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THE CONFORMITY OF INITIAL OBJECTIVES WITH THE ACTUAL IMPACTS OF THE HOSTILE TAKEOVER DEFENCES REGULATION IN THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS

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INTRODUCTION

The European Union Directive on Takeover Bids[1] (Directive on Takeover Bids or Directive) establishes a legal framework for takeover bids among Member States. The transactions targeted in the Directive are takeover bids which could be theoretically defined as general or public offer to all the shareholders of a target company.[2] The Directive applies to companies where all or some of its shares are listed in one or several Member States[3] and it is the choice of the Member State itself whether to apply the regulation also to companies not listed.[4] According to the prior the share purchase transactions analysed in the thesis are firmly determined and do not extend to other share purchase transactions.

A regulatory framework for the European Member States regarding the usage of defensive measures against hostile takeovers has been given in Articles 9, 11 and 12 of the Directive. The board neutrality rule in Article 9, breakthrough rule in Article 11 and optionality-reciprocity clauses in Article 12 regulate the post- and pre-bid defences the companies can put in action in case they become a target to a hostile takeover bid.

In the essence of the thesis and a takeover transaction lies control over the target company that the bidder aims to attain.[5] The control is achieved when the bidder has acquired enough shares in the target company to influence its business decisions and is able to appoint directors to the board of the company.[6] A hostile takeover has been defined to occur where the launched bid is against the will of the target company's management and directors of the board.[7] Hostility could signify also a broader concept where an offer is aggressively rejected by the target company as a whole.[8] The reason behind mobilizing against a takeover by the board, the employees or the management lies in the variety of controversial parties and their affected interests the takeover transaction possesses.[9] The arguments for rejecting the

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[1] European Parliament and the Council of European Union 21 April 2004 Directive 2004/25/EC on takeover bids. – L 142, 30.04.2004, pp 12-23

[2] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, pp 225-227

[3] B. Sjåfjell. Towards a sustainable European company law: A Normative Analysis of the Objectives of EU Law, with the Takeover Directive as a Test Case. The Netherlands: Wolters Kluwer 2009, p 297; Recital 1 in the Directive on Takeover Bids

[4] Additional restrictions are set out in Article 1 of the Directive on Takeover Bids

[5] B. Sjåfjell. 2009, p 296

[5] B. Sjåfjell. 2009, p 118

[6] C. Clerc, *et al.* (eds). A Legal and Economic Assessment of European Takeover Regulation. – Marccus Partners and Centre for European Policy Studies 2012, p 129. – Available: http://www.ceps.eu/book/legal-and-economic-assessment-european-takeover-regulation, (15.03.2013)

[7] A. Schianchi, A. Mantovi. A Theory of Hostile Takeovers. – The IUP Journal of Mergers and Acquisitions Sept 2007, p 4. – Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=901956, (12.01.2014)

[8] G.W. Schwert. Hostility in Takeovers: In the Eyes of the Be holder?. – Journal of Finance, 2000 No 6, p 2600

[9] B. Sjåfjell. 2009, p 296 and p 117;

potential takeover could result from its abusive nature and a gross asymmetry of information[10] the acquirer discloses or more accurately declines to disclose about its intentions towards the target company. Also the target company or the government of the Member State where the target company is listed could want to sustain the target company's unanimity and development in a long-term perspective. In short, the hostility towards takeovers accrues from the resistance by the target company as a whole and by third parties whose interests could be affected.

From the economical point of view takeovers could be profitable. They have been seen beneficial in terms of improvement of resource allocation, synergistic gains, solving agency problems and for accurate market valuation.[11] In comparison with friendly takeovers the commentators often bring forth that hostile takeovers generally cause higher price reactions for the target shareholders[12] which is argued to be the main positive reason for their justification. Nonetheless, a number of studies indicate also negative effects of hostile takeovers on the long-term performance of target companies.[13]

