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AN OCEAN APART: THE MANDATORY TAKEOVER RULE IN BRAZIL AND IN EUROPE

Jorge Brito Pereira

ABSTRACT

The common statement that there are two different regulatory systems concerning the mandatory takeover rule – the market rule system and the equal opportunity system – is, in practice, overly simplistic: facing the choice between freedom and strict regulation on whether the control premium should be proportionally shared with all non-controlling shareholders, some jurisdictions have adopted a hybrid solution. The Brazilian mandatory takeover rule (re)approved in 2001 is a good example. This paper will comprehensively analyse the Brazilian and European rules on mandatory takeover bids, using empirical data about the Brazilian markets and details of various cases that tested the limits of the existing regulation.

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INTRODUCTION

There are two coexisting regulatory systems concerning the mandatory takeover rule (MTR). In countries such as the United States (US), the seller of the controlling stake receives the control premium in full, and the acquirer of the controlling stake is free to decide whether to propose acquiring the remaining shares and, if so, on what proposed terms and conditions. This is designated as a market rule system, a private negotiation rule system, or a 'street' system. In other countries such as European Union (EU),[1] following a regulatory path dating back to the 1972 version of the United Kingdom's (UK's) City Code on Takeovers and Mergers,[2] the acquirer of a controlling stake in a listed company (30–33% of voting shares) must extend an offer to purchase the shares of all other shareholders on equivalent terms and conditions. This is designated as a sharing rule system or an equal opportunity system.

The US has no general federal MTR, which means the bidder may acquire a large block of shares (or several large blocks of shares) in a bilateral negotiation or the stock exchange or may launch a takeover bid to acquire some or all the target's shares, regardless of the voting threshold it thereby meets. At the state level, the only (limited) exceptions are Pennsylvania, Maine, and Utah.[3] The equal treatment of shareholders under the Williams Act (since its original text of 1968) is limited to federal rules requiring a tender offer to pay the same price for each acquired share and treat all tendering shareholders equally. These rules ensure *pro rata* tender offers, not that all shareholders can necessarily sell all their shares on conditions equivalent to those offered to the controlling shareholder.

Differences in takeover regulation between Europe and the US go far beyond the existence of an MTR, even if this is probably the most iconic; further examples include the actual role and fiduciary duties of the board of directors during a takeover (neutrality duty or passivity rule) and the effectiveness of defence strategies. Generally, the two regulatory approaches are philosophically different: while the European approach involves relevant restrictions for bidder and target, as well as larger protection for minority shareholders, the American approach accepts more freedom for both players.[4]

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1 Council Directive 2004/25, 2004 O.J. (L 142) (EC).

2 This is conventionally referred to as the City Code or Takeover Code.

3 This exception is not material as these rules are a limited equivalent to the MTR and none of these three states has a relevant number of listed companies incorporated under their laws. *See* Jo Watson Hackl & Rosa Anna Testani, *Second Generation State Takeover Statutes and Shareholder Wealth: An Empirical Study*, 97 YALE L.J. 1193, 1196 and 1207–1208 (1988); Carole Piacentile Aciman & Peter M Kent, *Rights of Minority Shareholders in the United States Under State Law upon a Sale of Control*, INT'L BUS. L.J. 203 (1995); Jeremy Grant, et al., *Financial Tunnelling and the Mandatory Bid Rule*, 10 EUR. BUS. ORG. L. REV. (EBOR) (2009); Stefan Grundmann, *The Market for Corporate Control: The Legal Framework, Alternatives, and Policy Considerations*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 423-424 (2005).

4 For an overview of the main discrepancies, *see* Marco Ventoruzzo, *Europe's Thirteenth Directive and US Takeover Tegulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171 (2006); Guido Ferrarini & Geoffrey P Miller, *A Simple Theory of Takeover Regulation in the United States and Europe*,

There are multiple explanations for this regulatory gap. Lucian Bebchuk points out that the dynamics of regulatory competition between different US states favour solutions preferred by the incumbent management of listed corporations.[5] Scholars such as John Armour and David Skeel argue that the respective structures of regulation – informal guidance by the UK's Panel on Takeovers and Mergers versus Delaware jurisprudence and federal regulation – explain why Britain grants shareholders extensive authority whereas significant managerial discretion is dominant in the US.[6] According to Andrew Johnston, the City Code rules were designed to address common law's incapability of establishing a regulatory system under which takeovers viably assure managerial accountability to shareholders – in particular, common law considered sales of shareholdings as private matters with no implications for those outside the contract, and so would not regulate equal treatment of shareholders in a change-of-control event.[7] Others, such as Marco Ventoruzzo, call attention to (a) the consequences of the typical dispersed ownership structures of listed companies in the US and (b) the general efficiency of robust financial markets as central reasons for the divergence.[8] Finally, scholars like Ferrarini and Miller point to the political forces operating at different geographical levels under different conditions.[9]

There are indisputably fundamental differences between the market rule and sharing rule systems – most prominent are differences in takeover dynamics and market efficiency, in the behaviour of bidder and shareholders, in the discipline of the board, in the protection of minority shareholders, and in the efficiency of the market for corporate control. In this sense, any mandatory takeover regulation implies a trade-off between the protection of non-controlling shareholders and the efficiency of the market for corporate control. These implications have been thoroughly discussed and debated, particularly in

42 CORNELL INT'L L.J. 301 (2009); William Magnuson, *Takeover Regulation in the United States and Europe: An Institutional Approach*, 21 PACE INT'L L. REV. 205 (2009); Grundmann *supra* note 3.

5 Lucian A Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VIRGINIA L. REV. 111 (2001) (explaining that there is wide support for introducing federal mandates in areas such as takeover law and/or the powers of the board during hostile takeovers). *See e.g.* Samuel C Thompson Jr, *Change of Control Board: Federal Preemption of the Law Governing a Target's Directors*, 70 MISS. L.J. 35 (2000) (explaining that regulatory competition admittedly favours solutions in line with the interests of management (the stakeholder that ultimately decides where to incorporate and where to remain incorporated), and state takeover law has provided incumbent managers substantial protection from hostile takeovers).

6 John Armour & David A Skeel Jr, *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation*, 95 GEO. L.J. 1727 (2006). *See also* Magnuson *supra* note 4.

7 Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAMBRIDGE L.J. 422 (2007).

8 Ventoruzzo *supra* note 4 at 190-91.

9 Ferrarini & Miller *supra* note 4 at 334.

European legal and economic literature during the decades preceding the approval of the Takeover Directive.[10]

This paper does not intend to dive into the specificities of the two systems, the reasons for the discrepancies, or the radically different economic effects of each solution. It acknowledges that there is a gap with tremendous implications between the American and European regulatory approaches to the MTR. However, I wish to focus on the hybrid solution developed by Brazil, among other jurisdictions: on many levels, this solution is quite distant from the letter and the spirit of the European rule and, in practical terms, may even be slightly closer to the dynamics of market rule jurisdictions. Because of the (limited) harmonization effects of the Takeover Directive, EU Member States ceased to apply hybrid solutions from 2004. By contrast, Brazil still has a hybrid regulatory solution.[11]

Such hybrid solutions are interesting on different levels. First, looking at the past, they make clear the historical context and the path dependence of each regulatory solution. This is one of those cases where history indeed matters. Second, looking at the future, such hybrid solutions are a relevant indicator of how market forces are operating in that specific jurisdiction, showing us if the regulation is stable or if it is being pushed in the direction of the market rule system or the sharing rule system.

I will conclude that there are strong forces pushing the Brazilian regulatory solution in the direction of the sharing rule system. To explain this trend, this paper undertakes a comprehensive historical and critical analysis of the Brazilian MTR, in part by comparing it against article 5º of the Takeover Directive. I argue that in a context of low ownership concentration, the ineffectiveness of the Brazilian MTR in article 254-A of the Lei das Sociedades por Ações (Joint-Stock Companies Law) of 1976 (LSA) opened the door for aggressive self-regulation led by, and serving the interests of, incumbent blockholders. This

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[10] Erik Berglöf et al., *European Takeover Regulation*, 18 ECON. POL'Y 171 (2003); Guido Ferrarini, *Share Ownership, Takeover Law and the Contestability of Corporate Control*, Paper prepared for Presentation at Conference on Company Law Reform in OECD Countries: A Comparative Outlook of Current Trends (2000); Luca Enriques, *The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?*, 1 EUR. CO. & FIN. L. REV. 440 (2004).

[11] There are interesting papers comparing the diverse MTRs in the United Kingdom, the European Union (under the Takeover Directive), and Brazil. *Compare* Erik Frederico Oioli, *Oferta pública de aquisição do controle de companhias abertas* (2008) (Master's dissertation, Universidade de São Paulo), *and* Pedro Testa, *The Mandatory Bid Rule in the European Community and in Brazil: A Critical View*, (2006) (LL.M. dissertation, the London School of Economics and Political Science), *with* Pedro Cordelli Alves, *A oferta pública de aquisição obrigatória nos ordenamentos jurídicos brasileiros e português*, 7 DIREITO DAS SOCIEDADES EM REVISTA 199 (2015).

movement led to provisions that generally work as pure defences against hostile takeovers, and not as proper, balanced responses to the MTR's insufficiencies. The result is that minority shareholders still lack protection; in fact, their position is probably worse now than two decades ago.

This paper is structured as follows. Section 2 describes the long and troubled road of the MTR in the Takeover Directive, from its original roots in the 1972 version of the UK Takeover Code, and the 1974 Pennington Report, until its final approval by the European Parliament in 2004. Section 3 does the same exercise for the history of the MTR in Brazil, from the contemporaneous roots of the preparation of the LSA to the approval of its 2001 revision that reinstated the MTR. I will point out how the original roots of the MTR in the Takeover Directive and in Brazilian regulations, dating back about half a century, have dramatically impacted the solutions adopted today. Section 4 dives into the most remarkable difference between the two regulations: whereas the MTR in the directive is triggered by the acquisition of securities above a certain threshold of voting rights, regardless of the cause of the acquisition, the Brazilian rule is triggered only by a secondary transfer of a controlling stake, thus presupposing – as was the case for most Brazilian listed companies until recently – that a transfer of control depends on the agreement of the incumbent controlling shareholder. Section 5 then describes the most important differences between the systems concerning the price of the mandatory bid. Section 6 explores how several companies listed on the Novo Mercado have recently used specific provisions in the articles of associations to trigger the obligation for a mandatory takeover bid, with thresholds usually set between 10% and 35% of voting shares. Finally, Section 7 concludes.

I. HISTORICAL CONTEXT OF THE MTR IN THE TAKEOVER DIRECTIVE

The MTR was first introduced in the UK in 1972 by the City Panel.[12] In October 1971, Ozalid Company Limited announced a takeover of Venesta International (and the shares of Keizer Venesta Limited not already owned by

[12] THE TAKEOVER PANEL (THE PANEL ON TAKEOVERS AND MERGERS), https://www.thetakeoverpanel.org.uk/. The City Panel was established in 1968 as the entity in charge of administering and enforcing the City Code. The Panel was a self-regulatory entity with no statutory authority. This changed with the implementation of the Takeover Directive. Article 4(1) of the Directive stipulates that 'Member States shall designate the authority or authorities competent to supervise bids for the purposes of the rules which they make or introduce pursuant to this Directive. The authorities thus designated shall be either public authorities, associations or private bodies recognized by national law or by public authorities expressly empowered for that purpose by national law.' Section 942 of the Companies Act 2006 confers certain statutory powers to the Panel. *See* PAUL DAVIES & SARAH WORTHINGTON, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 920-930 (Sweet & Maxwell, 10th ed. 2016).

