dual class stock which is the circumstance when the shares in a company carry different classes of voting rights.[58] Instead, changing the corporate control in a company in a way that is ordinarily considered impossible due to the concentration of ownership holding dual shares, may be feasible when applying this rule. Consequently, the rule prevents the possibility of having a share with more than one vote. In accordance with Art. 11.3 subsection 3, multiple-voting securities shall carry only one vote at general meetings regarding decisions of defensive measures. This is also the case for the first general meeting that follows a successful takeover. Conclusively, the principle of one share one vote is decisive in respect of defensive measures.

Moreover, when the offeror acquires more than 75% of the shares, it is possible to call a general meeting and for example appoint a new board pursuant to Art. 11.4. The new board will in turn not be governed by the provisions in the former target company's articles of association; on the contrary, the breakthrough rule facilitates amendments to the charter. The compensation rights in Art. 11.5 also deserve a clarification; "if the offeror has (…) acquired at least 75% of the share capital carrying voting rights, an equitable compensation shall be provided for any loss suffered by the holders of those rights".

[55] SEC(2007) 268, 21.02.2007, pp. 5-6.
[56] COM (2012) 347 final, Brussels, 28.6.2012, p. 3.
[57] C/03/59, Brussels 3.3.2003, 6874/1/03 (Presse 59), p. 18.
[58] Skog, Rolf, The Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock, 2004, pp. 1439 and 1441.

In spite of the Commission's expectations, the rule is unlikely to be successfully applied since no Member State except the Baltic States has yet chosen to implement the rule in its national system. As mentioned in the previous section, Member States have the ability to opt out of this rule. Still, the possibility of imposing the rule by the company itself on a voluntary basis remains open. However, conditions in regard to the process including approval by shareholders or those benefitting from certain rights will probably make such insertion more difficult. For instance, applying the breakthrough rule voluntarily requires a resolution at the general meeting endorsed by the shareholders. In the UK, the rule cannot be applied unless it is supported by more than three-quarters of the shares in a certain class. Sweden on the other hand requires no less than nine-tenths of the shares of all the shareholders in the company. Moreover, the breakthrough rule does not comprehend all potential pre-bid measures which is why Member States can circumvent the rule by permitting other types of defenses.[59]

3.2.3 The no frustration rule (board neutrality)

As soon as a bid is present, the board can take actions to interrupt it by conducting frustration rules. In practice, such maneuvers include selling off valuable assets thus making the target company's appear less attractive and repurchasing shares or issuing new shares containing unequal voting rights. A board might also look for a white knight who typically acquires a substantial amount of stakes in order to thwart the original bidder from obtaining the control of the company.[60] The 'no frustration rule' may be regarded as the counterpart to aforementioned 'joint decision-making' where the incumbent management has the power to act on behalf of the shareholders and their interests (*supra* 2.3.3). The no frustration rule, on the other hand, empowers the shareholders with significant influence in respect of decision-making. The rule is embedded in Art. 9.2 of the Directive and, like the breakthrough rule, this rule is optional, allowing Member States to either adopt or opt-out of it. Art. 9.2 stresses that the board of the target company shall obtain an approval at the meeting of shareholders before taking any action other than seeking alternative bids, which may result in the frustration of a bid. More specifically, shareholders should, pursuant to this rule, have the right to accept an offer from the offeror as well as the later should be able to make a public offer. The Directive does not define which measures may frustrate a bid explicitly, although the proposal of the Directive refers to actions outside of the normal course of a company's business or what goes against normal market practices.[61] It has however been discussed in literature whether 'normal' should be replaced by 'ordinary'.[62]

[59] SEC(2007) 268, 21.02.2007, pp. 7-8.
[60] Clift, Ben, The Second Time As Farce? The EU Takeover Directive, the Clash of Capitalisms and the Hamstrung Harmonization of European (and French) Corporate Governance, 2009, p. 59.
[61] COM (2002) 534 final, 2002/0240(COD), p. 8.
[62] Clift, B., p. 59.

The 'no frustration rule' is applicable once a bid is envisaged and owing to its wording it is occasionally considered as a rule of passivity, although instances when the rule is applied rather indicate the opposite.[63] Despite the incapability of taking actions that may frustrate the bid, like for instance issuing shares, options and bonds and disposing respectively, and acquiring assets, the board is nevertheless able to invoke other measures. First of all, the management may and is commonly required to inform the shareholders about the offer and make its standpoint in relation to the offer known as well. A second active measure is to contest the bid with an appropriate authority which in case of a dismissal, at least will buy the management board some time. Thirdly and finally, looking for alternative bids by finding a 'white knight' increases the options for the shareholders and may impede the initial buyer from taking control of the company (usually >30% of the company's shares). This method certainly brings about other consequences, since finding a white knight usually results in a strain on time and expenses.[64] In Art. 9.3 however, the Directive permits pre-bid authority if the action is 'a normal course of the company's business' and provided that the action does not cause any frustration on the bid.

Laws demanding shareholder approval for the usage of post-bid defenses have never been adopted in Germany. Not surprisingly, Germany chose to opt-out of the board neutrality rule and agreed on the exception of reciprocity in Art. 12.3 of the Takeover Directive, which rather work against an active takeover market.[65] The UK, on the other hand, enacted the rule which was not unexpected, since the no frustration rule originates from the UK City Code (*see* Chapter 4). Sweden followed the same line as the UK and adopted the rule.

3.2.4 Mandatory bid rule

When the acquirer has obtained enough shares to take over the control of the target company he is obliged to make a general offer to the remaining shareholders in the target company. The average of control in a company is usually estimated to one-third of the voting shares although Art. 5.3 of the Takeover Directive allows Member States to set their own minimum standard.[66] This is the mandatory bid rule and the reason for implementing it lies in the conflict that may arise between minority and majority shareholders when the acquirer obtains the control of the company. Pursuant to Art. 5.1 the minority shareholders should therefore have the right to a satisfying offer and, provided an acceptance of the proposal, to exit the company.

The conditions triggering the mandatory bid rule slightly vary among the Member States. The UK has adopted a relatively strict mandatory bid rule in

[63] Kraakman R., et. al., p. 245.
[64] Kraakman R., et. al., pp. 235-237.
[65] SEC(2007) 268, 21.02.2007, pp. 6-7.
[66] Malta and Latvia have a requirement of 50% and Poland 66%, (SEC)2007 268 21.02.2007, pp. 13-14.

the UK City Code (defined under section 4.2). However, due to the rule's intention of supporting the interests and influence of institutional investors who possess large but non-controlling stakes, the rule has apparently been regarded as shareholder centric. Rule 9.1(1) stipulates that the mandatory bid rule is applicable with the "acquisition of an interest in shares which carry 30% or more of the voting rights of a company". As far as countries with a continental tradition (unlike the UK Anglo-Saxon tradition) e.g. France, Italy and Germany are concerned, their attitude towards the mandatory bid rule has been less congenial, especially in Germany. Germany's Takeover Act (explained infra) frankly has a weak prevention for minority shareholders against tunneling,[67] for instance when the management or shareholders own the acquiring company thus making profit from an otherwise depraved sale. The mandatory bid rule however is stated in the German Takeover Act §35 and is triggered by "indirect or direct acquisition of control, which is 30% of the voting rights of the target company". Finally, the rule in Sweden is triggered in conjunction with an "acquisition of 30% of voting rights or the increase of 30% holding if a person attained a 30% shareholding as a result of measures taken by the company or another shareholder", Chapter 3, 1 § LUA (2006:451).