Takeover defences are designed to slow down the process of an uninvited bid[14] by either making the company unattractive or more costly to acquire. Post-bid defences are put in place after the company has become a subject to the takeover bid.[15] The core issue in such circumstances is to whom should be given the right to decide upon adopting and utilizing those measures – to the shareholders or to the board of the target company. Pre-bid defences are aimed to prevent sudden and unexpected hostile bids before the management-board is able to assess their options.[16] Pre-bid defences are used as barriers to a takeover of company's shares or barriers for shareholders to exercise the control that the shares represent at the general meeting.[17] Numerous commentators argue that defensive measures have destructive effect, destroy shareholder value[18] and that they raise the cost and reduce the benefits of a

[10] C. Clerc. *et al*, (eds), *op. cit.,* p 120; Information asymmetry creates a situation where because of the uncertainty over the target company's future development the inetrested parties inside of the target company could resist the bid.

[11] W. Magnuson. Takeover Regulation in the United States and Europe: An Institutional Approach. – Pace International Law Review, 2009/21 No 1, p 235

[12] M. Martynova, L.D.R. Renneboog. The performance of the European market for corporate control: Evidence from the 5th takeover wave. – European Financial Management, 2011a/17 No 2, p 248

[13] M. Martynova, S. Oosting, L. Renneboog. The long-term operating performance of european mergers and acquisitions – ECGI Finance Working Paper no 137/2006, p 19. - Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=944407 (15.01.2014)

[14] D. DePamphilis. Mergers and acquisitions basics. Oxford: Elsevier, 2011, p 73

[15] C. Clerc, *et al*, (eds), *op. cit.*, p 85*;* Most commonly used post-bid defences among others are poison pills, pac-man defence, greenmail, white knight, white squire and share repurchases.

[16] D. DePamphilis. *op. cit.*, p 73

[17] C. Clerc. *et al*, (eds), *op. cit.,* p 85

[18] R.W. Masulis, C.Wang, F. Xie. Corporate Governance and acquirer returns. – Journal of Finance, 2007/62 No 4, p 1852

takeover for the bidder[19]. Nonetheless, both post- and pre-bid defensive measures are widely practiced and possess a variety of positive and beneficial effects for the target company.

The aim of the thesis is to analyse whether the initial objectives set to Articles 9, 11 and 12 regulating the usage of defensive measures against hostile takeovers in the European Directive on Takeover Bids are in conformity with the actual impacts and effects of the articles deriving from the legal regulation interpretation and implementation analysis. In accordance with the results, the proposals for possible regulatory amendments to the articles regarding the board neutrality rule, the breakthrough rule and optionality-reciprocity clauses will be made.

Thesis concentrates firmly on analysing the defensive measures against hostile takeovers regulation in the scope of the Directive on Takeover Bids. The review over the implementation of the Directive's regulation in different Member States is merely taken as a comparison for indicating diversities the takeover defences regulation in the Directive would possess. Member States under the examination – the United Kingdom, the Netherlands and Estonia – are chosen based on the controversial and rather opposite viewpoints and regulation implementation these Member States represent.
Based on the latter the hypothesis is established – The initial objectives set to the defensive measures regulation are in conformity with the actual impacts.

In the thesis the author is using various analysing methods. In the analysis of the theoretical grounds and initial objectives is used qualitative method. In the analysis of the defensive measures regulation is mostly used systematic method for understanding the Articles 9, 11 and 12 in the Directive, their interrelations and impacts in concurrence with each other. By analysing the implementation of defensive measures regulation in United Kingdom, the Netherlands and Estonia the comparative method is used for comparing takeover laws in different legal systems. In the analysis over the conformity between the initial objectives and actual impacts is mostly used qualitative method which is supported by statistical data. In the section of introducing possible changes to the defensive measures regulation is used modelling method.

Thesis is divided into five chapters by following the aim of verifying or disconfirming with the hypothesis established to the thesis.

[19] M. Ventoruzzo. The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends. – Texas International Law Journal, 2006/41 No 2, p 177

In the first chapter an overview is given about the theoretical grounds behind the initial objectives for understanding the reasons for setting such goals to the articles regulating the defensive measures against hostile takeovers in the Directive on Takeover Bids. The usage of these underlying theories has significant influence on both the initial objectives and on the actual outcome results which is the reason why a short overview of these theories is crucial for the thesis.