Venesta). The offer was partly in shares and partly in convertible unsecured stock. The Venesta shares were valued at about 42p. The board of Venesta advised shareholders to reject the offer, stating it was 'far below the true value of the group'. The price of Venesta shares rose on the stock market to over 50p. In the meantime, company shareholder David Rowland started acquiring shares in Venesta, privately purchasing a block of 1,000,000 shares at 55p per share. In November, the rival bidder Norcros Limited announced its offers for Venesta and Keizer's equity, valuing the shares at approximately 52p. Following this announcement, David Rowland (indirectly) acquired more shares in Venesta on the market at prices ranging from 50p to 56p. While stating that he merely intended to oppose the takeovers and preserve the value of his investment (which he successfully did), such acquisitions granted him a controlling position in Venesta without a takeover bid and without giving minority shareholders of Venesta and Keizer the option to sell their shares on the more favourable terms they would been offered had a rival bid succeeded.

The Takeover Panel analysed if rule 33 of the Code – intended to prevent the frustration of a *bona fide* takeover by a third party – had been breached. It concluded that the City Code 'did not impose any obligation on an individual who has acquired control by a series of purchases in the market to endeavour to obtain the remaining shares. Under the 1968 version of the Code, the Panel had enforced rules 10 and 26 – envisaging sales of controlling stakes by directors and partial bids – to require those acquiring significant blocks of shares to make an offer to the remaining shareholders. It became clear, however, that this was insufficient, requiring the Panel to determine in each case if 'effective control' was transferred, which involved assessing factors such as the company's ownership structure and the level of shareholder involvement.[13] Conversely, it became clear that creeping acquisitions of shares through market purchases and bilateral share purchase agreements could have the effect of frustrating the fair expectations of minority shareholders, and that the 1968 rules would only apply upon a transfer of control from an existing controlling shareholder (a secondary transfer of control). Following the takeovers of Venesta and Keizer, the Panel approved the first version of the MTR: a new rule 35, requiring any person who purchases 40% or more of a listed company's shares to bid for the remaining shares; and a new rule 34, concerning the acquisition of significant holdings

[13] Panel Statement, The Takeover Panel, *The Consolidated Signal Company Limited/Venesta International Limited* (Jan. 6, 1972), https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1972-01.pdf; Johnston, *supra* note 7; Armour & Skeel Jr, *supra* note 6 at 1763–1764; Ferna Ipekel, A Comparative Study of Takeover Regulation in the UK and France 154 (Aug. 2004) (Ph.D. thesis, London School of Economics and Political Science).

from directors or a limited number of sellers. The threshold of rule 35 was lowered to 30% in 1974,[14] where it still stands.[15]

The functionality underlying the MTR remains essentially the same as in the 1972 version of the City Code and is based on two fundamental premises. First, all shareholders should be given an option to sell out – an exit option – on favourable terms if a new controlling shareholder emerges (regardless of whether this results from a secondary transfer of control).[16] Second, if any control premium is paid, it must be proportionally shared by all shareholders.

The current version of article 9.1 of the Code states:

> Except with the consent of the Panel, when: (a) any person acquires, whether by a series of transactions over a period of time or not, an interest in shares which (taken together with shares in which persons acting in concert with that person are interested) carry 30% or more of the voting rights of a company; or (b) any person, together with persons acting in concert with that person, is interested in shares which in the aggregate carry not less than 30% of the voting rights of a company but does not hold shares carrying more than 50% of such voting rights and such person, or any person acting in concert with that person, acquires an interest in any other shares which increases the percentage of shares carrying voting rights in which that person is interested, such person shall extend offers, on the basis set out in rules 9.3 and 9.5, to the holders of any class of equity share capital whether voting or non-voting and also to the holders of any other class of transferable securities carrying voting rights. Offers for different classes of equity share capital must be comparable; the Panel should be consulted in advance in such cases.[17]

The influence of the UK legal system on the Takeover Directive and on the MTR is unequivocal. Gelter and Reif call the Takeover Directive a 'watered-

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[14] Proposals made in 1989 and 1992 to reduce the 30% threshold were both rejected: see Panel Statement of 26 June 1989 on the Report of a Panel Working Party on Takeover Rules and Practices; Ipkel, *supra* note 13 at 157.

[15] The 1974 revision went deeper. First, it replaced the old rules 34 and 35 with one set of requirements, eliminating the distinction between selective purchases and market purchases; second, it established the 30% threshold as 'effective control' for Code purposes in virtually all circumstances. *See* Johnston, *supra* note 7 at 445*; see also* Ipkel, *supra* note 13 at 155–156 (comprehensively describing the 1972 and 1974 versions).

[16] The explanation for article 35 in the 1971/72 Report of the Takeover Panel is very clear on this: the rule 'brings within the scope of the Code any series of purchases (or other acquisitions) of shares, however gradual, which brings about a change of effective control'.

[17] The Takeover Panel (The Panel on Takeovers and Mergers), *The Takeover Code*, (12th ed. 2016), https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf.

down version of UK takeover law'.[18] Others, like Venturozzo, make the important point that the influence of the UK system is also indirect, since several continental European systems adopted the British approach before this was required by the EU.[19] In fact, this regulatory inspiration is one of the few coherent features throughout the long, troubled and embarrassing[20] approval process of the Takeover Directive, from the 1974 draft to its final approval by the European Parliament in April 2004.

Attempts to harmonize takeover regulation in Europe began in 1974, when a first draft proposal for a directive was presented. At that time, requiring an entity to launch a general offer to acquire all outstanding shares following the acquisition of a certain number of shares was not exclusive to the English legal system; however, it was far from a generally accepted principle. This first draft was based on the 'Pennington Report',[21] an appraisal of takeover regulation authored by UK company law expert Professor Robert Pennington, at the instigation of the European Commission. Unsurprisingly, this report reflected the then-dominant perspectives of UK corporate law, particularly because London was home to the most important stock exchange in Europe and the reference for takeovers experience. After 1953, the number and complexity of takeover bids in the UK led to special attention from regulators, aiming to discipline tenders and protect minority shareholders. The focus of regulation and litigation was defensive measures taken by boards. Only in the 1970s and 1980s did other countries follow this path.

With the focus on abuse prevention, equal treatment of shareholders, and protection of minority shareholders, the draft proposal was directly influenced by the recent UK experience concerning the MTR and the recently approved revision of the Takeover Code (1972). As the Pennington Report stated, 'inevitably abuses and unfair practices have occurred in connection with takeover bids, and national legislation in some of the Member States of the European Communities and professional rules and codes of conduct in others

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[18] Martin Gelter & Alexandra M. Reif, *What Is Dead May Never Die: The UK's Influence on EU Company Law*, 40 FORDHAM INT'L L.J. 1413 (2017).

[19] Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking UK Rules to Continental Europe*, 11 J. BUS. L. 135 (2008). It is generally stated that, in the 1980s, several continental European countries followed the City Code as *the* regulatory benchmark. *See also* Marc Goergen, et al., *Corporate Governance Convergence: Evidence from Takeover Regulation Reforms in Europe*, 21 OXFORD REV. OF ECON. POL'Y 243 (2005); Klaus J Hopt, *Common Principles of Corporate Governance in Europe*, *in* CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY 178-181 (Joseph McCahery et al., eds., 2002).

[20] EILÍS FERRAN, BUILDING AN EU SECURITIES MARKET 117-118 (Cambridge Univ. Press 2004).

[21] Commission Report of the Directorate-General for Internal Market on Takeover and Other Bids XI/56/74-E (1974), retrieved from http://aei.pitt.edu/33743/1/A304_1.pdf.

have been devised to counter them'. Article 7 of the 1974 draft regulated the 'obligation to make a general offer', stating that an entity must make a general offer to acquire all voting securities if that entity (a) holds securities entitling the holders to exercise at least 40% of the voting rights; (b) has within the preceding 12 months acquired securities entitling the holders to exercise at least 20% of the voting rights; or (c) 'enters into an agreement to acquire securities of the other company which, when added to the securities already held by that person or body of persons, will entitle their holders to exercise voting control over the other company'.

The Pennington Report and the draft directive did not receive the support required to continue the legislative process. This reflects that takeover regulation was not considered necessary in most continental jurisdictions in the late 1970s and the 1980s, as there were virtually no takeovers outside the UK.[22] After a couple of years, interest in the project was lost.

Only in the mid-1980s did the European Commission reenergize the initiative. The catalyst was the Commission's 1985 white paper 'Completing the Internal Market', which included general remarks concerning takeovers. The most important ones were as follows:

> There is a case, however, for making better use of certain procedures such as offers of shares to the public for reshaping the pattern of share ownership in enterprises, since the rules currently in force in this sphere vary a great deal from one country to another. Such operations should be made more attractive. This could be done by requiring minimum guarantees, particularly on the information to be given to those concerned, while it would be left to the Member State to devise procedures for monitoring such operations and to designate the authorities to which the powers of supervision were to be assigned. (paragraph 139º)
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> In order to adapt Community obligations to changes in financial techniques and so improve the arrangements for operations which have grown substantially in importance. Action will have to be taken at Community level to liberalize operations such as the issue, placing and acquisition of securities representing risk capital, transactions in securities issued by Community institutions and long-term commercial credit. (paragraph 141º)

[22] *See* Robert R Pennington, *Takeover Bids in the United Kingdom*, 17 AM. J. OF COMPAR. L. 159 (1969); Johnston, *supra* note 7 at 422-460; Armour & Skeel Jr, *supra* note 6 at 1727-1794; Rolf Skog, *The Takeover Directive–An Endless Saga?*, 13 EUR. BUS. L. REV. 301 (2002); Berglöf et al., *supra* note 10.

At the end of the white paper, the Commission announced its intention to propose a directive governing takeover activity. [23]

In 1989, the European Commission presented its first draft proposal for a Thirteenth Directive on company law concerning takeover and other general bids.[24] This proposal was revised in September 1990 to reflect the opinions of the Economic and Social Committee and the European Parliament. Regarding the MTR, article 4º of the 1989 proposal – still in line with the City Code – stipulated that 'any person aiming to acquire a number or percentage of securities, which, added to any existing holdings, gives him a percentage of the voting rights in a company which may not be fixed at more than 33%, shall be obliged to make a bid to acquire all the securities of that company'. The amended 1990 proposal[25] kept the same principles, although it differed on several minor technical issues: 'any person ('the acquirer') who as a result of acquisition by himself or by a person referred to in paragraph 2 holds securities which added to any existing holdings give him a percentage of the voting rights in a company which may not be fixed at more than one-third of the voting rights existing at the date of acquisition shall be obliged to make a bid to acquire all the securities of the company'.