3.3 Discussion

One of the main purposes with the incorporation of the Takeover Directive is to achieve a common legislation among EU members regarding takeovers by hostile bids. The Directive intends to outline some fundamental standards and, provided that the minimum requirements are achieved, Member States' freedom to implement the rules of the Directive into their domestic legal systems is reasonably broad. At first, the Directive was criticized and thereby amended several times until it reached its current version. The debate mainly focused on the risks with a Directive banning pre-bid measures.[68] Nevertheless, the fundamental factor causing disorder in respect of the adoption of the Takeover Directive was probably the existence of diverging views on how the market should be governed. There are two outstanding visions of corporate governance, namely the shareholder value view deriving from the Anglo-Saxon tradition and the institutional and stakeholder friendly view which represents the Continental tradition. Whereas the UK and Sweden largely represent the former, worker oriented Germany supports the latter.[69] The Directive is based on and derives from the UK City Code and is thus destined to be disadvantageous for legal systems based on dual class system, like Germany and Sweden.[70]

[67] Kraakman et. al., pp. 309-310.
[68] Ipekel, F, pp. 341-342.
[69] Sweden is similar to UK in relation to the Takeover Act. However, Sweden has, like Germany, co-determination and a two-tier system but it has no relevance for the comparison.
[70] Stattin, Daniel, Takeover - Offentliga Uppköpserbjudanden på Aktiemarknaden Enligt Svensk Rätt, 2009, p. 97.

3.3.1 The breakthrough rule strikes out multiple voting rights

Several authors have deemed that the breakthrough rule creates discrepancy between Member States on unequal grounds. This section illuminates some observations alleging that the facultative breakthrough rule impedes the creation of a level playing field throughout the EU. A dispute typically appearing in relation to the Takeover Directive concerns multiple voting shares. As the breakthrough rule strikes out this pre-bid measure, it obviously affects Member States that have implemented a dual class share system, for instance France and the Scandinavian countries. By restricting shareholders' voting rights, the breakthrough rule thus decreases shareholders' veto power which may foster the process of a hostile bid. Sweden for instance uses a dual class share system which means that listed companies' shares are divided in several classes. A shares usually carries ten times more votes than B shares but an A share, especially in older companies, may be encumbered with 1000 votes. For example, a person holds 7% of the A shares in a company where an A share has 1000 times more votes than a B share. In spite of being a minority shareholder, the person nonetheless has control in the company owing to the votes. If the breakthrough rule were used, the person would lose significant power and would no longer have control. Bebchuk and Hart[71] argue that the breakthrough rule would deter companies from using a dual class system and apply other defensive measures not covered by the breakthrough rule e.g. "pyramids".[72] By virtue of the foregoing, the breakthrough rule will not have any effect when there are other defenses available to use. Berglöf and Burkart have additionally asserted that the breakthrough rule tempts dual class companies to transform themselves into pyramid structures, creating an opaque control structure or strengthening the stakes of controlling minority shareholders. An example of the latter is when an owner or manager sells the majority of the shares but, owing to his position, maintains a substantial amount of control.[73] Besides the pyramid structure, neither cross-shareholdings nor golden shares are covered by the breakthrough rule.[74] Member States fearing that companies might be subject to a hostile takeover by foreign investors may use golden shares thereby hampering a level playing field in EU (see the *Volkswagen-case supra* 2.3.1.3).[75] Ipekel claims that EU has failed with its main intention to create a level playing field in EU by making the breakthrough rule (and the board neutrality rule for that matter) optional. Ipekel also states that all "Continental" Member States (virtually every state except the UK) will

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[71] Bebchuck, Lucian et. al., A Threat to Dual-Class Shares, *Financial Times*, 2002.

[72] That is a structure when a person or a company possesses a controlling stake in a company and the company in turn holds a controlling stake in another company etc. Different voting power and pyramids are encumbered in the shares, allowing a controlling owner at the bottom of the company to retain control of the company. Berglöf, et. al., p. 180 and COM (2012) 347 final, Brussels, 28.6.2012, p. 5.

[73] Berglöf, Erik, et. al., European Takeover Regulation, 2003, p. 180.

[74] Ipekel, F, p. 345.

[75] van Bekkum, J, p. 10.

choose to opt out of the breakthrough rule thus affecting the UK notwithstanding its one tier system to do the same.[76] Finally, in his article Skog argues that the breakthrough rule is based on an assumption that takeovers of companies in a dual class share system is obstructed by the dual shares. Skog himself disagrees and claims that controlling shareholders in a company on the contrary may facilitate a takeover. The offeror is forced to negotiate directly with the controlling shareholder who in turn may listen to the rest of the shareholders in the target company. This may be an advantage for dispersed shareholders since they usually lack the capacity of collaborating.[77]

3.3.2 The Takeover Directive – supporter of managerial entrenchment?

It has been asserted that the Takeover Directive might create managerial entrenchment, thus exacerbating the conflict between agency and principal resulting in less prosperity for the shareholders. An author has identified certain reasons supporting this claim. To begin with, Humphery-Jenner blames the Takeover Directive for being a fuzzy framework and refers to Art. 5.3 containing 'control rights', Art. 12 regarding exemption rules for certain companies and Art. 11.3 which concerns reduction of voting rights due to defensive measures. These articles have a common denominator which consists of indistinct definitions thus causing a more discretionary interpretation by its members. Furthermore, there are some provisions creating discrepancy when agency conflicts of managerial entrenchment emerge to the advantage of the managers. Art. 5 of the Directive for instance concerns the mandatory bid rule and minimum price rule. The article is equipped with a generous space for the interpreter leading to different outcomes of the mandatory bid rule since each Member State has its own requirements. This advantage primarily serves managers due to agency motivated investments. Criticism has also been leveled at the Directive in regard to the condition in Art. 5.3 requiring the bidder to offer cash consideration in the case of a potential stock consideration. In addition, Art. 7 allows Member States to permit the takeover firm a consideration of ten weeks whether they want to accept the bid or not. These two factors are not only time consuming; due to the period of ten weeks, the value of the shares in the target company might decrease substantially during this period thus making a takeover less attractive and reduce the profit for the acquirer.[78] That is however something the acquirer has to take into account when making the bid. But is ten weeks necessary? If the actors are interrupted by periods like this consideration period, the market will simultaneously slow down.

[76] Ipekel, F, p 345.
[77] Skog, R, p. 1451.
[78] Humphery-Jenner, Mark, The impact on the EU takeover directive on takeover performance and empire building, 2011, pp. 256-258.