In the second chapter of the thesis the board neutrality rule in Article 9 of the Directive on Takeover Bids is analysed. Firstly, there is given an overview of the objectives set to the rule which the requirement was aimed at achieving through the regulation and its implementation. Secondly, the regulation and its implementation has been analysed more profoundly for detecting the actual impacts the board neutrality has had or would have. Based on the latter, the outcomes of the board neutrality rule are presented and their conformity with the initial objectives analysed. Chapters three and four analysing the Articles 11 and 12 respectively follow the outline set out in the second chapter. Article 12 does not embody a rule for defensive measures against hostile takeovers such as Articles 9 and 11 but regulates the usage of the rules. The reasons for Article 12 to form a separate chapter lies in that it firstly, pertains to both Articles 9 and 11, and secondly, attaching the analysis of Article 12 to both Articles 9 and 11 would increase the capacity groundlessly. In the final chapter the outcome from hypothesis analysis is represented together with the reasoning behind the outcome results and introduction of possible changes to the Directive on Takeover Bids for the future.

In the thesis are used different materials for analysing the validity of set hypothesis. The most important materials are legislations – especially the Directive on Takeover Bids but in addition regulations from several Member States. In addition to legal regulation the case law is used. An important part in the analysis form several different legal and economic reports regarding the defensive measures regulation in the Directive. Important sources for the thesis are also numerous academic articles and books.

1. Grounds for establishing unitary takeover defences regulation

1.1. Takeovers in Europe and the adoption of European Directive on Takeover Bids

Takeovers are regarded to be less common in Europe than in United States.[20] However, the United Kingdom attracts takeovers with its highly liquid financial market, making it clearly the leading takeover market in European Union.[21] According to Figure 1 in the Annex, the financial crisis has lowered the number of takeovers occurring in United Kingdom remarkably while leaving the figures in Continental Europe relatively unchanged. These results exhibit that takeovers perform a fairly important and stable role in Continental Europe and should not be underestimated as a financial market in comparison with United Kingdom.

The first proposal for the Directive was presented to the European Council already in 1989 and the second proposal was published in 1996.[22] During the first considerations of the Directive only few Member States had their own regulation governing takeovers – United Kingdom as a leading takeover bid market in Europe had regulated takeovers including defensive measures against hostile takeovers for a long period. The latter was the argument for favouring the United Kingdom's City Code[23] to be taken as the basis of the Directive because of its development and high takeover activity on United Kingdom's financial market.[24]

The Directive on Takeover Bids was adopted in 2004 and was requested to be transposed to the national laws of the Member States by May 2006.[25] The core principle of the Directive was to promote the creation of a Single European Market and enhancement of competitiveness of European companies[26] through takeovers which were at least in a short-term dimension seen valuable for the target shareholders.[27]

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[20] M. Ventoruzzo, *op. cit.,* p 173; A. Zwecker. The EU Takeover Directive: Eight Years Later, Implementation But Still No Harmonization Among Member States on Acceptable Takeover Defenses. – Tulane Journal of International and Comparative Law, 2012/21 , p 254

[21] C. Clerc, *et al*, (eds), *op. cit.,* p 148; Martynova/Renneboog, 2011a, p 224, stating that 61% of domestic and 41% of the cross-border hostile bids in European Union take place in United Kingdom.