The proposal faced strong opposition from certain Member States, with the UK particularly vocal in opposing it. Even though the draft directive was mostly inspired by the City Code, the UK government feared that its approval would force the United Kingdom to abandon the self-regulation system, replacing it with a 'statutory' form of regulation that would compromise the special position of the Takeover Panel.

Even though takeover bids were mostly concentrated in the UK, in the late 1980s and early 1990s the phenomenon was rapidly spreading in continental Europe, after the hostile takeover of Société Générale de Belgique in 1988,[26] Schneider's takeover of Télémecanique[27] and Banco de Bilbao's attempted takeover of Banco Español de Credito (Banesto). Europe was not a regulatory level playing field: while some jurisdictions ignored takeover regulation

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[23] Commission White Paper on Completing the Internal Market (June 14, 1985), https://op.europa.eu/en/publication-detail/-/publication/4ff490f3-dbb6-4331-a2ea-a3ca59f974a8/language-en; Dmitry Tuchinsky, *The Takeover Directive and Inspire Art: Reevaluating the European Union's Market for Corporate Control in the New Millennium*, 51 N.Y.L. SCH. L. REV. 689 (2006-2007).

[24] Official Journal of the European Communities, 27.11.1989.

[25] Official Journal of the European Communities, 26. 9. 1990.

[26] Dominique Barjot, *OPA sur la Générale de Belgique (1988)*, REVUE FRANCAISE D'HISTOIRE ECONOMIQUE 178 (2021) (Fr.).

[27] Michel Quere, *French Poison Pills and Take-over Restrictions*, 7 INT'L FIN. L. REV. 8 (1988).

(Denmark and Greece), others approved high-level regulation (France, Spain, and Portugal), and still others approved codes of conduct (the UK, Germany, and the Netherlands).[28] The Commission indicated in 1992 that it was planning to revise its proposal.[29]

Only in February 1996 was a new proposal for a Thirteenth Directive on company law concerning takeover bids presented.[30] It was finally adopted by the European Commission in 1997. This proposal was less detailed and attempted a lower level of harmonization to handle the opposition of different Member States. It is often referred to as a 'framework' directive, with five general principles that Member States would have to follow. Concerning the MTR, article 3º stipulated:

> where a natural person or legal entity who as a result of acquisition, holds securities which added to any existing holdings give him a specified percentage of voting rights in a company referred to in Article 1, conferring on him the control of that company, Member States should ensure that rules or other mechanisms or arrangements are in force which either oblige this person to make a bid in accordance with Article 10º or offer other appropriate and at least equivalent means in order to protect the minority shareholders of that company.31

Meanwhile, article 10º stipulated:

> Where a Member State provides for a mandatory bid as a means to protect the minority shareholders, this bid shall be launched to all shareholders for all or for a substantial part of their holdings at a price which meets the objective of protecting their interests. If the mandatory bid comprises only a part of the securities of the offeree company and the shareholders offer to sell to the offeror more shares than the partial offer covers, shareholders should be treated equally by means of a pro rata treatment of their shareholdings.

As explained in the proposal's introduction,

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[28] Corporate Governance in Europe: Report of a CEPS Working Party. No. 9290791942(1995); Skog, *supra* note 22. *See also* Nathalie Basaldua, *Towards the Harmonization of EC-Member States' Regulations on Takeover Bids: The Proposal for a Thirteenth Council Directive on Company Law*, 9 NW. J. INT'L L. & BUS. 487 (1989); Tuchinsky, *supra* at note 23; Rolf Skog, *The European Union's Proposed Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock*, 15 Eur. Bus. L. Rev. 1439 (2004).

[29] Conclusions of the Presidency (EC) SN 456/1/92 (Dec. 12, 1992), https://www.consilium.europa.eu/media/20492/1992_december_-_edinburgh__eng_.pdf.

[30] Official Journal of the European Communities, 6.6.1996.

[31] Equivalent means of protecting minority shareholders included the *procedure de garantie de cours* (or *mantien de cours)*, traditionally regulated in France as an alternative to the MTR and deeply revised in 1992. *See* ALAIN VIANDIER, OPA, OPE, GARANTIE DE COURS, RETRAIT, OPV – DROIT DES OFFRES PUBLIQUES 311–348 (Litec, 2d ed. 1993).

> Member States should take the necessary steps in order to protect shareholders having minority holdings after the purchase of the control of their company; whereas such a protection can be ensured either by obliging the person who acquired the control of a company to make a bid to all shareholders for all or for a substantial part of their holdings or by providing for other means which attain the objective of at least an equivalent level of protection of minority shareholders.

The principle and regulatory structure of the MTR were, thus, left untouched.

The proposal was once again rejected by Member States, leading to revisions by the European Commission at the end of 1997. Article 3º was again left untouched: Member States should ensure that rules are in force which set certain voting-share thresholds beyond which a shareholder must bid in accordance with article 10º or offer other equivalent means to protect the minority shareholders of that company. In July 2001 the proposal was finally put to a vote in the European Parliament; surprisingly, it was rejected[32] (273 votes for and 273 against).

The MTR, albeit lacking consensus, was not central to the division. Parliament's decision is usually attributed to three main reasons. First, there was disagreement over whether a board of directors should be entitled to adopt defensive measures; in particular, Germany did not accept the European Council's restrictive stance on the use of defensive measures.[33] Second, employee protection caused division. Third, there was disagreement over restricting multiple voting rights (and equivalent structures) in case of a takeover. Notably, the revised proposal kept the MTR wording untouched but made optional for Member States and companies the two most contentious directive provisions: article 9º (takeover defences) and article 11 (the breakthrough rule, which neutralized certain pre-bid defences during a takeover and allowed a successful offeror to remove the offeree's incumbent board and modify its bylaws).[34]

In July 2001, shortly after the European Parliament vote, the European Commission appointed a High-Level Group of Company Law Experts, led by Professor Jaap Winter, to present two reports: on European takeover regulation and on a modern regulatory framework for company law in the EU. The takeover

[32] Only once previously had the European Parliament rejected a conciliation agreement. *See* Skog, *supra* note 28.

[33] Ferran, *supra* note 20 at 110.

[34] See Tuchinsky, *supra* at note 23; Thomas Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LAW & FIN. MARKETS REV. 525 (2007); Skog, *supra* note 28.

regulation report was presented in July 2002[35] and made several influential (and some controversial) recommendations covering matters such as the equitable price to be offered in mandatory bids, the availability of squeeze-out mechanisms and sell-out rights after a takeover bid, and the (then) central issue of proportionality between risk-bearing capital and control. Notably, the report did not question if an MTR is the best solution: this debate was not running at that time, and the report lacked economic analysis.

In October 2002, the European Commission submitted a revised proposal for the Takeover Directive, which was finally approved on 30 March 2004. Concerning the MTR, article 5.1 kept the same basic principles:

> Where a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company as referred to in Article 1(1) which, added to any existing holdings of those securities of his/hers and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price as defined in paragraph 4.

The existence of an MTR is not optional for EU Member States (or for listed companies),[36] even though there is a strong margin for fluctuation of national regimes. First, Member States retain the power to determine the relevant threshold of voting rights triggering the MTR (generally established at 30% or 33%) and to specify the calculation method. Second, they are entitled to establish exceptions to the rule. According to article 4(5),

> provided that the general principles laid down in Article 3(1) are respected, Member States may provide in the rules that they make or introduce pursuant to this directive for derogations from those rules: (i) by including such derogations in their national rules, in order to take

[35] Jaap W. Winter et al., *Report of the High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 825-924 (Guido Ferrarini et al., eds. Oxford Univ. Press 2004).

[36] The MTR had been adopted across most Member States by 2004, with few exceptions; some had to amend the rule to transpose the Directive. *See* Goergen, et al., *supra* note 19 at 23; Harald Baum, *Change of Governance in Historic Perspective: The German Experience* (European Corporate Governance Institute, Working Paper No. 28, 2005), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=695741; CHRISTOPHE CLERC, ET AL., A LEGAL AND ECONOMIC ASSESSMENT OF EUROPEAN TAKEOVER REGULATION 55 (Center for European Policy Studies (CEPS) Paperbacks, 2012).

> account of circumstances determined at national level and/or (ii) by granting their supervisory authorities, where they are competent, powers to waive such national rules, to take account of the circumstances referred to in (i) or in other specific circumstances, in which case a reasoned decision must be required.

Also, the Takeover Directive only provides for one explicit derogation from the MTR (when the threshold is crossed following a 100% bid), but most Member States have established a broad set of derogations. In its 2012 report on the application of the directive, the European Commission points out that the wide range of national derogations to the MTR raises the question of whether the rule adequately protects minority shareholders in change-of-control situations.[37]

II. HISTORICAL CONTEXT OF THE MTR IN THE BRAZILIAN LSA

In Brazil, the debate concerning entitlement to the control premium originates in the preparation of the LSA (Lei 6.404 of 15 December 1976). The previous law – Decreto-Lei nº 2.627 of 26 September 1940 – made no reference to entitlement to the control premium and did not in fact regulate the legal position of controlling shareholders[38] Indeed, until 1882, most of the companies incorporated in Brazil were subject to voting-rights ceilings as a condition for incorporation; in the following years, when the 'one share, one vote' rule became dominant, few companies had a controlling shareholder.[39]

In 1974, two years before the LSA was enacted, the Brazilian government gave two powerful indications of its intention to approve a premium-sharing solution through revising the law. The Second National Development Plan[40] stated that regulatory revision should 'prevent that the market value of the minority shareholders' shares is lower than those of the majority shareholder'

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[37] *See Report of the European Economic and Social Committee and the Committee of the Regions on the Application of Directive 2004/25/EC on takeover bids*, at 6 (June 28, 2012), http://www.cdep.ro/afaceri_europene/CE/2012/COM_2012_347_EN_ACTE_f.pdf. Admittedly, this power to establish MTR exemptions gives Member States a wide range of discretion. *See* Enriques, *supra* note 10 at 443–446; Papadopoulos, *supra* note 34 at 526–527.

[38] ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, A LEI DAS S.A 119-120 (Renovar 1992).

[39] *See* Mariana Pargendler, *Cinco mitos sobre a história das sociedades anônimas no Brasil*, 119 HARVARD LAW REVIEW (2006); OIOLI. 2010, 53–56. For a thorough and complete description of the legislative process of the LSA, *see* Lamy Filho & Pedreira, *supra* note 38.

[40] Lei nº 6.151 of 4 December 1974. The Second National Development Plan (1975–1979) was a general economic plan approved by the government in accordance with the Brazilian Constitution. *See* Lamy Filho & Pedreira, *supra* note 38 at 125–130; Nelson Laks Eizirik, *The Role of the State in the Regulation of the Securities Markets: The Brazilian Experience*, 1 U. PA. J. INT'L L. 211 (1978).

and should consider 'the Government's concern that minority shareholders should have reinforced protection vis-à-vis controlling shareholders'.[41] Moreover, the Council for Economic Development (CDE) approved a recommendation that, in revising Decreto-Lei nº 2.627 of 1940, the legislator should approve 'a solution that does not allow that each share of the controlling shareholder has a potential value much higher than those of the minority shareholders'.