3.3.3 The severity task of a mutual regulation

EU's intention of unifying its Members by imposing directives is nothing new. In addition, failure of a common regulation owing to the Member States' different backgrounds, traditions, economies etc, is not completely uncommon either. At present, more than 50 Directives or regulations are incorporated in the EU and according to Clift, the Takeover Directive might be considered as a failure when paying attention to all enduring of defaults in the Directive. The main reasons indicating that a concerted directive on takeover bids between Member States in the EU is almost impracticable without imminent disputes include national diversities of capitalism, corporate governance, ownership structures and miscellaneous takeover markets. Varieties of capitalism may refer to several types of market economies. Two remarkable varieties are the liberal market economy (LME) and the co-ordinated market economy (CME). Their common denominator is indisputably corporate governance i.e., how the government, state and firms co-operate and how economic activity within a member state is regulated. The distinction between shareholder value and stakeholder value is one way of explaining the markets' different priorities (*see* also 2.1). The differences lie in that LME is identified by a market in favor of capitalization. Firms subject to a capital market are consisted of a competitive market where banks and financial institutions such as pension funds and insurance companies do not usually represent companies in the role of large block holders. CME on the other hand signifies the relationship between financial institutions and the frequent usage of co-ordination approaches. A well integrated correlation between corporations and banks resulting in sustainability through long-term relationships corresponds to the expectations of a CME.[79] The attitude to takeovers differs tremendously between supporters of LME and CME. This is why a comparison of the implementation of the Takeover Directive in the UK, a country typically associated with LME, and Germany, whose market approach corresponds to a CME, is about to be presented. In addition, the implementation in Sweden will be considered as well, partly because of an adoption virtually identical to the UK regulation and partly due to its possession of multiple-voting rights and co-determination like Germany.

The market economy has also been defined by two other theories, namely the laissez-faire theory supporting a market establishing its own regulations without being interfered by any authority and its counterpart, the 'institutional' theory based on government policies where the benefit of stakeholders and society is highly valued.[80] When observing the theories' visions of how the market shall be governed, UK seems to be inspired by the laissez-faire theory. Germany on the other hand, is strongly associated with the institutional features.

[79] Clift, B, pp. 56-58 and p. 60.
[80] Dey, Joy, p. 9.

3.4 Report of the Commission

3.4.1 Report of the impact of and compliance with the Takeover Directive

Just recently, the European Commission released a statement to the European Parliament containing a presentation of the impact of and compliance with the Takeover Directive over the past years.[81] The overall consideration by virtue of the External Study reveals that there has not been any significant changes in the legal framework of the Member States either because the rules already existed or were about to be adopted prior to the enactment of the Directive. That may also be the reason why barely any litigation has been conducted so far under the Takeover Directive. The External Study contains a legal questionnaire performed by 115[82] stakeholders from 22 of the Member States including supervisors, stock exchanges, issuers, employee representatives and investors. On the whole, they have been satisfied with the clarification of the Directive's rules. Employee representatives however criticize the Directive claiming that employees are less protected after a takeover. The defensive measure co-determination used in Germany and Sweden was furthermore discussed in the Report. According to the Study, the measure might obstruct a takeover if the offeror wants to take control of the company but the Commission has not in this context considered the obstacle as unjustified.[83]

3.4.1.1 Evaluation of the mandatory bid rule, the board neutrality rule and the breakthrough rule

To begin with, the Commission sets out certain doubts regarding the implementation of the mandatory bid rule. Since Art. 5(2) regulates that where control has been acquired following a voluntary bid (…), a mandatory bid no longer applies, offerors cultivate the habit of offering a very low price for the shares and are in so doing likely to acquire control by a voluntary bid. By circumventing the rule, the offeror escapes the obligation of offering a mandatory bid and minority shareholders may not be able to control the share premium. As a result of national deviations of the mandatory bid rule, one of the Directive's fundamental purposes, protection for minority shareholders, has been undermined. In regard to the board neutrality rule, the External Study shows that it has been adopted by 19 of the Member States, which is regarded as a relative success. A greater failure is the breakthrough rule, which has been exempted by almost every

[81] Apparently, the Commission has within the Report chosen to define the Takeover Directive as "Takeover Bids Directive". I on the other hand will continue with the former definition thus avoiding potential misunderstandings.
[82] ANNEX 2: Tables included in the study, p. 2 ("The Study", *see footnote* 83).
[83] The Takeover Bids Directive Assessment Report, Study on the application of Directive 2004/25/EC on takeover bids (MARKT/2010/10/F) (the "Study"), pp. 47-48 and COM (2012) 347 final, Brussels, 28.6.2012, pp. 3-5.

Member State. Notwithstanding the opportunity for companies to adopt the rule voluntarily, it has hardly been used. In addition, the External Study criticizes the rule for its violation of the principle of shareholder decision-making, crucial when confirming the principle of the board neutrality rule.[84] In light of these claims, the Commission states that there is no reason for making either the board neutrality rule or the breakthrough rule mandatory.[85] I will refer to this statement later in the project.

[84] (MARKT/2010/10/F) (the "Study"), p. 196.
[85] COM (2012) 347 final, Brussels, 28.6.2012, pp. 8-10.

4 Comparison

4.1 Introduction

The purpose with the Comparison is to compare the implementation of the Takeover Directive between Sweden, UK and Germany. By examining how the Directive was implemented and which rules that have been enacted; this section will enable an explanation of how the Directive has affected Member States' national laws.

4.2 Sweden

4.2.1 Introduction

Virtually in all respects, the Swedish product of the Takeover Directive is identical to the English City Code on Takeovers and Mergers, hereinafter the UK City Code (explained *infra* 4.2). The similarities cover the rules set up for regulated markets and for the specific type of European financial trading system: Multilateral Trading Facility (MTF).[86] The main purpose with this section is for that reason not to present what has been implemented or not but rather how the Directive was implemented and how the Takeover Directive works in Sweden to date compared to the time before its implementation.

4.2.2 LUA and relevant authorities

In Sweden, statutes have governed activity in combination with takeovers although the Swedish Act on Public Takeover Bids (LUA)[87] is the first Swedish law regulating takeover offers.[88] Previous to LUA more particularly in 1971, the Swedish Business Stock Exchange Committee (NBK)[89] launched several recommendations in respect to public takeovers. Lately, these recommendations have turned into "rules" and were used as such by regulated markets e.g. Nordic Growth Market, Aktietorget and Stockholm Stock Exchange. These actors within the private sector cannot establish rules with a binding effect prima facie, i.e. at first glance. However, the rules are determined to be legally binding in regards to general contractual rules thus virtually considered as binding. These rules are moreover recognized as good practice.[90] An example may be that shareholders' decision rights shall be respected. The principle relies on the vision that shareholders are empowered to determine whether it is worth

[86] SOU 2005:58, p. 54.
[87] My own translation of "Lag om Offentliga Uppköpserbjudanden på Aktiemarknaden", 2006:451.
[88] Stattin, D, p. 101.
[89] Näringslivets Börskommitté (NBK).
[90] Prop. 2005/06:140, p. 38.

investing in a company or if an exit in connection with the repurchasing of shares is more appropriate. Shareholders' attitude towards risks are generally sensible compared to the management whereas the latter occasionally may not be trustworthy enough as the former.[91]

For the avoidance of superfluous conductions of judicial actions, the Takeover Directive takes into account self-regulatory systems within the Member States and emphasizes that exercising of control by supervisory authority is preferable.[92] In addition, the aim of LUA is to achieve the requirement of implementing the Takeover Directive and according to Art 4.1 Member States shall designate the regulatory competence to public authorities, associations or private bodies recognized by law or regulation. What concerns the Swedish conduct, 8 chap. 2 § of the Constitution of the Government[93] states that the regulation of a legal relationship between individuals shall be performed by law. As a result, the option of imposing the statutes of the initial directive as a regulation is thus not feasible.[94] The supervisor Finansinpektionen (FI) is a public authority adapted to have the responsibility of the imposition of fines in accordance to Chapter 7, LUA and additionally to delegate some of its own powers to the authority Aktiemarknadsnämnden (AMN). AMN appears to be the most important actor on the market owing to its competence comprising defensive measures and the mandatory bid rule.[95] With regards to its authorization, the institution is in certain ways similar to the Takeover Panel in the UK (explained *infra*).[96] AMN is unlike Swedish courts incapable of imposing an opinion with any precedent function whatsoever.