[22] The Takeover Bids Directive Assessment Report. European Commission 2012, p 23. - Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf, (13.01.2014)

[23] The City Code on Takeovers and Mergers. London: The Panel of Takeovers 1985 (11th edition 20.05.2013). – Available: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf, (20.01.2014)

[24] B. Clarke. The Takeover Directive: Is a Little Regulation Better Than No Regulation? – European Law Journal, 2009/15 No 2, p 176 (B. Clarke 2009a)

[25] The Takeover Bids Directive Assessment Report. *op. cit.*, p 23

[26] P. Davis, E-P. Schuster, E. van de Walle de Ghelcke. Takeover Directive as a Protectionist Tool? – European Corporate Governance Intitute Working paper No 141/2010, p 1. – Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1554616, (12.22.2012)

[27] M. Ventoruzzo, *op. cit.*, p 177

1.2. Theoretical grounds for constituting initial objectives

1.2.1. Prevalent presumption of takeover benignancy

The underlying and prevalent presumption of takeover benignancy lies in the positive effects the takeovers as well as hostile takeovers are presupposed to possess – effective restructuring of companies businesses, allocation of resources, disciplining self-interested management and post takeover synergy gains – and because takeovers have been expected to be value-enhancing for the target shareholders.[28] Based on the latter and taking into account a grounding goal of the Directive on Takeover Bids of shareholder primacy facilitation of takeovers was set as one of the main objectives of the Directive. For the purpose of facilitating takeovers obstacles to takeovers in general including to hostile takeovers had to be removed[29] and strong restrictions on takeover defences that could disrupt a successful completion of a control transaction set. A greater number of takeovers in the market have been seen as the basis for efficient functioning of the market for corporate control which is one of the core aspects of the takeover defences regulation in the Directive on Takeover Bids.

1.2.2. Solving agent – principal conflict[30] through defensive measures regulation

A conflict of interests between an agent and a principal is known as agency problem or agent-principal conflict.[31]. Agency conflict emerges in three divisions of interrelations of a company – the conflict between the managers and the shareholders, between the non-controlling shareholders and controlling shareholders and between the company itself and its contracting parties[32] such as employees, clients and other stakeholders. The primary reason for the conflict to occur lies in the information asymmetry[33] as the principal does not possess the same information as the agent and differences in the position of power between the agents

[28] J.A. McCahery, *et al.* The Economics of the Proposed European Takeover Directive. – CEPS Reports in Finance and Banking, 2003/32, p 38. – Available: http://aei.pitt.edu/9562/, (21.02.2014)
[29] B. Sjåfjell. 2009, p 296
[30] Agent – principal conflict is widely used term in the legal literature for referring to various conflict of interests between different parties inside of a company which in the takeover regulation are partly tried to be solved through certain theories. Because of its extensive usage in the literature the concept is also used in the current thesis.
[31] B. Sjåfjell. 2009, p 275
[32] J. Armour, H. Hansmann, P. Kraakman. Agency Problems and Legal Strategies. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 35-36
[33] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 248-249

and the principals. The agent possesses a sort of decisive power in the interrelationship with the principal to influence the impacts of decisions made on both of the conflicting parties.

Agency conflict between the managers and shareholders is especially relevant in companies with dispersed or semi-dispersed ownership[34] where the shareholders confront, because of their multiplicity, excessive coordination problems[35]. To overcome shareholders' coordination problem the decision-making power is delegated to the management.[36] The latter is the basis for the agency conflict to emerge – in the delegated decision-making the managers are believed to face significant conflict of interest of saving their jobs rather than maximizing shareholder value[37] and managerial entrenchment allows managers to carry out value-destroying control transactions.[38]

Aligning the interests of the managers with those of the principal could be achieved by paying executive compensation to the agents[39] or by monitoring the management which would involve herewith excessive monitoring costs.[40] Both the compensation and monitoring costs could be referred to as agency costs which would incur in situations where the interests of the agents are not wholly aligned with the interests of the principals.[41] As the agency problem could impede control transactions and set unwanted barriers to takeovers[42] there is a vigorous need for detecting effective measures for solving the agent – principal conflict.

Differently to dispersed ownerships, in concentrated ownership companies controlling shareholders have better potentiality to monitor the management[43] which is the reason for the agency conflict to be more relevant between the controlling and non-controlling shareholders.