Opposing the signals emerging from governmental entities, the two professors who drafted the 1976 reform – José Luiz Bulhões Pedreira and Alfredo Lamy Filho – opined that the control premium belonged to the controlling shareholder; accordingly, they believed there was no reason to share that control premium among all shareholders in a listed company. This stance was reflected in the solution adopted in the draft bill. According to the explanatory memorandum of the LSA from the Finance Ministry to the President of the Republic (Exposição de Motivos nº 196 of 24 June 1976), the draft bill was prepared in accordance with the principles of the President-approved CDE document (June 1974) yet states that the control premium belongs to the controlling shareholder (Section VI).[42]

The two respected professors drew a clear line between 'controlling shareholders' and 'speculative investors'. They described controlling shareholders as 'the real entrepreneurs, the ones that create wealth and that, because of their power in the economic world, have duties to the community, the minority shareholders, the company and all the employees'. By contrast, they described speculative investors as:

> the ones that buy shares in the market with the intention of selling them as soon as they can make a profit, exclusively motivated by their expectation about the future evolution of the stock prices or by information, real or false, spread out in the market, often with the intention of manipulation.[43]

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41 *See* MODESTO CARVALHOSA, OFERTA PÚBLICA DE AQUISIÇÃO DE AÇÕES § 7 118-120 (Ibmec 1979); FÁBIO KONDER COMPARATO & CALIXTO SALOMÃO FILHO, O PODER DE CONTROLE NA SOCIEDADE ANÔNIMA 271 (Forense 2014); LAURA FALLACE RONCA ANGRISANI, ALIENAÇÃO DE CONTROLO ACIONÁRIO 14 (PUC 2015).

42 *Id.*

43 Lamy Filho & Pedreira, *supra* note 38 at 157 and 162. This dichotomy between the controlling shareholder – accountable for his actions and responsible for the board composition – and minority shareholders – uninterested in the life of the company and mere lenders of capital – was described in Alfredo Lamy Filho, *A reforma da lei de sociedades anônimas*, REVISTA FORENSE 142 (1972). *See also* Laks Eizirik, *supra* note 40 at 214–216; ERIK FREDERICO OIOLI, REGIME JURÍDICO DO CAPITAL DISPERSO NA LEI DAS SA 300-301 (Almedina 2019).

For controlling shareholders, the LSA structured a framework incentivizing the formation of groups controlled by a shareholder (or group of shareholders) holding the controlling power and corresponding responsibility.[44] Appropriation of the control premium by the controlling shareholder should be regarded as compensation for the responsibilities intrinsic to the controlling position. For speculative investors, the LSA opened the doors for the issuance of preferential non-voting shares as a preferential security for stock exchange listing.

Unsurprisingly, in a 2000 study on the structure of ownership and control of 325 companies listed on the São Paulo Stock Exchange, the findings revealed a very high degree of ownership concentration (62% of companies had one shareholder owning over 50% of voting shares); a very high proportion (89%) of companies issuing non-voting shares;[45] on average, only 54% of a company's equity capital was voting capital.[46]

The draft bill stated clearly that there was no justification to share the control premium among all shareholders: (a) as a rule, the transfer of control is not damaging to minority shareholders; (b) although there is economic value in the controlling position, this value belongs to the shareholders who control the company, so they are entitled to receive a premium reflecting this value; (c) the

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44 *See* LSA, articles 243º to 250º, 265º to 279º, 116º and 117º.

45 Unlike in most equity markets, voting shares have been traded at a discount relative to non-voting shares for many years in Brazil, according to empirical studies. *See* Richard Saito & Alexandre Di Miceli da Silveira, *The Relevance of Tag Along Rights and Identity of Controlling Shareholders for the Price Spreads between Dual-Class Shares: The Brazilian Case*, 7 BRAZILIAN ADMIN. REV. 1 (2010); Richard Saito, *Determinants of the Differential Pricing between Voting and Non-Voting Shares in Brazil'*, 23 BRAZILIAN REV. ECONOMETRICS (2003). These findings are partly explained by liquidity/sample reasons and the relative valuation of the preferential dividend vis-à-vis voting rights.

46 Sílvia Mourthé Valadares & Ricardo PC Leal, *Ownership and control structure of Brazilian companies*, AVAILABLE AT SSRN 213409 (2000); Oioli, *supra* note 43 at 47–52; Comparato & Salomão Filho, *supra* note 41 at 63-65. For a list of other empirical studies of ownership concentration in Brazil between 1985 and 2002, *see* Oioli, *supra* note 11 at 56–58. This panorama is changing, and ownership concentration declined recently, notably in the Novo Mercado: at the most demanding listing level, requirements include (for example) the listing of voting shares with a 'one share, one vote' ruling and dispersing at least 25% of listed shares. A company listed in these market segments must comply with BM&FBovespa's set of corporate governance practices. *See* Érica Gorga, *Changing the Paradigm of Stock Ownership from Concentrated towards Dispersed Ownership: Evidence from Brazil and Consequences for Emerging Countries*, 29 NW. J. INT'L L. & BUS 439 (2009); Érica Gorga, *Corporate Control and Governance after a Decade from 'Novo Mercado': Changes in Ownership Structures and shareholder power in Brazil*, RESEARCH HANDBOOK ON SHAREHOLDER POWER (2015), 1–2; Antonio Gledson De Carvalho & George G Pennacchi, *Can a stock exchange improve corporate behavior? Evidence from firms' migration to premium listings in Brazil*, 18 JOURNAL OF CORPORATE FINANCE (2012); Oioli, *supra* note 11 at 58–68; Eduardo Secchi Munhoz, *Transferência de controle nas companhias sem controlador majoritário*, *in* PODER DE CONTROLE E OUTROS TEMAS DE DIREITO SOCIETÁRIO E MERCADO DE CAPITAIS 289–293 (SÃO PAULO: QUARTIER LATIN 2010).

controlling position of the controlling shareholder implies special responsibilities. This was the solution adopted in the draft bill.

This opinion was controversial from the beginning of the legislative process. During the legislative discussions, Modesto Carvalhosa stated in Congress that the draft bill clearly lacked a rule establishing the right of minority shareholders to participate in a transfer of control.[47] Later, Carvalhosa stated that the non-existence of a rule protecting minority shareholders in a sale of control was a 'perplexity'. Although the original draft bill did not regulate the transfer of control of listed companies, it did cover companies subject to government approval (article 255º) and stated a general principle of equal treatment of all shareholders (article 255º). This might be considered incoherent but can be understood as reflecting historical abusive and controversial ownership transfers in the banking sector (companies subject to government approval).[48]

The draft bill was subject to lively debate in both Congress and the Senate. This debate featured three interrelated perspectives: the unquestionable fact that the draft bill was misaligned with previous guidelines approved by the Brazilian government (the 1974 Recommendation of the CDE and the Second National Development Plan); the doctrinal dispute concerning the social or individual property of the control premium; and public opinion on the scandalously unfair treatment of minority shareholders in many M&A transactions (particularly involving banks) in the late 1960s and the 1970s.[49] In Congress, two amendments were proposed to article 254º of the LSA, intending to guarantee equality of treatment between all shareholders; however, they were both rejected in the final vote. In the Senate, the amendment proposed by Senator Otto Lehmann was finally approved, giving the *Conselho Monetário Nacional* (National Monetary Council; hereafter 'CMN') responsibility for establishing

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[47] Admittedly, the most important issues he raised concerned the 'denationalization' of Brazilian companies and the institutionalization of a model of finance capitalism directed by the banks. Laks Eizirik, *supra* note 40 at 213.

[48] Lamy Filho & Pedreira, *supra* note 38 at 178–183; MODESTO CARVALHOSA, A NOVA LEI DAS SOCIEDADES ANÔNIMAS: SEU MODELO ECONÔMICO 120 (Saraiva 1976); CARVALHOSA, OFERTA PÚBLICA DE AQUISIÇÃO DE AÇÕES 119 (Ibmec 1979). Oioli, *supra* note 43 at 306; Carlos Augusto da Silveira Lobo, *Alienação do Controle de Companhia Aberta*, *in* DIREITO DAS COMPANHIAS II 2006–2007 (2009).

[49] Such concentrations happened in many areas but mainly in the banking sector; in many cases, transactions were sponsored by the government and regulators. It should be noted that 1971, following the years of the 'Brazilian miracle', saw unprecedented speculation in the Brazilian stock exchanges: for the 85 most liquid shares in the Rio de Janeiro stock exchange, the average price increase in the first semester of 1971 was 230%. However, this was followed later that year by a long winter of decreasing stock prices. *See* Lamy Filho & Pedreira, *supra* note 38 at 135–136; Comparato & Salomão Filho, *supra* note 41 at 232-236; Carvalhosa, *supra* note 48 at 112–114; Lobo, *supra* note 48; ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, DIREITO DAS COMPANHIAS 2005-2006 (Forense 2009).

the rules for any offer to sell control of a public company, and granting the *Comissão dos Valores Mobiliários* (Securities and Exchange Commission; hereafter 'CVM') the power to ensure 'minority shareholders would be granted equal treatment' in the transfer of control of a public company.[50]

After the 'Lehman amendment', article 254º of the LSA stated:

The sale of control of a public company depends on the prior approval of the Securities Commission.

> § 1º The Securities Commission guarantees minority shareholders are treated equally with the simultaneous offer to buy the shares;
>
> § 2º If the number of offered shares, including the shares of the controlling or majority shareholders, is higher than those contemplated by the offer, they will be proportionally apportioned in accordance with the terms and conditions of the public offer;
>
> § 3º It will be the responsibility of the National Monetary Council to establish the rules of any offer to sell the control of a public company.

After the draft bill's approval, Lamy Filho and Bulhões Pedreira wrote to the Minister of Finance, Mário Henrique Simonsen, to comment on the amendments introduced by Congress and the Senate. Concerning the Lehman amendment, the two professors restated the position they originally advanced in the draft bill, maintained the opinion that sharing the control premium would drastically limit the property rights of controlling shareholders, and argued that the new rule would (a) negatively impact on the decision to list companies in the stock exchange and to acquire control of a listed company, and (b) create an imperfect solution that would provoke artificial responses by the market.[51]

The new article 254º of the LSA (sale of control of a public company) transposed the wording of the pre-existing article 255º (sale of control of a company subject to government approval).[52] This appropriation of the mechanics and wording of article 255º in the new article 254º had regulatory consequences whose effects are still felt today. First, article 255º was strictly activated by a bilateral sale of control agreement – a transaction by which the

[50] Jorge Lobo, *Interpretação realista da alienação de controle de companhia aberta*, REVISTA DA EMERJ 45-46 (2001).

[51] *See* Lamy Filho & Pedreira, *supra* note 38 at 277–283.