4.2.3 How LUA should be interpreted in Sweden

Generally with regard to the interpretation of the rules, the methods of interpretation must align with the approaches within the EU. The preamble of the Directive states that each Member State is to implement the Directive through more detailed rules in accordance to its national system and their cultural contexts.[97] It has been stated in the legal Government Bill of LUA that the Directive partially shall be enforced by rules achieving the requirements of the Directive and that otherwise are teleological.[98] Anyway, in some instances including the mandatory bid rule and the breakthrough rule, there would be more appropriate to implement current rules into the law directly, pursuant to the rules' civil characterization.[99] The obligation of a mandatory bid has moreover been regarded as onerous for the bidder and

[91] Stattin, D, p. 112.
[92] IP/97/1022, Brussels 20.11.1997, p. 2.
[93] In Swedish terms 'Regeringsformen'.
[94] SOU 2005:58 p. 73 and Prop. 2005/06:140 pp. 41-42.
[95] Prop. 2005/06:140, p. 40.
[96] SOU 2003:22 p. 64.
[97] L 142/14 2004/25 EC, Preamble Recital (26).
[98] The term 'teleological' refers to the Swedish term "ändamålsenlig". Although the word "effective" occasionally is used by several authors alongside, I prefer the former definition for this context.
[99] Prop. 2005/06:140 p. 44.

should for this reason be interpreted restrictive.[100] Conclusively, since both LUA and the Directive enable a teleological interpretation, the interpreter of LUA may also use the Directive due to their similarities in terms of methods of interpretation. Finally, solving an issue by the ECJ is an alternative although the Community refers the Member States to solve the dispute in the national court unless the question contains a clarification of Community Law. For that matter, the Member State´s courts may send a request to the ECJ thus receiving an opinion which is not legally binding.[101]

In Swedish Law, self-regulation is a rule effective once the party obliged to follow such rule voluntarily assumes such obligation. Takeover rules for instance are considered as contractually agreed self-regulated. It is a question of self-regulation and a factor important to observe is if it matters whether self-regulation is adjusted in an agreement or not and how the rules shall be interpreted in either case.[102] What concerns Swedish Law, the circumstance that an agreement regulates the rules or not has substantial significance. Namely, when a condition is included in an agreement, the interpretation normally takes the parties' subjective intentions into account. However, regulations deriving from normative Public Law shall conversely be regarded on the basis of a teleological interpretation.[103] Irrespective of what conditions in terms of takeover rules that has been included in the agreement; a dispute concerning such rules will be interpreted by AMN determining the dispute by virtue of its own interpretation and not the parties'. Hence, AMN applies principles set up by NBK, the initial creator of the rules (*supra* 4.1.2 first section "good practice"). Presumably though, the interpretation will be similar as to regular interpretation of intention utilized by constitutional courts.[104]

4.2.4 Company Finance-case

The authority of AMN explained in previous section can be illustrated by the "Company Finance Case" from 1985 where a decision of imposing a fine by the Exchange Board[105] of (former) Stockholm Stock Exchange[106] was appealed to the Swedish Supreme Court.[107] The target company "Företagsfinans" was listed on Stockholm Stock Exhange and held A shares and B shares.[108] The company Beijerinvest held the majority of Företagsfinans' B shares and made a bid dependent on a completion condition stating that the validity of the bid relied on an acceptance

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[100] Stattin, D, pp. 109-110.
[101] IP/97/1022, Brussels 20.11.1997, p. 2.
[102] Stattin, D, p. 105.
[103] Also in this context I use "teleological interpretation" as a substitute for the Swedish term ”ändamålstolkning" although "intention of the rule" might be a more appropriate translation indeed.
[104] Stattin, D, p. 106.
[105] In Swedish terms ”Börsstyrelsen."
[106] In Swedish terms ”Stockholms Fondbörs".
[107] NJA 1985 s. 343 "Föreningsfinansfallet".
[108] A shares differ from B shares mainly because of different voting rights. While the first provides its owner with ten votes, the second possesses one vote.

supported by at least 50 per cent of the shares.[109] The offer was not preceded by any negotiations in the target company. Two days after the bid's annunciation, the board of the target company discouraged the shareholders to whom the bid was made to accept the offer on the ground that the board was looking for alternative proposals. Another offer was made by owners of the A shares in the target company and the only difference from the former bid was that it was made to shareholders possessing less than 5000 B shares. The Exchange Board's reaction to the board's (of the target company) wrongfully conduct was an imposition of a fine. At this point, neither was LUA nor any other takeover regulation incorporated in Swedish law and the Exchange Board's decision relied on recommendations from NBK. The current recommendation regarded equal treatment of shareholders and referred to, in this context, the shareholders of the target company. The decision was appealed and all three instances exclusively agreed with the Exchange Board's decision. The Supreme Court established that the interpretation of the intention of regulations shall prevail contractual as a privately governed instrument.[110]

Due to the present regulation of takeovers in LUA, this case may not be relevant in respect of the treatment of shareholders. Namely, if the circumstances would have occurred today they would probably be considered as a breach against Chapter 5, 1 §, section 2 and in the light of section 1 of LUA. This paragraph (the board neutrality rule) regarding post-bid measures states that "when the board has reasonable grounds to believe that a public offer is imminent,[111] a decision that may exacerbate the offer must be supported on a shareholder meeting unless the measure implies the search for alternative offers".[112] The outcome nevertheless demonstrates that the Swedish legal system managed to deal with hostile takeovers prior to LUA similar as to date, *i.e.,* by relying on recommendations which corresponds relatively well with current legislation.

4.3 The UK

During the 1950's already did Britain experience its first hostile bid and because the period around the 1980's was intense due to an increase of hostile takeovers;[113] a regulation on this front was needed. 4400 listed companies within the UK furthermore make the market vulnerable against hostile takeovers because only listed companies on a stock market are potential targets for hostile bids. Germany has never had more than 750 listed companies.[114] Lately, the UK Takeover Code became a framework for what represents the EU Takeover Directive to date.[115] The UK City Code was enacted in 2006 and mainly has three fundamental purposes, that is a

[109] NJA 1985 s. 343, on pp. 344-345.
[110] NJA 1985 s. 343 on p. 351.
[111] My own translation of "nära förestående".
[112] 5 kap, 2§ 1-2 st. LUA.
[113] Callaghan, H, et. al., p. 743.
[114] Callaghan, H, et. al., p. 740.
[115] Callaghan, H, et. al., p. 758.

fair treatment for shareholders, an opportunity for shareholders to decide on the merits of a takeover and that the offeror treats the shareholders equivalent.