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[34] C. Clerc *et al*, (eds), *op. cit.,* p 138; M. Ventoruzzo, *op cit,* p 186

[35] M. Martynova, L.D.R. Renneboog. Evidence on the international evolution and convergence of corporate governance regulations – Journal of Corporate Finance, 2011b/17 No 5 , p 1533

[36] J. Armour, H. Hansmann, P. Kraakman. Agency Problems and Legal Strategies. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 35-36; Martynova/Renneboog, 2011b, p 1533

[37] B. Sjåfjell. The Core of Corporate Governance: Implications of the Takeover Directive for Corporate Governance in Europe - European Business Law Review, 2011/22 No 5, p 647 ; J. Winter, *et al.* Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids. 10 January 2002, p 21 – Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf, (15.02.2014)

[38] Masulis/Wang/Xie. *op. cit.*, p 1854

[39] C. Kulich, *et al.* Who gets the carrot and who gets the stick? Evidence of gender disparities in executive remuneration - Strategic Management Journal, 2011/32 No 3, p 303

[40] B. Sjåfjell, 2009, p 274; C. Clerc *et al*, (eds), *op. cit.*, p 138 was stating „/---/ the shareholders cannot ordinarily be considered to be fully informed about the post-takeover value as they may not have enough knowledge to acquire and process complex information".

[41] D. Kershaw. The illusion of importance: reconsidering the UK's takeover defence prohibition - International & comparative law quarterly, 2007/56 No 2, p 301

[42] B. Clarke. Where was the market for corporat control when we needed it?. – UCD Working Papers in Law No 23/2009, p 11, (B. Clarke 2009b). – Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1524785, (13.01.2014)

[43] C. Mayer, L. Renneboog, J. Franks. Who Disciplines Management in Poorly Performing Companies? – Journal of Financial Intermediation, 2001/10 No 3-4, p 233

In such agency issue controlling shareholders possess significant power and advantage in comparison with the non-controlling minority shareholders who have no means of possibility to participate in running company's ordinary businesses or influence corporate strategies.

In the Directive the position is taken that the solution to the agency conflict between managers – shareholders lies in the market for corporate control doctrine. The agency conflict between controlling and non-controlling shareholders is assumed to be overcome by promoting dispersed ownership and one share-one vote principle. The agency conflict between the company itself and the contracting parties was not intended to be targeted with the defensive measures regulation.

1.2.3. The market for corporate control doctrine

The doctrine of market for corporate control has been defined so that the mismanagement of a company could be reflected in its share price due to the company's poor performance and the low share price in turn would provide an opportunity for potential bidders to acquire company cheaply and replace the managers.[44] The premises of the market for corporate control lie in the threat of being taken over[45] or in credible risk of a hostile acquisition[46] which would diminish managerial opportunism, as the managers have an incentive to act opportunistically, and reduce agency costs.[47] As the share price of the company is presumed to reflect the value of it and the quality of company's management[48] on the rationally acting market the underperforming company shall become attractive to other companies who are aimed at attaining control in the underperforming company. Resulting from a successful takeover the underperforming management would be replaced. The market for corporate control is especially important in companies with dispersed ownership[49] because it should discipline the management from carrying out actions which would otherwise result in creating agency conflict.

[44] H. Manne. Mergers and the Market for Corporate Control. – Journal Political Economy 1965/110

[45] P. Lysandrou, P.A. Pra. The Irrelevance of the European Union's Takeover Directive. – Competition and Change, 2010/14 No 3-4, p 209 states that „Investors threat the managers with a takeover by selling their shares to a potential bidder."

[46] W.W. Bratton. Private Equity's Three Lessons for Agency Theory. – European Business Organization Law Review, 2008/9 No 4, p 516

[47] C. Rose. A critical analysis of the „one share – one vote" controversy. – International Journal of Disclosure and Governance, 2008/5 No 2, p 128; J. Armour, H. Hansmann, P. Kraakman. Agency Problems and Legal Strategies. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 35-36

[48] B. Sjåfjell. 2009, p 330

[49] Lysandrou/Pra. *op. cit.*, p 205

The market for corporate control is assumed to lead to positive effects of resource allocation, synergies and most importantly possesses a disciplining effect of managers.[50] The Chicago school economists have claimed that the continuous threat of being taken over in hostile acquisitions and the free market for corporate control would discipline the management, lead to better performance and increase economic growth.[51] It has also been argued that cross-border market for corporate control would align the interests of managers and shareholders[52] and the constant risk of hostile takeovers prevents managerial self-dealing.[53] It has been believed that if the market for corporate control would work in practice as it does in theory the takeovers could be valuable and value-enhancing.[54] Because of the prior the market of corporate control should contribute to solving the agency conflict between the managers and the shareholders of the company.