[52] In the draft bill presented to Congress, article 255º regulated the transparency requirements for a sale of control of a public company, article 256º regulated the sale of control of a public company subject to government approval, and article 257º required that the shareholders' meeting approved transactions in certain sales of control of a public company. Articles 255º to 257º of the draft bill became articles 254º to 256º of the LSA.

controlling shareholder of a company subject to government approval transferred the controlling block to a buyer. These mechanics were replicated in article 254º, making the MTR also dependent on such a transaction.[53] Second, the wording of article 255º was unclear in many ways, the best example being the legal treatment of non-voting shares; this would not be a material problem for companies subject to government approval, but was definitively problematic for listed companies. Third, this transposition created the idea that control of listed companies could only be acquired with authorization from the CVM. Under article 255º, the sale of control of a public company subject to government approval was conditional upon the approval of the respective governmental agency. This solution was coherent given the regulated activity performed by the company. In accordance with the new article 254º, the sale of control of a public/listed company became dependent on the prior approval of the CVM; however, in accordance with § 1º, intervention by the CVM was strictly intended to guarantee that minority shareholders were treated equally through the simultaneous offer to buy their shares.

The intervention of public agencies, particularly the CVM, was also controversial. ABRASCA (https://www.abrasca.org.br/), a private association of listed companies, led a movement seeking the political veto of article 254º of the LSA by the President of the Republic. This was motivated by fear of the government being empowered to approve or disapprove sales of shares, which would be a severe intervention in the markets. The President decided not to veto the rule but promised this issue would be clarified in the resolution of the CMN, as eventually happened. The meaning of the CVM authorization was clarified with the approval of Resolution 401/76 of the CMN:

> I – the sale of control of a public company can only be agreed subject to the condition, precedent or subsequent, that the entity that acquires control has the obligation to present, under the terms of this Resolution, a mandatory offer for all voting shares of the remaining shareholders of the company, in order to guarantee equal treatment vis-à-vis the controlling shareholder.

This resolution was enacted under § 3 of article 254 of the LSA (‘it will be the responsibility of the National Monetary Council to establish the rules of any offer to sell the control of a public company’), and it clarified the requirement for authorization from the CVM. In many ways, however, it went beyond the LSA. The best example is the restriction of the offer to ‘voting shares’: no such restriction is expressly contemplated by the LSA, yet it is still in force today.

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53 Lamy Filho & Pedreira, *supra* note 38 at 692–696.

Article 254º of the LSA remained in force in Brazil for almost two decades. In May 1997, Law nº 9.457 revised the LSA and revoked the existing MTR. The contents of Law n.º 9.457 provide little explanation for this revocation. The explanation of António Kandir, the representative of Congress who authored the proposal, is as follows:

> the mandatory takeover rule produces the worst of both worlds. At the same time, it inhibits and complicates the transactions for transfer of control that are required for healthy companies and is harmful for minority shareholders, since an unhealthy company will cause the loss of value of their shares which is a problem, first, for minority shareholders.

It seems clear that there may have been other reasons behind the 1997 reform. The Brazilian federal government intended to privatize many state-owned companies, which placed it in the position of seller of control with respect to the premium-sharing rule. Revoking article 254º of the LSA thus enabled the government to transfer control of such companies without sharing the control premium.[54]

Four years later, Law nº 10.303 of 31 October 2001 further revised the LSA by, *inter alia*, introducing the MTR currently in force in Brazil. Specifically, article 254-A states that (a) the sale of the controlling position in a public company is subject to the condition of launching an offer to buy the remaining voting shares; (b) in such an offer, the minimum price to be paid to outstanding shareholders equals 80% of the price paid for the controlling position; (c) the sale of a controlling position is the transfer, directly or indirectly, of a controlling stake or of shares related to a shareholders' agreement, convertible securities, or sales of warrants (that may cause the sale of the controlling position); (d) the CVM will authorize the sale of a controlling position if the legal terms and conditions of a mandatory public bid are met; (e) the CVM is responsible for establishing the rules on offers to sell control of a public company; (f) the acquirer of the controlling position may offer minority shareholders the option to remain shareholders, paying them a premium equivalent to the difference between the market price of the shares and the price paid to the selling controlling shareholder.

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[54] NELSON EIZIRIK, A LEI DAS S/A COMENTADA § III 420 (Quartier Latin 2011).

III. THE MTR AS A MERE PREMIUM-SHARING RULE AND (ALSO) AS AN EXIT RULE

The UK approach has historically been the most extreme form of MTR, effectively preventing the acquisition of a controlling position in a listed company without sharing any control premium (assuming such premium exists). First, it envisages transfer of control transactions and scenarios in which someone obtains a controlling position where none previously existed: the trigger for the obligation strictly depends on the accumulation of voting shares above a certain threshold. Second, the rule does not contemplate a price discount for minority non-controlling shareholders and effectively extends to all shareholders (at least) the same terms and conditions agreed with the controlling shareholder. Third, the rule does not allow restrictions on the quantity of outstanding shares for which the offer must be extended: a general offer must be made to buy all remaining shares.

This is the approach directly adopted by the Takeover Directive.[55] Under article 5(1) of the Takeover Directive, the mandatory bid is triggered by the acquisition by the bidder, or by entities acting in concert with them, of securities above a certain threshold of voting rights. It is irrelevant whether the new controlling shareholder acquired the controlling position from a former controlling shareholder or instead built a controlling position that did not exist before. The same rule mandates extension of the bid 'to all the holders of those securities for all their holdings', but not for partial voluntary bids below the MTR threshold. However, Member States are free to prohibit partial offers or to allow them only in certain conditions.[56] Finally, the offer must be presented at the equitable price defined in article 5(4).

The Brazilian rule has a completely different approach: the MTR is only triggered by secondary transfers of a controlling stake (thus presupposing that a controlling shareholder transfers its controlling stake to a new controlling shareholder), and so is not triggered by a specific threshold of voting rights. Since its first version, with the Lehman amendment, the scope of the MTR in

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[55] Before the directive, the equal treatment principle was not a general rule in most continental European countries, many of which allowed for a price discount or restrictions on the quantity of outstanding shares for which the offer must be made, trying to adapt the concept of the mandatory bid to specific local conditions. *See* Berglöf et al., *supra* note 10; Ferrarini, *supra* note 10 at 23–24.

[56] Rule 36.1 of the City Code states that "The Panel's consent is required for any partial offer. In the case of an offer which could not result in the offeror and persons acting in concert with it being interested in shares carrying 30% or more of the voting rights of a company, consent will normally be granted." *See* DAVIES & WORTHINGTON, *supra* note 12 at 958–59; Enriques, *supra* note 10; Silja Maul & Athanasios Kouloridas, *The Takeover Bids Directive*, 5 GER. L. J. (2004); CLERC et al., *supra* note 36 at 62–63.

Brazil has been limited to cases of transfer of control, and primary acquisitions of control do not trigger the requirement to share the control premium with minority shareholders. This is particularly relevant to creeping acquisitions, whereby the shareholder acquires shares in the secondary market until it has a large enough percentage to control the company.[57] In this sense, the Brazilian MTR is close to a co-sale or a tag-along right, giving minority shareholders the right to join a transaction of the controlling shareholder and sell their minority stake. Therefore, the rule's trigger depends on three conditions: (a) the pre-existence of a controlling shareholder; (b) a transaction by which the controlling shareholder transfers the controlling stake to another shareholder[58]; and (c) the existence of a control premium, a surplus above the stock price, to be shared with minority/non-controlling shareholders.

In 2007, RFS Holding, BV, acquired 94.17% of the shares of ABN Amro Holding through a takeover. ABN Amro was the controlling shareholder of two Brazilian listed companies – ABN Amro Arrendamento Mercantil, S.A. and Real Leasing, S.A. – that became indirectly controlled by RFS. Even though this transaction represented the indirect acquisition of over 50% of voting shares by RFS, the CVM revoked a previous decision and concluded that it did not involve the *transfer* of a controlling stake: before the RFS takeover, the largest shareholders of the Brazilian listed companies owned stakes of 2–3%, so the transaction did not qualify as a secondary transfer of control and, thus, article 254-A of the LSA did not apply.[59]

The rule's trigger being a sale of control has material consequences: the accumulation of shares above a predetermined threshold – even 50.01% of voting shares – is not relevant *per se*. It is only relevant when such acquisition derives from a transfer of control from an existing controlling shareholder. This becomes clear when we read article 29 § 4 of Instrução CVM 361 (05/03/2002):

> In the context of this Instruction, sale of control is the transaction, or group of transactions, of sale of voting securities, or securities convertible in voting securities, by a controlling shareholder or other shareholders integrating the control group, by which a third party, or

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[57] Marcelo Godke Veiga & Erik Frederico Oioli, *Convergence and Divergence in Capital Market Systems: The Case of Brazil*, 18 EUR. BUS. ORG. L. REV. 351 (2017). (As explained above, the Lehman amendment was inspired by the wording of the pre-existing article 255º, which was triggered by the controlling shareholder of a company subject to government approval agreeing to transfer the controlling position to a buyer. These mechanics were replicated in article 254º).

[58] The rule does not require that the controlling shareholder transfers all the controlling stake. For instance, if a shareholder owning 55% of the voting shares sells 30% to a shareholder that already owns 21%, this would qualify as the transfer of a controlling stake.

[59] *Id.*

group of concerted third parties, acquires the control of the company, as defined by article 116 of Law 6.404/1976.

Article 116º of the LSA states that a controlling shareholder is the entity, or group of entities bound by a shareholders' agreement or commonly controlled, that (a) owns rights that guarantee, on a permanent basis, the majority of voting rights in the shareholders' meeting, and the right to appoint the majority of board members, and (b) exercises such power to direct the company's activities and the functioning of the company's board. A shareholder (or group of shareholders) owning over 50% of the voting rights (and exercising the respective power) is clearly a controlling shareholder for the purposes of article 116. Therefore, if such controlling shareholder transfers its controlling shareholding, article 254-A is triggered.[60]

Whether to apply the rule becomes complicated and controversial if the sale of a minority position may, because of the target company's dispersed ownership structure, qualify as the sale of a controlling position. This problem divides opinions. For scholars like Nelson Eizirik,[61] the sale of a controlling block is the sale of a position that guarantees the acquirer, regardless of any other circumstances (such as the future attendance of shareholders' meetings), the ability to control the company in the future.[62] A controlling block is a block with over 50% of voting shares or a stake that guarantees permanently the majority of voting rights (because the acquirer was already a shareholder or pursuant to a shareholders' agreement). This is in line with the classic opinion of Comparato.[63] For others, such as Erik Frederico Oioli,[64] interpreting LSA article 254-A considering article 116º means it inevitably covers all transfers of a controlling stake, regardless of the percentage involved.

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60 *See* Nelson Eizirik, *Aquisição de controle minoritário. Inexigibilidade de oferta pública, in* PODER DE CONTROLE E OUTROS TEMAS DE DIREITO SOCIETARIO E MERCADO DE CAPITAIS 177, 182-84 (SÃO PAULO: QUARTIER LATIN 2010). (Where over 50% of voting shares are sold, LSA article 254-A is clearly triggered except when the selling shareholder does not exercise its controlling position. In accordance with article 116º of the LSA, qualifying as a controlling shareholder depends on the effective exercise of the power to conduct the companies' activities. However, the fact that a shareholder does not qualify as a controlling shareholder for the purposes of LSA article 116º – because it does not attend shareholders' meetings or vote in board elections – does not automatically imply that a block being sold is not a controlling block for the purposes of article 254-A, which would trigger the MTR.).