4.3.1 Relevant authorities

The City Code is administrated by the Takeover Panel which is comparable to the Swedish authority "Aktiemarknadsnämnden" except that the Takeover Panel has a greater power than AMN. Firstly, the Panel determines disputes of how to apply the City Code (similar to the Swedish authority AMN) and secondly, the Panel makes the City Code normative. An appeal of a decision shall be made to the Appeal Committee. In the Company Law Reform Bills [HL],[116] the Panel possesses "the power to do anything that it considers necessary or expedient for the purposes of (…) its functions".[117] In respect of rulings, the Panel "may give rulings on the interpretation, application or effect of rules" which has a binding effect if the rulings are specified in law or subject to any review or appeal.[118] Furthermore, the Panel has as a duty to co-operate with the Financial Services Authority[119] whose liability comprehends the financial services industry in the U.K. The Executive moreover manages the day-to-day work in a takeover including supervision and regulation. The Executive works alongside but is not dependent on the Panel and consists of employees from law firms, accountancy firms, corporate brokers etc.[120] The Takeover Appeal Board lastly is also an organ independent from the Panel and is responsible for appeals against rulings of the Hearings Committee of the Takeover Panel which basically reviews the ruling of the Executive.[121] This system where decisions determined under the City Code are appealed to the Takeover Appeal Board which specializes on issues regarding the City Code seems to be preferable from a legal certainty point of view. In Sweden for instance, decisions by the AMN authority is appealed to the public courts which may not have the same experience as the Takeover Appeal Board which focuses exclusively on takeovers.

4.3.2 Interpretation of the City Code

The Takeover Panel has long advocated that the City Code must have a teleological construction. By that means thinking in terms of a purposeful action, commonly associated with Management by Objectives (MBO).[122] At the same time though, the City Code is non-statutory, i.e. a non-legislative

[116] Bills before Parliament may be proposal of new laws or proposal of amendments in laws already existing. [HL] means that the bill started in the House of Lords, the upper house of the Parliament in the U.K.
[117] Company Law Reform Bill [HL], Part 22, Chapter 1, 617(2), Session 2005-06.
[118] Chapter 1, 620(1-2).
[119] Chapter 1, 625(1)(a).
[120] The City Code on Takeovers and Mergers, Section 5, A10.
[121] The City Code on Takeovers and Mergers, Section 5, A12 and Section 8, A16.
[122] MBO is an instant when the management and employees within a company agree to certain objectives aspired to be achieved within the organization. In spite of its importance on goal setting, decision making etc. MBO is beyond this scope.

statute and has hereby symbolized fragmentation omitting parts significant when interpreting the Code. The most obvious question for this matter is when it is appropriate to apply a certain literal interpretation or respectively, if a literal interpretation is not suffice, any other particular interpretation.[123] The City Code has been subject to judicial review by English courts. In R. v. Spens,[124] the Court of Appeal stated that in spite of "the construction of documents normally a question of fact for the jury"[125] the City Code's similarities with legislation were sufficient as to regard the Code as "demanding construction of its provisions by a judge". In other words, the Code shall be interpreted as a *question of law* rather than a *question of fact* which is relevant when interpreting an agreement.[126]

4.3.3 Implementation of the rules

Chapter 3 defines certain rules of the Takeover Directive with regards to defensive measures and to the obligation of a mandatory bid. This section presents how the rules are set forth in UK beginning with the mandatory bid. The rule is applicable when the acquirer has obtained enough with shares to take over the control of the target company. Control means an interest, or interests in shares, carrying in aggregate 30% or more of the voting rights of a company, the City Code, C6 - Control. By the requirement of making a bid for all shareholders, bidders are subject to the equal treatment rule that requires the bidder to pay the same price to all shareholders wishing to accept a tender offer. The mandatory bid rule in the UK contains derogation from the rule provided with two conditions. The first requirement refers to the level of law; a bid must be subject to the requirement of an acquisition of at least 50% of the shares to trigger the rule. Secondly, the authority is empowered to impose or to deviate a waiver from the mandatory bid rule if it is predicted that the absence of such method could have negative effects on the company.[127] When it comes to the decision of opting in or out from the no frustration rule, UK's choice of opting in was rather unexpected since the rule originally derives from the UK City Code. Rule 21.1 of the Code states that the board of the target company must not take any action which may result in any offer being frustrated, without the approval of shareholders in a general meeting.[128]

Rules of the Takeover Directive that has not yet been enacted nor implemented in the UK include the breakthrough rule (Art. 11) and optional arrangements (Art. 12). However, the Interim Implementation that came into force in 2006 contained a Section governing companies' opportunity of opting-in and opting-out.[129]

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[123] Ogowewo, Tunde, The Jurisprudence of the Takeover Panel (Contemporary Studies in Corporate Law), Editorial review, Synopsis, 2012.
[124] R. v. Spens [1991] 1 W.L.R. 624, 632F (C.A).
[125] R. v. Spens.
[126] Stattin, D, p. 115.
[127] COM (2012) 347 final, Brussels, 28.6.2012, p. 8.
[128] Rule 21.1, The City Code on Takeovers and Mergers.
[129] 2006 No. 1183, The Takeovers Directive (Interim Implementation), Regulations 2006, Ch. 3, 22.

4.3.4 Corporate Governance in the UK

"The UK policy seems to be dominated by an industrial strategy and encourages competition and fair play, thereby protecting the interests of the shareholders to the maximum."[130]

- Joy Dey

As previous sections within the project clearly demonstrate, the UK corporate governance system has shareholder value as the priority. It becomes apparent when studying restrictions against directors stated in the Company Act Chapter 2, § 550 in the light of § 549. Pursuant to its meaning, issuing new shares by directors requires an approval from the general meeting and in listed companies such approval is commonly accepted if the formalized guidelines derive from institutional investors. By case law the courts distinctly strikes down their opinion of decision rights by defying management boards, particularly in *Hogg v. Cramphorn Ltd*. The board allotted shares to the employees thus forestalling a takeover bid and in spite of alleging that the act was in the best interest of the company the transfer was held invalid by the courts "because the matter rests (…) between the trusts and the company".[131] The ability of using this type of defensive measure by the management board is thereby not possible. Poison pills were moreover subject to another dispute where the court held that a poison pill agreement signed by the management board in order to deter outsiders from making offers to the shareholders is void owing to the disadvantage of the shareholders.[132] These occasions are examples of when the management board cannot pursue any discretion whatsoever unless they have the approval by the shareholders.