61 *Id*. at 184-190; EIZIRIK, *supra* note 54 at 432-33.

62 Resolução CMN nº 401/1976 defined a controlling shareholder as an entity or group of entities party to a shareholders' agreement (or under common control) that owns shares guaranteeing the majority of votes in the last three shareholders' meetings. This rule was revoked in 2002 by Resolução CMN nº 2.927/2002.

63 Comparato & Salomão Filho, *supra* note 41 at 206-207.

64 Oioli, *supra* note 43 at 309–313.

Notwithstanding that only a shareholding exceeding 50% of voting rights constitutes a stable and guaranteed controlling stake, it is hard to accept that this validly balances the interests of all shareholders, especially for companies with dispersed ownership. In this sense, as the Brazilian experience clearly shows, the use of a voting threshold would be a more effective and clear solution.

> The legal dispute concerning Tim Participações, a telco listed on the São Paulo Stock Exchange and ultimately controlled by Telecom Italia S.p.A. ('Telecom Italia'), was one of the most relevant legal cases in Brazil.
>
> Before 2009, the largest (indirect) shareholder of Telecom Italia was Olimpia S.p.A ('Olimpia') with 17.99% of voting rights. Olimpia was then controlled by Pirelli & C. S.p.A. ('Pirelli'), with 80% of the votes, while companies in the Sintonia III group held the remaining 20%. In October 2007, a holding company incorporated by a new group of shareholders – Assicurazioni Generalli S.p.A., Sintonia S.A., Intesa Sanpaolo S.p.A., Mediobanca S.p.A., and Telefónica S.A. – acquired shares in Olimpia that (combined with the shares of new shareholders) gave the holding company 24.5% of voting rights in Telecom Italia. Again, the dispute concerned the indirect effects of the transaction in Brazil. Several minority shareholders of Tim Participações filed a complaint with the CVM, arguing that Olimpia (and ultimately Pirelli) was already the de facto controlling shareholder of Telecom Italia, despite owing only 17.99% of voting shares. The CVM decided in 2009 that the MTR was triggered: in accordance with the applicable rules, Italian law should determine if Olimpia was indeed the controlling shareholder of Telecom Italia, while Brazilian law should determine whether a mandatory takeover should be launched. In July 2009, the CVM revoked its first decision, ruling that while the concept of de facto control is accepted in Italian law, Brazilian law should be applied to determine what qualifies as a controlling position. For the purposes of Brazilian law, the position of Olimpia in Telecom Italia was not a controlling position. During the dispute, different CVM directors stated contradictory positions on the possibility that a stake below 50% of voting rights qualified as a controlling stake under LSA article 254-A.[65]

The MTR is a premium-sharing solution, aiming to prevent a party from obtaining control unless able to pay for the outstanding shares of all shareholders under equal terms and conditions. This means the offeror cannot take control without offering all shareholders at least the same control premium as the controlling shareholder is paid. In this sense, the MTR is a consequence of the

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[65] Eizirik, *supra* note 54 at 431; Munhoz, *supra* note 46.

equal-treatment principle,[66] since all shareholders within each individual share class are offered the same price, regardless of the number of shares they own. In Europe – but not in Brazil – the MTR is also a structure intended to protect minority shareholders against the emergence of a new controlling shareholder, granting an exit right to all shareholders on favourable terms in case a change of control occurs. In this sense, the MTR of the Takeover Directive complies with both rationales, whereas the MTR of the LSA only complies with the first.

> Coelce is one of the largest electrical power distribution companies of Northeast Brazil and is listed on the São Paulo Stock Exchange. It was controlled by the Spanish company Endesa (which owned 58.9% of the share capital and 92% of voting shares through Investluz, S.A., a local subsidiary). In September 2005, Gaz Natural launched a tender offer trying to secure control over Endesa, which triggered a multi-player 25-month dispute over control of the company that ended with a successful takeover by Acciona and Enel. After the takeover, 92% of shares in Endesa were jointly controlled by Enel (67.05%) and Acciona (25.01%) in a holding company under a 10-year shareholder agreement. Before the Gaz Natural offer, the largest shareholder of Endesa held less than 6% of voting rights.
>
> Endesa had a new controlling shareholder (more accurately, two new controlling shareholders under a holding company and a shareholders' agreement) while Coelce had a new (indirect) controlling shareholder. One minority shareholder of Coelce, Fundo Fator Sinergia III, filed a complaint with the CVM, arguing that the acquisition of control by the new ultimate shareholders of Endesa should trigger the obligation to launch a mandatory takeover. However, the complaint was rejected: the acquisition of control of Endesa by Acciona and Enel was the consequence of a takeover and not the result of a sale of control by a former controlling shareholder, as there was no controlling shareholder of Endesa before the takeover; therefore, there was no obligation to

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[66] *See* MICHAEL HOFFMANN-BECKING, MÜNCHENER HANDBUCH DES GESELLSCHAFTSRECHTS 4 123-25 (Beck 2020) (1988); TIM DRYGALA, ET AL., KAPITALGESELLSCHAFTSRECHT: MIT GRUNDZÜGEN DES KONZERN UND UMWANDLUNGSRECHTS 538-39 (Springer 2012); YVES DE CORDT, L'ÉGALITÉ ENTRE ACTIONNAIRES 297 (Bruylant 2004).The fair and equal treatment of shareholders is a general principle in most jurisdictions and has different implications. First, it implies that the shares of each class are homogeneous. Second, it implies that the legal position of each shareholder in relation to each class of shares is equivalent. Shareholders cannot be arbitrarily discriminated against (*Untersagt ist nur die willkürliche*). Nonetheless, this principle does not mean that all shares, regardless of class, must be equal. This is quite clear in Germany, where the general equality rule of § 53a of the Aktiengesetz has several exceptions, such as shares issued with special rights in accordance with §§ 11, 12i, and 23III4 of the Aktiengesetz. Furthermore, this principle applies to relations between the company and its shareholders but not necessarily to relations between the shareholders themselves. This is again quite clear in jurisdictions such as Germany (under § 53a of the German Stock Corporation Act (*Aktiengesetz*)) but is generally implied in most jurisdictions.

> launch a mandatory takeover. The case would have been decided differently in Europe, where the MTR would have been triggered.
>
> It is unquestionable that Coelce was controlled by Endesa. After the takeover, 92% of shares in Endesa were jointly controlled by Enel (67.05%) and Acciona (25.01%) in a holding company under a 10-year shareholder agreement. However, because this new controlling shareholder emerged when no controlling shareholder existed before (the largest shareholder of Endesa previously held less than 6% of voting rights), the MTR of LSA article 254-A was not triggered, whereas the equivalent MTR in article 5 of the Takeover Directive would have been activated.

IV. EQUITABLE PRICE

The Takeover Directive adopted a definition of 'equitable price' for the MTR in line with article 9.5 of the City Code, taking as the primary criterion the highest price paid in a certain period before the announcement of the offer.[67] In accordance with article 5(1), the mandatory bid must offer an 'equitable price'. Article 5(4) establishes that the 'equitable price' shall correspond to the highest price paid for the same securities by the offeror, or by persons acting in concert, over a period of six to twelve months before the bid. Under the same rule, as a strong expression of the equality principle, if the offeror, or any person acting in concert, purchases the relevant securities at a price higher than the offer price after the bid is made public and before it closes, the offeror shall increase the offer under the MTR.[68]

Article 5(2) of the Takeover Directive establishes that 'where control has been acquired following a voluntary bid made in accordance with this Directive to all the holders of securities for all their holdings, the obligation laid down in paragraph 1 to launch a bid shall no longer apply'. Technically, this exemption can be used to avoid the equitable price requirements, since there are no minimum requirements for the price of a voluntary bid. Where control is acquired following a voluntary bid, it is assumed that the offer price was

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[67] Article 9.5(a) of the City Code states that "An offer made under rule 9 must, in respect of each class of share capital involved, be in cash or be accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for any interest in shares of that class during the 12 months prior to the announcement of that offer. The Panel should be consulted where there is more than one class of share capital involved."

[68] Under several national regulations, when the highest price paid by the bidder is below the market price at the time when the obligation to bid arises (or the average weighted price of the shares during a reference time, varying from 30 days to 12 months), the bid price shall be at least as high as the market price (or the average weighted price during the relevant period). *See* Clerc, *supra* note 36 at 67.

attractive enough to persuade a significant proportion of shareholders to accept the offer. However, as the European Commission points out in its 2012 report on the application of the directive, if the offeror already holds an interest very close to the control threshold, only a few shareholders need to offer their shares for the offeror to cross the threshold.[69]

The Takeover Directive also allows Member States (and their supervisory authorities) to adjust the equitable price in several cases.[70] This optional derogation gives a wide range of discretion to national regulations.[71] Provided the principles in article 3(1) are respected, Member States may authorize their supervisory authorities to adjust the 'equitable price' in circumstances and in accordance with criteria that are clearly determined. To that end, they may draw up a list of circumstances in which the highest price may be adjusted (either upwards or downwards), for example where the highest price was set by agreement between the purchaser and a seller, where the market prices of the securities in question have been manipulated, where market prices in general or certain market prices in particular have been affected by exceptional occurrences, or to enable the rescue of a firm in difficulty. National supervisory authorities may also determine the criteria to be applied in such cases, such as the average market value over a particular period, the break-up value of the company, or other objective evaluation criteria. Most relevant here is the general principle laid down in article 3(1)(a): 'all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected'. The style of regulation underlying the equitable price definition – which corresponds to the highest price paid for the same securities over a given

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[69] *See* Report of the European Economic and Social Committee and the Committee of the Regions on the Application of Directive 2004/25/EC on takeover bids, (Jun. 28, 2012), http://www.cdep.ro/afaceri_europene/CE/2012/COM_2012_347_EN_ACTE_f.pdf. This exemption is unavailable in several Member States.

[70] The highest price paid for the same shares over a certain period pre-bid is usually easy to calculate. However, the criterion is not always representative of a fair minimum price for the bid, and national regulation establish exceptions in which the supervisory authorities may disregard this price. Article 11.3 of the City Code establishes several cases in which the bidder may dispense with the 'highest price rule' after consulting with the Takeover Panel. Factors the Panel might consider include: (a) the size and timing of the relevant acquisitions; (b) the attitude of the board of the offeree company; (c) whether interests in shares had been acquired at high prices from directors or other persons closely connected with the offeror or the offeree company; and (d) the number of shares in which interests have been acquired in the preceding 12 months.

[71] *See* Thomas Papadopoulos, *Acquisition of Corporate Control and Clear Criteria in the Adjustment of the Mandatory Bid Price*, 7 LAW & FIN. MARKETS REV. 97 (2013). (In AS v Oslo Børs ASA and Erik Must AS, the Court of Justice of the European Free Trade Association States ("EFTA Court") examined the conditions and criteria applicable to adjustment of the mandatory bid price by national supervisory authorities (Case E-1/10, EFTA Court Report 2009–2010).

time while simultaneously giving Member States high flexibility in establishing adjustments – was directly influenced by the recommendations of Chapter II of the Winter Report.[72]

The equitable price rule is a direct consequence of the principle of equal ('equivalent') treatment of shareholders. The function behind the rule is easy to understand: minority or non-controlling shareholders must be treated at least as favourably as the best-treated shareholders.