4.4 Germany

4.4.1 Introduction

The unexpected hostile takeover of the Mannesmann Company made Germany to realize its vulnerability against hostile takeovers and the importance of defensive measures. The occurrence was criticized by German politicians and as a reaction, Germany proposed for a new regulation similar, but not equal to EU's Takeover Directive. Reasons for not having implemented the Takeover Directive in Germany at an earlier stage basically depended on the high level of cross-shareholder ship and of the system of "Depotstimmrecht".[133] Despite not having imposed Depotstimmrecht in any regulation, Germany in 1989 still rejected a proposal of the EU Takeover Directive with the motivation "there is no need for such regulation". Anyway, the German Control and Transparency Act was enacted in 2001 and included a clause containing a preauthorization of

[130] Dey, Joy, p. 9.
[131] Hogg v. Craphorn Ltd [1967] Ch. 254, 3 All E.R. 420, p. 426.
[132] [2004] UKHL 28, sections 29 and 36.
[133] Callaghan, Helen et. al., pp. 741-742.

poison pills.[134] Following year, the German Securities Acquisition and Takeover Act (hereafter WpÜG)[135] was implemented in Germany and had some modifications in 2006 to suit the Takeover Directive. The two most substantial modifications concerned the choice to opt out from the 'no frustration rule' in Art. 9 and the breakthrough rule stated in Art. 11.

4.4.2 Legal structure

Germany has like other EU jurisdictions (e.g. France and Belgium) chosen to appoint a higher civil law court specialized on takeover bids (Higher District Court of Frankfurt) where decisions of the supervisory authorities may be contested.[136] Usually, supervisory authority in Germany is not authorized to grant exemptions of the mandatory bid rule. However, the German Takeover Act is furthermore supervised by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht hereafter "BaFin"), a federal agency working as a neutral organ and may therefore represent the bidder or target in the event of a takeover. In this way the implementation of the Directive shall be prevented from potential imminent circumstances that may have affection on the implementation. The authority moreover has the power to make an exemption from the mandatory bid rule thus allowing the bidder to disregard from the rule if it is assumed to be in the best interest of the company.[137] It may be questioned whether BaFin has enough knowledge and experience to decide what is in the best interest of a company. Since companies are not equal, the exemption from the mandatory bid rule must be interpreted in the individual case. I doubt that an authority knows what is in the best of a company owing to every company's different needs, experiences, features etc.

4.4.3 Purposes

WpÜG essentially has two purposes. The first is to function as a legal framework providing an understandable overview of rules in respect of offering procedures in connection with a takeover whereas the second aims to maintain the transparency for all the persons concerned by the procedure. The German Takeover Act shall be applicable when a person offers to acquire a German target company listed on an organized securities market (stock exchange) in Germany or anywhere else within the European Economic Area (EEA).[138] The largest stock exchange in Germany, Frankfurt Stock Exchange FSE (Frankfurter Wertpapierbörse) is a trading center for securities. According to the Act there are three kinds of offers, namely Regular Offers - offers not aimed to take over the control of a company, §§ 10 et seqq. WpÜG, Takeover Offers - offers aiming to take

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[134] Callaghan, Helen et. al., pp. 749-752.
[135] Wertpapiererwerbs- und Übernahmegesetz, WpÜG.
[136] (MARKT/2010/10/F) (the "Study"), p. 46.
[137] Lohner, Andreas et. al., Public Takeovers in Germany, 2010, p. 10.
[138] EEA is an agreement between all EU Member States allowing the non-member states Norway, Iceland and Liechtenstein to participate in EU's market.

over the control of a company (acquisition >30% of the voting shares), §§ 29 et seqq. WpÜG, and Mandatory Offers - when individuals acquire control by purchasing shares from a shareholder or the stock exchange, §§ 35 et seqq. WpÜG. Provided that the offer is public, the WpÜG will be applicable regardless of whether the bidder aims to acquire control or not over the company.

4.4.4 The rejection of the board neutrality rule

Germany has chosen to opt out from the board neutrality rule and as a representative of EU's major states, Germany is quite unique with its position. Other Member States that have refrained from the rule as well are Luxembourg, the Netherlands, Belgium and Denmark.[139] According to 33§ WpÜG, the management board is permitted to allow defensive measures regardless of the shareholders' approval. The rule allows the management board to ask the shareholders voluntary. It seems odd to ask for an approval if not required by law since it increases the chances of taking a defensive measure. It might be appropriate if the management board has a closer relationship with the shareholders.[140]

4.5 The Directive has not led to major changes

In the Report of 2012 made by the European Commission it is explained that the Directive on Takeover Bids has not led to any major changes. The Commission refers its statement to that rules similar to those within the Directive already existed in the Member States' national legislation prior to the Directive.[141] I want to refer the circumstance additionally to the Directive's optional arrangements. If the breakthrough rule and board neutrality rule were mandatory; the Member States would likely experience changes in their national system. One can argue why EU implemented the Directive in the first place if it did not make any difference as compared to the conditions prior to the Directive. This issue is discussed more in the second question of the Analysis.

4.6 Conclusion

When observing the three countries' implementation of the Directive, there is nothing indicating that the Directive has affected the Member States more than certain confusion owing to the Directive's rules' general definitions. The Finance Company-case in Sweden for instance shows that interpretation of LUA is identical compared with the time prior to the implementation of the Takeover Directive. The UK furthermore did not have to worry much about how the implementation of the Directive would affect the national law

[139] (SEC)2007 268 21.02.2007, p. 12.
[140] My own opinion.
[141] COM (2012) 347 final, Brussels, 28.6.2012, p. 3.

since the Directive has been inspired by the UK Takeover Code and because the board neutrality rule derives from the Code. Finally, the only country that would have to fear substantial changes in law is Germany since it does not apply the board neutrality rule like UK and Sweden. However, since the rule is optional as well as the breakthrough rule, neither did Germany face any major changes in its domestic law owing to the implementation of the Takeover Directive.

5 Analysis

5.1 Introduction

This Chapter aims to answer the questions presented in the Introduction. A brief summary from previous Chapters are enclosed in each of the three following sections. Every section ends with a reflection where the answer to the question is embedded along with my own opinion of the issue.

5.1.1 Does the Directive serve its purposes?

The first question treats the issue whether the Directive on Takeover Bids serves its purposes. In order to answer the question it is of substantial significance to determine the purposes aspired to be achieved by the Directive. Within the project, certain goals have been mentioned occasionally and I will focus on three of them: increased competiveness on the European market, a common regulation among EU members regarding takeovers by hostile bids and greater legal certainty for cross-border takeover bids.