In Brazil, article 254-A of the LSA establishes the minimum price for the mandatory bid in a totally different way, strictly envisaging that minority shareholders share 80% of the price paid to the controlling shareholder. This clearly represents a political compromise aiming to balance the advantages and costs of the MTR, but there is no evidence of a clear economic rationale for the 80% figure. It is usually explained as a compromise between those advocating the return of an MTR and those contending that the control premium is not supposed to be shared with non-controlling shareholders (and/or that the overall negative effects of the premium-sharing rule exceed the positive effects for minority shareholders).[73]

This means that article 254-A of the LSA established a rule under which, even in cases when the MTR is triggered, the control premium is shared only in certain circumstances. The rule does not compel the new controller to offer 80% of the premium; instead, it must offer 80% of the price paid to the controlling shareholder. This means that minority shareholders will only share the control premium if the price paid to the controlling shareholder is more than 25% above the market price (price paid to the controlling shareholder X 0,8 > share price, which means that price paid to the controlling shareholder > share price of X (1/0,8), which means price paid to the controlling shareholder > (1+25%) X share price).[74]

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[72] These derogations should be interpreted narrowly, but the level of fluctuation the rule allows clearly implies deficient harmonization. *See* Winter, *supra* note 35; Papadopoulos, supra note 34; Eddy Wymeersch, *The Takeover Bid Directive, Light and Darkness* 4-5 (Fin. L. Inst., Working Paper No. 2008-01, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086987.

[73] Munhoz, *supra* note 46 at 296. *See also* ROBERTA NIOAC PRADO, OFERTA PÚBLICA DE AÇÕES OBRIGATÓRIA NAS SA: TAG ALONG (Quartier Latin. 2005), 112; Paulo Eduardo Penna, *Preço das Ações na Oferta Pública por Alienação de Controle de Companhia Aberta*, 3 ATUALIDADES EM DIREITO SOCIETÁRIO E MERCADO DE CAPITAIS (2018), 3.

[74] The most recent relevant study found that the mean average control premium in Brazil is 24.37%: Eduardo Lopes Junqueira, et al., *Antecedents of the Control Premium in Brazilian Companies: a study of acquisitions in the 21st century*, 9 REVISTA DE ADMINISTRAÇÃO, CONTABILIDADE E ECONOMIA DA FUNDACE (2018). However, conclusions in the literature are highly inconsistent. For instance, in two studies by Nenova conducted three years apart, the control premium was found to be 23% in 2003 and 41% in 2006: Tatiana

Article 254-A of the LSA seems to make two assumptions: (a) that 80% of the price paid for the controlling block's shares is necessarily higher than the market price of the shares (if minority shareholders can sell their shares in the market for a better price, the mandatory bid obligation would seem worthless); and (b) that the price paid for the controlling block is necessarily higher than the market price. In practice, neither assumption is necessarily correct (although the second is more reasonable), particularly in companies with limited free flow of shares, in problematic economic conditions or, more generally, when for any reason a low control premium (below the 25% threshold) is agreed with the controlling shareholder. [75]

Under the Takeover Directive, it is unquestionable that the MTR still applies to a bid lower than the market price.[76] However, that is not the case in Brazil. Under the now revoked article 254 of the LSA, the CVM issued two contradictory opinions on this. Opinion CVM/SJU nº 079/83[77] considered that the acquisition of shares for a price with no premium does not exempt the new controller from the obligation to launch a mandatory bid. By contrast, opinion CVM/SJU nº 007/86[78] concluded that article 254º serves to share the control premium with minority shareholders, not protect them against a non-liquid

Nenova, *The value of corporate voting rights and control: A cross-country analysis*, 68 JOURNAL OF FINANCIAL ECONOMICS (2003); Tatiana Nenova, *Control values and changes in corporate law in Brazil*, 6 LATIN AMERICAN BUSINESS REVIEW (2006). See also Marcelo Fernandes & Vitor Frango de Souza, *Voting Premium in the Brazilian Equity Market*, 34 BRAZILIAN REVIEW OF ECONOMETRICS (2014); Paul Hanouna, et al., *Value of corporate control: some international evidence*, JOURNAL OF INVESTMENT MANAGEMENT (2001); Alexander Dyck & Luigi Zingales, *Private benefits of control: An international comparison*, 59 THE JOURNAL OF FINANCE (2004). There are several possible explanations for the discrepancies, particularly regulatory changes (e.g., on transparency, minority protection, and board composition) and key differences in ownership structure.

75 A listed company is allowed to establish a more demanding minimum price rule in its articles of association. For instance, to be classified as Level 2 in the Novo Mercado, 'the company and its controlling shareholders must adopt and observe a wider range of corporate governance practices and minority shareholder rights'. One specific requirement is that where 'majority shareholders sell their stake, the same conditions granted to them must be extended to common shareholders, while preferred shareholders must get, at least, 100% of the value/conditions (tag along)': https://www.b3.com.br/en_us/products-and-services/solutions-for-issuers/listing-segments/nivel2/; see also OIOLI, Oferta pública de aquisição do controle de companhias abertas. 2010, 67; Munhoz, PODER DE CONTROLE E OUTROS TEMAS DE DIREITO SOCIETÁRIO E MERCADO DE CAPITAIS. SÃO PAULO: QUARTIER LATIN, (2010), 310–311.

75 *Id.*

76 A bid launched at a price lower than the market price is not in all cases unnecessary. First, the market may not be liquid, so a more favourable market price at a certain moment does not guarantee that the shareholder will be able to sell its shares at that price. Second, the market price at a certain moment is not necessarily the market price during the takeover acceptance period.

77 https://www.investidor.gov.br/pareceresJuridicos/arquivos/1983/Parecer_79_1983.html.

78 https://www.investidor.gov.br/pareceresJuridicos/arquivos/1986/Parecer_07_1986.html.

market. Under the new article 254-A of the LSA the dominant opinion is that the MTR does not apply if the takeover price is lower than the market price.[79]

V. THE *CONTRACTUAL* MTR OF BRAZILIAN COMPANIES LISTED ON THE NOVO MERCADO

A legal structure where the MTR is triggered only by the bilateral transfer of a pre-existing controlling stake would have no material regulatory impact in a market with highly concentrated shareholder ownership, such as the traditional Brazilian stock market. With such high ownership concentration, the acquisition of a controlling stake in a listed company would inevitably result from a bilateral transfer of control agreement; it is virtually impossible to acquire that controlling stake without the active engagement and agreement of the incumbent controlling shareholder.[80] This was the context of Brazil's capital markets until the end of the 20th century, but it started changing in the early years of the 21st century, when the number of IPOs increased dramatically and firms started listing in special segments – particularly in the Novo Mercado – with higher standards of corporate governance, lower levels of ownership concentration, and higher compliance with the 'one share, one vote' rule.[81]

It would seem reasonable that a different ownership structure requires a different MTR response, if not at the federal level, then at least through self-regulation. However, the regulatory framework of the Novo Mercado established an MTR in line with the relevant LSA provision, assuming the pre-existence of a controlling stake that is transferred to a new controlling shareholder. Under article 8.2 of the Corporate Governance Level 2 Listing Regulation, even the 'acquisition of control pursuant to a series of transactions' assumes there was a stock purchase agreement executed with the controlling shareholder. This makes clear that a primary acquisition of control not involving

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79 Lamy Filho & Pedreira, *supra* note 38 at 2013–2014. With a different opinion, *see* Eizirik, *supra* note 54 at 428-29.

80 ROBERTA NIOAC PRADO, DESCONCENTRAÇÃO DO PODER DE CONTROLE E POISON PILLS: EVOLUÇÃO NO MERCADO DE CAPITAIS BRASILEIRO 393-98 (Quartier Latin 2010). (The failed takeover of Perdigão by Sadia in 2006 is generally considered the first hostile takeover in Brazil, although the first attempt seems to have been in 1971, with the failed takeover of Sulbanco by Mercosul).

81 *See* Gorga, NORTHWESTERN JOURNAL OF INTERNATIONAL LAW & BUSINESS, (2009); Oioli, *Oferta pública de aquisição do controle de companhias abertas*, 69 and 79–86; Munhoz, "Transferência de controle nas companhias sem controlador majoritário", 297–309 and 311–316; Saito & Silveira, BRAZILIAN ADMINISTRATION REVIEW, (2010), 8–9. (Bovespa launched its three listing premium levels in 2001: Level 1, which requires additional disclosure practices; Level 2, which has all the requirements of Level 1 plus additional corporate governance requirements (including tag-along rights of 100% for voting shares and 80% for non-voting shares); and Novo Mercado, which is similar to Level 2 but does not accept listings of non-voting shares).

the transfer of a controlling position – e.g. the typical case of a '*ramassage boursier*' or '*escalada acionária*' (creeping acquisitions), with the progressive acquisition of shares in the market – would not trigger a mandatory bid, in line with article 254-A of the LSA.[82]

In a market with higher ownership dispersion, such as the Novo Mercado, having no MTR for primary acquisitions of control (and triggered by a voting-rights threshold) promotes a more efficient market for corporate control: third parties can acquire minority stakes and progressively build a larger stake, while minority shareholders are denied an exit right and a share of any control premium. Conversely, for minority shareholders this represents a worse outcome than the traditional combination of LSA article 254-A in a context of ownership concentration: as the only available route for acquiring control of the company, the new controlling shareholders would have to negotiate the control premium with the incumbent controlling shareholder and this premium would eventually be partially shared. This becomes even more material in a market with weaker legal protection for shareholders, such as the Brazilian market.[83] The combination of these factors led to an auto-regulatory movement mostly envisaging the protection of blockholders.[84]

> The IPO of Natura Cosméticos, S.A., in 2004, is generally considered one of the most important and successful capital market offers in Brazil. First, it is one of the first offers in the Novo Mercado and inaugurated a successful trend of initial offers in this market. Second, unlike previous initial offers in Brazil, the IPO dispersed only ordinary voting shares. Third, this IPO inaugurated a trend that became very popular over the next couple of years: setting clauses in the bylaws that trigger mandatory takeovers after certain voting-rights thresholds are met. In the case of Natura, article 33 of the bylaws set an MTR trigger for acquisitions of over 15% of voting shares. Under this MTR, the price extended to shareholders should be the highest of (i) the highest market price of the share in the previous 12 months (not the weighted

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82 In practical terms, it is highly unlikely that a shareholder would be able to go from zero to a controlling position with stock exchange acquisitions. This is for two main reasons: (a) disclosure obligations – awareness in the market that a certain shareholder is building a controlling position would increase the prices and diminish liquidity; and (b) the rules concerning auctions of shares, particularly the Regulamento de Operações da Bolsa de Valores do Estado de São Paulo and the Instrução CVM nº 168. However, it is plausible to put in place a strategy of gradually increasing a material non-controlling position up until the moment it becomes a controlling position.