To attain increased competiveness on the European market the Commission established the board neutrality rule and the breakthrough rule. The former had some penetrative power since 19 of the Member States adopted the rule whereas the latter was a great breakdown. The breakthrough rule (e.g. strikes out multiple voting rights and facilitates amendments in the corporate charter, *see 3.2.*2) carries an important feature for takeover activities because it facilitates the process of acquiring the target company tremendously. In spite of the Commission's supporting attitude towards the rule it has not been enacted by any Member State (except the Baltic States). The failure of implementation of the rule is not surprisingly mentioned briefly by the Commission. Several authors on the other hand have frequent claimed that the rule is a failure including the allegation that neutralization on pre-bid measures (*i.e.* the one share, one vote principle) may damage companies in Member States using dual class share system (France and the Scandinavian countries).[142] Others have asserted that the impediment of pre-bid defenses forces affected companies to take pre-bid measures that are not included in the breakthrough rule such as pyramids or golden shares.[143] If a company is transformed into a pyramid structure it will furthermore create an opaque control structure (which would contradict the general principle of disclosure) or strengthening the stakes of controlling minority shareholders.[144] What concerns golden shares, the ECJ laid down in the *Volkswagen-case* that the golden shares interfered with the provisions in Art. 56 EC regarding free establishment and movement, and that the golden

[142] Stattin, Daniel.
[143] Bebchuk and Hart.
[144] Berglöf and Burkart.

shares are an obstacle especially for foreign investors.[145] EU is usually featured as a market in favor of free movement and a free market for its own actors as well as for outsiders, e.g. actors from the USA and China. Nonetheless, there will always be a dispute of how much freedom the Member States are willing to allow respectively and to prohibit. The *Volkswagen-case* has substantial relevance for the illustration of EU's standpoint against golden shares and marks clearly that Germany is reluctant regarding actions taken for a freer market. In addition, given that the Directive's rules concerning board neutrality and breakthrough remain optional, the aim of a level playing field will not be accomplished.[146]

The next purpose is a common regulation among EU members regarding takeovers by hostile bids. In the Takeover Directive, there are various ways to provide the shareholders with equal protection associated with takeovers e.g. by imposing the mandatory bid rule (making a proposal to all the shareholders) and the board neutrality rule (defensive measures cannot be applied unless the action has been approved by shareholders at a general meeting). The Directive thus contains several rules in favor of the shareholders and if they were implemented equally by the Member States, shareholders in EU would probably treated equally in relation to a takeover. However, the Commission seems to be unsatisfied in regards to the Member States' implementation of the mandatory bid and board neutrality. Owing to certain ambiguities concerning the conditions on the mandatory bid set forth in Art. 5(2), offerors have been able to offer an excessively low bid thus circumventing the expression "where control has been acquired following a voluntary bid (…), a mandatory bid no longer applies".[147] Nonetheless, some countries including the UK have a condition requiring the acceptance of at least 50% of the shares to trigger the mandatory bid.[148] Yet, the mandatory bid in most jurisdictions threatens to injure the protection of minority shareholders. Therefore, if the rule requiring that 50% of the bid must be accepted to trigger the mandatory bid were adopted by Member States struggling with offerors who circumvent the law, the prevention against the evasion of the mandatory bid might protect their shareholders as well. In addition, Art. 5 permits the Member States to decide when the rule is triggered. In spite of a general rule of 30% which many states seem to apply; Malta and Lativa require 50% of the shares and Poland 67%.[149] The subject of a mutual board neutrality rule has on the other hand been a relative success in the EU since it has been adopted by 19 of the Member States.[150] Still, several countries choose to refrain from the rule resulting in unequal regulation of takeovers in EU. What concerns the breakthrough rule, there is no unequal provisions since virtually no Member State has enacted the rule.

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[145] *See supra* 2.3.1.3.
[146] Ipekel, Ferna.
[147] *See supra* 3.4.1.1.
[148] *See supra* 4.2.3.
[149] *See supra* 3.2.4.
[150] *See supra* 3.4.1.1.

The third and last intention with the Directive is greater legal certainty for cross-border takeover bids. Except the recent statement of the *Volkswagen-case* in favor of actors outside the EU, legal certainty for cross-border (as well as domestic) bids moreover requires clear rules. To begin with, the Directive has been accused for being a fuzzy framework owing to obscure rules and too much discretion for the interpreter of certain rules e.g. the mandatory bid rule.[151] The Commission contrariwise asserts in the Commission's last Report of 2012 made to the Parliament, that stakeholders in the EU have been satisfied with the clarification of the Directive's rules. The statement is based on a legal questionnaire answered by 115 stakeholders from 22 of the Member States.[152] That is approximately 5 persons from each country and since the study reveals nothing about the participating stakeholders more than supervisors, stock exchanges or issuers etc., the lack of information makes the study less convincing or reliable.[153]

5.1.1.1 Reflections

The board neutrality rule and especially the breakthrough rule are both a valuable tool for increased competiveness owing to their effects but since they are optional, they will not foster takeover activity unless a majority of the Member States enact them. Optional arrangements which offer the opportunity to opt-out from these competition rules additionally result in different regulations dependent on which rules the Member States choose to opt in to or not. Moreover, since the interpreter has certain discretionary power when inserting the rules; each rule may vary from state to state (e.g. the mandatory bid rule). Finally, the discretionary power causes discrepancy and several authors accuse the legal framework for being fuzzy. In spite of the Commission's Study telling that stakeholders in general have been satisfied with the clarification; a Study based on 115 participators from 22 Member States is not in my opinion sufficient to represent EU as a whole. The objective of legal certainty is not accomplished either. With support of the foregoing it is my opinion the Directive does not achieve its purposes.

5.1.2 How has the implementation of the Directive affected the Member States' national law?

The answer to how the implementation of the Takeover Directive has affected the Member States' national law, is based on the comparison set forth in Chapter 4. When answering the question there are two factors that need to be taken into account, namely how the Directive was implemented and what has been implemented. The answers will enable an examination of whether the Directive has led to any changes in national law and eventually how it has affected the Member States' national law. A brief description of how the Directive has been implemented will be presented in the following starting with Sweden. Pursuant to Art. 4.1 of the Takeover Directive, states

[151] Humphery-Jenner, Mark.
[152] *See supra* 3.4.1.
[153] My own opinion.

shall designate the regulatory competence to public authorities, associations or private bodies recognized by law or regulation. Finansinspektionen has been appointed as supervisor and Aktiemarknadsnämnden whose liability comprises rules regarding defensive measures and the mandatory bid rule. The UK uses the Takeover Panel and its decisions may be appealed to the Takeover Appeal Board. In Germany, BaFin is the representative authority in regards to takeovers. BaFin additionally has the power to make an exemption of the mandatory bid rule if it considers the action to be in the best interest of the company.

The Directive requires that it shall be implemented in accordance to the Member States' national system and their cultural context. Sweden has enforced the rules partially through rules that are teleological. Anyhow, the mandatory bid rule was implemented more restrictive due to its characterization of being onerous for the bidder. Since the Directive permits both a teleological and a restrictive interpretation, Sweden has implemented the Directive without any particular remarks. In addition, the Company Finance-case shows that AMN's decisions prior to LUA are equal to its standpoint to date. The UK used the same method when interpreted the Takeover Directive and since the Directive is based on the UK Takeover Code, the UK did not face any particular changes. Germany has chosen to opt out from both the breakthrough rule and the board neutrality rule and the Takeover Directive has thus not led to any major changes in the German law either.

5.1.2.1 Reflections

The answer to the question how the Takeover Directive has affected the Member States' national law is by virtue of the comparison in Chapter 4 and comments in previous section that Member States have not faced any remarkable changes in national law owing to the opportunity to refrain from certain rules. What is the point of implementing a Directive that has no affect on any of the Member States' national laws whatsoever? One explanation might be that the Commission did not expect the rule of breakthrough and board neutrality to be adopted at first but might be in the future if the rules are made mandatory to apply.

5.1.3 Is a mutual regulation on takeover bids in EU reasonable for the Member States?

The third question set forth in the 'Introduction' deals with the issue whether a mutual regulation on takeover bids in EU is reasonable for the Member States. Finding the answer of that question requires a comparison between certain Member States' corporate governance, legal structure and market economy. As explained in Chapter 3, these features differ among the Member States dependent on different experiences, backgrounds and traditions. In this section I will compare these features between Germany and UK. The corporate governance in Germany is recognized by its two-tier system which is a board structure consisted of managers and either shareholder representatives or labor directors or both. The two-tier system

moreover contains dual decision-making power; an appraisal right governed by the principle to act in the best interest of the company. The management board's decisions concerning insertion of defensive measures does not have to be supported by the company's shareholders although the approval of a supervisory board is required by law. A problem that may occur in this context when a board has too much discretionary power is the familiar agent-principal conflict. Managers who are afraid of losing their position as a result of a takeover might apply defense measures in their own interest rather than in the company's. However, this structure is asserted to be stakeholder friendly, it fosters and protects "insiders" which are persons possessing an interest within the firm, *inter alia* employees, investors, issuers and directors. Companies in the UK on the other hand belong to a one-tier system where the directors of the board have decreased power compared to the control in a two-tier system. Shareholders contrariwise have a greater influence and owing to the board neutrality rule, the board cannot take any action to frustrate a bid (defensive measures) unless the measure is supported by the shareholders. This version of corporate governance seems to be in favor of "outsiders" represented by shareholders. The corporate system thus supports the shareholder value.

Another important aspect is a country's legal structure. The German structure 'German Model' explained *supra* will be repeated briefly in this context with focus on the Model's three fundamental elements; banks' influence, co-determination and golden shares. German banks have substantial influence over corporations and owing to 'Depotstimmrecht' (rights to vote on behalf of shareholders), banks' reluctance against takeover activities thus hampering the performance of a hostile takeover. Next element, co-determination, allows workers to represent the board of a company and to posses certain power to affect the takeover process. This defensive measure is therefore an advantage for the company's stakeholders. For this reason, the measure may also make the company less attractive in the buyers' (foreign commonly) eyes who may disregard a purchase of a company encumbered with co-determination in the management board.[154] Because employees might lose certain rights if the acquirer changes the employee conditions, they are the stakeholder gaining most from this measure. A quite unexpected enemy of the co-determination is EU. The Commission blames the measure for obstructing a takeover if the offeror wants to take control of the company but does not mention anything about prohibiting co-determination by law.[155] Golden shares are the last element of the German Model and provide the government the advantage of veto rights in the company irrespective of how many per cent the golden shares represents. The UK is on the contrary characterized by the laissez-faire theory[156] since the market is supported by self-regulation without the involvement of e.g. authorities. Unlike Germany, banks in the UK are separated from the corporation and do not vote on behalf of the shareholders. Co-determination and golden shares are moreover unknown

[154] *See supra* 2.1 third section.
[155] *See supra* 3.4.1.
[156] *See supra* 3.3.3.

by UK companies and poison pills are undesirable and have even been subject to legal cases.[157] Conclusively for the section treating corporate governance; the most vital difference between the countries is the view of for whom decisions shall be made. According to Germany, decisions shall be made in the interest of the company while UK utters that decisions shall be made in the interest of the shareholders.[158]

At last, the values of a market economy has an important role for how rules governing corporations are performed and the differences between Germany and the UK are salient. Chapter 3 in the project regarding takeover bids defines two types of 'market economy'; Co-ordinated Market Economy (CME) and Liberal Market Economy (LME). While a CME is characterized by the close relationship between financial institutions and the use of co-ordination approaches, a LME on the other hand consists of a competitive market where financial institutions do not co-operate with the company in the same manner. The German market economy is typically regarded as a CME owing to the close relationship between German corporations and financial institutions such as banks. The system is regarded as a long-term relationship because it aims to foster the company's "insiders" *i.e.,* the stakeholders. The UK laissez-faire theory is contrariwise associated with LME, the structure instead signifies competiveness and the UK is thus not unfamiliar with takeover activities like Germany. Frankly, the UK has 4400 listed companies and is, dependent on the competitive market, in need of an extensive legislation governing takeovers. The relative low activity on takeovers in Germany where only 750 companies are listed and where several defensive measures are supported by law, decreases the need for a takeover law.

5.1.3.1 Reflections

The question whether a mutual regulation on takeover bids in the EU is reasonable for the Member States carries an ambiguous answer. To begin with, a comparison between two Member States' determinations of corporate governance, legal structure and market economy proofs that the differences are remarkable. Supposedly, Germany and the UK might be the States within EU containing most dissimilarities one to another. In respect of corporate governance, the two legal systems mainly differ on the board structure. Germany uses two-tier system while the UK has a one-tier system. What concerns the use of defensive measures, the German legal structure simplifies the use of such defenses while the UK despises them. Additionally, the market economy differs among the countries since Germany supports a CME and UK appears to follow a LME. Neither is this outcome of this study of any news or particularly unusual. Due to historical experiences such as financial crises, wars and of political reasons, Member States' jurisdictions have been shaped differently. Therefore, a working mutual regulation on takeover bids in the EU is rather than realistic, probably an utopia. The differences between Member States' Corporate Law

[157] [2004] UKHL 28 and Hogg v. Craphorn Ltd. For further information, *see supra* 4.2.4.
[158] What concerns Sweden, the Company Law is built on the same principle as UK, 'in the best of the shareholders'.

are too significant to find a solution that suits everyone. Simultaneously, the corporate market within the EU has grown tremendously lately and for actors participating on the market, a uniform law governing takeover activity would probably be preferable. For that reason, my persuasion is that in practice, a mutual legislation is not possible owing to factors like differences in corporate governance, legal structure and market economy among the States. However, a mutual law might be a way of increasing activity on the corporate market which is appropriate for parties acting on the market and for the development of EU as a whole.

6 Conclusion

6.1 Final remarks

The reflections from the analyzing part of this project have proven that the Directive does not serve its purposes, that the Directive has not affected the Member States' national regulation and that a common regulation on takeover bids in EU might be reasonable but not practically forcible.

Moreover, the Commission's Report of 2012 explains that the Commission does not intend to make the board neutrality rule and breakthrough rule mandatory. Yet, I would not be surprised if the Commission bares in mind that the rules will become obligatory one day in order to achieve the purpose of an increased competitive market.

I do not believe that a mandatory breakthrough rule would be appropriate at present owing to a strong opposition by several Member States. It is likely that it would harm dual-share class system due to the principle 'one share-one vote'. On the contrary, I support Skog regarding the protection of shareholders; a controlling shareholder in a dual-share class system listens to the minority thus protect them in combination with a takeover. Anyway, there is nothing that indicates any signs of dissatisfaction regarding the board neutrality rule. Out of the 19 Member States that have implemented the rule, none has opt-out from the rule afterwards; nor is there any case law where the rule has been subject to a dispute. Making the rule mandatory could therefore be an alternative to increase the competitive market irrespective of the maintenance of a voluntary breakthrough rule.

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