83 Stijn Claessens & B. Burcin Yurtoglu, *Corporate governance in emerging markets: A survey*, 15 EMERGING MKTS. REV. 1 (2013); Saito & Silveira, *supra* note 45; Yuri Gomes Paiva Azevedo, Hellen Bomfim Gomes, & Silvio Hiroshi Nakao, *Poison pills and corporate governance: a study in the Brazilian stock market*, 15 REVISTA DE CONTABILIDADE E ORGANIZAÇÕES 1 (2021).

84 Comparato & Salomão Filho, *supra* note 41 at 215-16.

> average price); (ii) the highest price paid for the share by the bidder in the previous 12 months; and (iii) a value per share corresponding to a valuation of 12 times EBITDA minus net debt; plus a premium of 50%. Neither the trigger threshold nor the mandatory price is compatible or coherent with the principles of the MTR. This clause was later revised to establish an MTR threshold of 25% of the total number of shares issued by the company (article 34º), with the mandatory offer price corresponding to:
>
> > (i) the highest unit price achieved by shares issued by the Company during the period of twelve (12) months prior to the OPA in any stock exchange in which the Company's shares are traded, (ii) the highest unit price paid by the Relevant Shareholder, at any time, for one share or tranche of shares issued by the Company; and (iii) the amount equivalent to twelve (12) times the Company's Average Consolidated EBITDA (…) minus the Company's net consolidated debt, divided by the total number of shares issued by the Company.
> >
> > According to Natura's 2001 Report on the Brazilian Code of Corporate Governance:
> >
> > the criteria for the determination of the tender offer price are provided for in paragraph 2 of article 34 of the Company's Bylaws and do not impose any addition of premiums on the economic value or market value of the Company's shares. The combination of proposed criteria for the determination of the tender offer price protects the Company and its shareholders from opportunistic investors who could take advantage of the high volatility of the Brazilian market to acquire a relevant participation in a time of instability without the obligation to make a tender offer. However, the possibility that, in exceptional market situations and beyond the Company's control, the use of the adopted criteria may result in an amount potentially higher than the market value at the time of the event cannot be ruled out.
>
> The controlling shareholders own 38.609% of the company's shares.[85]

Many companies listed on the Novo Mercado approved equivalent provisions triggering the obligation to launch a mandatory takeover bid, with thresholds usually set between 10% and 35%, regardless of the cause for the transfer of control (i.e. not connecting the MTR trigger to a secondary transaction transferring a controlling stake). This trend represents an interesting

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[85] *Id.*

self-regulatory response[86] of the companies and shareholders to the insufficiencies of an MTR that is difficult and complex and gives minority shareholders limited protection. However, in most cases this regulatory movement has a different inspiration, aiming not to replace the MTR but rather to protect the best interests of blockholders.

These bylaw clauses are the so-called *Brazilian poison pills* or *tropicalized poison pills.* It seems ironic that these MTR-trigger provisions in the articles of association are designated as 'poison pills': they are close to the regulatory framework of the Takeover Directive, and distinct from the 'poison pill' concept that became popular in the US in the late 1980s as a way for the boards of hostile-takeover targets to gain negotiating leverage.[87] In practice, however, most of the provisions function as an aggressive defence of incumbent blockholders against hostile takeovers, rather than a self-regulatory response to the insufficiencies of the LSA's MTR. That is the case where the threshold trigger is incoherently low or the price calculation model makes the acquisition of control absurdly expensive.[88] To work as a 'contractual' MTR, and not as a pure hostile-takeover defence, reasonable coherence is required between the voting threshold triggering the mandatory bid and the voting-rights percentage that effectively grants control of the company. That is the reason most EU Member States do not mandate a bid when the relevant threshold is met but the acquirer convinces the regulator that no control was acquired. A good example is article 187.2 of the Portuguese Securities Code, which establishes a 'negative demonstration of control': a mandatory bid is not required when the relevant entity proves before the Securities Exchange Commission, the *Comissão do Mercado de Valores Mobiliários,* that although it owns more than 33.3% of voting shares, it has no effective control over the target company.

Most Brazilian companies establish thresholds between 15% and 20%. In some exceptional cases, the threshold is established at 10%,[89] which is, without question, incoherently low. Conversely, it is no coincidence that most thresholds are set at a level below the blockholder's voting percentage, creating a privileged position for the incumbent blockholder since no third party will be able to

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86 OIOLI, Regime jurídico do capital disperso na lei das SA. 2019, 329–330.

87 *See* Andrew L. Bab & Sean P. Neenan, *Poison Pills in 2011*, 3 DIR. NOTES SERIES (2011); Ofer Eldar & Michael Wittry, *The Return of Poison Pills: A First Look at "Crisis Pills"*, HARV. L. SCH. F. CORP. GOVERNANCE (2020).

88 *See* Carlos Klein Zanini, *A* Poison Pill *Brasileira: Desvirtuamento, Antijuridicidade e Ineficiência*, *in* TEMAS DE DIREITO SOCIETÁRIO E EMPRESARIAL CONTEMPORÂNEOS 258-61 & 264-70 (SÃO PAULO: MALHEIROS 2011); Oioli, *supra* note 43 at 330-31.

89 This corresponds to the threshold for the right of the minority shareholder to elect a member of the supervisory board – 'conselho fiscal' – in accordance with article 161º of the LSA.

challenge its position.[90] Finally, many of these provisions in the articles of association set price conditions clearly beyond what may be considered equitable.

Several clauses were 'entrenched' in the articles of association, protected by clauses triggering a mandatory bid by those shareholders that vote to revoke the clause.[91] These were the so-called '*cláusulas pétreas*' ('clauses set in stone' or 'eternity clauses'), a concept imported from constitutional law where it refers to those constitutional rules not subject to ordinary revision. In 2009, the CVM (Parecer de Orientação nº 36/2009) concluded such clauses breached several rules of the LSA (articles 115º, 121º, 122º, 129º) and were legally ineffective. In 2010, Bovespa (the São Paulo Stock Exchange) approved several rules including the prohibition of bylaw provisions that hinder voting for changes to other provisions or that impose a penalty on shareholders approving bylaw changes (applicable to Novo Mercado and Level 2).[92]

According to recent research, 55 companies (around 25%) listed on the Novo Mercado have adopted similar clauses.[93] If the sample is restricted to the 84 Novo Mercado companies without a shareholder holding over 50% of voting rights (Level 1 and Level 2), 56% set equivalent bid rules in their respective bylaws.[94]

CONCLUSION

There are generally perceived to be two different regulatory systems concerning the MTR. Hybrid solutions, such as the Brazilian MTR adopted by the LSA, are particularly interesting. First, they show us the historical context and the path dependence of each regulatory solution. Second, they provide

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90 Munhoz, *supra* note 46 at 312-13. Some bylaws go even further by stipulating that when a shareholder owning shares above a predetermined threshold (usually 5–30%) intends to acquire more shares, it must do so through a public auction. This kind of statutory clauses has questionable legality, since LSA article 36º purportedly upholds the free negotiation of the shares of listed/public companies.

91 Zanini, *supra* note 88 at 261-62.

92 Munhoz, *supra* note 46 at 312-13; Gorga, RESEARCH HANDBOOK ON SHAREHOLDER POWER, (2015), 6; https://conteudo.cvm.gov.br/legislacao/pareceres-orientacao/pare036.html.

93 Azevedo et al., *supra* note 83. This percentage is in line with that found by a study of 217 non-financial publicly traded companies: Henrique Portulhak et al., *Poison Pills e Gerenciamento de Resultados: Estudo em Companhias do Novo Mercado da BM&FBovespa*, 13 REVISTA UNIVERSO CONTÁBIL 25 (2017). Moreover, the number of companies adopting this kind of clauses is increasing: *see* Jorge Vieira, Eliseu Martins, & Luiz Paulo Lopes Favero, *Poison pills no Brasil: um estudo exploratório*, 20 REVISTA CONTABILIDADE & FINANÇAS 50 (2009).

94 Érica Gorga, *Changing the paradigm of stock ownership from concentrated towards dispersed ownership: evidence from Brazil and consequences for emerging countries*, 29 NW. J. INT'L L. & BUS. (2009), 45–46.

valuable insights into whether such regulation is being pushed in the direction of the market rule system or the sharing rule system.

The original roots of the MTR in both the Takeover Directive and in Brazilian regulations, dating back about half a century, have dramatically impacted the solutions adopted today. The MTR of the Takeover Directive is structured as a rule giving all shareholders an option to sell out – an exit option – on favourable terms if a new controlling shareholder emerges (regardless of whether this results from a secondary transfer of control) and requiring any control premium to be shared by all shareholders. This was inspired by the first version of the MTR in the City Code. In Brazil, the MTR of article 254-A of the LSA is only triggered by the bilateral transfer of a pre-existing 'controlling' stake in a listed company; in this sense, it is a (limited) sharing rule but not an exit rule. It is inspired by the mechanics and wording of article 255º of the LSA.

For minority/non-controlling shareholders, the Brazilian MTR is rather ineffective. First, the rule is triggered only by secondary transfers of a controlling stake. Second, it ignores controlling stakes below 50% of voting shares and is not triggered by a predetermined threshold of voting rights (e.g. 30%, 33%). Third, non-controlling shareholders are not offered the same terms and conditions as the controlling shareholder receives, since the price of the mandatory bid is equivalent to 80% of the price paid to the controlling shareholder. This inefficiency was uncontroversial for decades as the Brazilian stock exchanges were characterized by highly concentrated shareholder ownership. However, it became problematic when new IPOs started adhering to the requirements of special listing segments with higher standards of corporate governance, lower levels of ownership concentration, and higher compliance with the 'one share, one vote' rule.

The market's correction of the LSA rule's inefficiency was not natural. Contrary to the US regulatory solution, incumbent blockholders in Brazil were unwilling to control companies with minority stakes without proper anti-takeover protection. Regulatory inefficiency was thus corrected by setting predetermined thresholds in the articles of association that trigger a mandatory takeover bid. However, the provisions have typically been structured to favour the incumbent blockholder, and thus function as aggressive defences against hostile takeovers, rather than a reasonable self-regulatory response to the insufficiencies of the LSA's MTR. Threshold triggers have been set at incoherently low levels and the price calculation models for mandatory takeovers have made it virtually impossible to acquire control. Also, several clauses were entrenched in the articles of association, protected by clauses triggering a mandatory bid by those shareholders that vote to revoke the clause.

Overall, the inefficiencies persist for minority shareholders. article 254-A of the LSA continues to grant limited protection, while most of the MTR provisions established in listed companies' bylaws work as anti-takeover defences, not effective exit clauses guaranteeing equitable terms and conditions. In practice, minority shareholders are in a worse position than two decades ago.

The Brazilian MTR, as a hybrid between the EU's strong sharing rule system and the US open market rule system, has evolved in a third direction: it does not grant minority shareholders effective protection (equivalent to the European MTR) yet imposes strong limitations on the effectiveness of the market for corporate control (unlike the US regulatory approach). Most probably, the only way out of the current scenario is through federal intervention through amending the LSA.