1.2.4. Supremacy of dispersed ownership and one share-one vote principle

Takeover benignancy presumption created the ground for establishing another underlying doctrine important for promoting takeovers – dispersed ownership and one share-one vote control structure in companies. In dispersed company structure the control over a company is more easily acquirable[55] as there is no controlling shareholder whose lack of interest would frustrate the successful outcome of the bid. Concentrated ownerships are prevailing among companies in Continental Europe whereas companies in United Kingdom are historically dispersed – the median of largest block-holding in companies of United Kingdom was 11.09 % while in Continental Europe the relevant percentage was 47.23 %.[56] The latter indicates strong dissimilarity between the ownership structures in United Kingdom and Continental Europe and for promoting the takeover market in the latter dispersed ownership was stated to be superior over the concentrated ownership.

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[50] B. Sjåfjell. 2009, p 325

[51] A. Nilsen. The EU Takeover Directive and the Competitiveness of European Industry. – The Oxford Council on Good Governance, 2004, p 5. – Available: http://www.ocgg.org/index.php/305/0/, (20.02.2014)

[52] J.A. McCahery, E.P.M. Vermeulen. Does the Takeover Bids Directive Need Revision?. – Tilburg Law School Research Paper No. 005/2010, p 3. – Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1547861, (19.02.2014)

[53] W.W. Bratton. *op. cit.,* p 510

[54] D. Henry. Director's Recommendation in Takeovers: An Agency and Governance Analysis. – Journal of Business Finance Accounting, 32/2005 No 1-2, p 130

[55] B. Clarke. 2009b, *op.cit.*, p 16

[56] M. Köhler. Blockholdings and Corporate Governance in the EU Banking Sector. – European Economy Research Discussion Paper 2009 No 08-110, p 5. – Available: http://ftp.zew.de/pub/zew-docs/dp/dp08110.pdf, (30.01.2014)

Company's control structure determines the nature and strength different classes of shareholders possess in a company and the impacts the usage of defensive measures could entail. Control enhancing mechanisms feature strong superior position for controlling shareholders enabling them to block the bid in case there is lack of interest on their behalf. Non-controlling shareholders are left without any actual opportunities to put their interests into practice. The latter constitutes the agency problem between controlling and non-controlling shareholders which could be solved by prohibiting control enhancing mechanisms and introducing one share-one vote principle.

1.2.5. Shareholder primacy

According to the theory of shareholder primacy, the primary obligation of the board of directors is maximizing shareholder value – in case of a takeover the latter implicates to high share price during the bid and to superior right of the shareholders to decide on the merits of the bid.[57] The opposing stakeholder-model, mostly uphold in Continental Europe, has taken a broader approach where the company is seen as an entity consisting of numerous and diverse participants trying to accomplish their purposes[58] rather than just a tool for the shareholders to maximise their own interests.

The shareholder primacy view applies strongly also to the afore-mentioned principal-agent theory where the shareholders are defined to be the weak party[59]. This is the reason why the interests of the agents should be aligned with the interests of the shareholders which in case of takeovers and shareholder primacy model is maximising shareholder value. Nonetheless, it is argued that the board of the company has to ensure that all the interests inside the company are dealt with fairly and properly[60]. Even where the objective of the board is maximising the shareholder value, the board should take into consideration and balance other involved interests inside the company. According to the European Commission Assessment Report in 2012, the European legislators have taken the basis of the regulation in the shareholder primacy view where as a result to the concepts like principal-agent theory and alignment of interests the non-frustration rule prevails.[61]

The European Commission has taken a viewpoint that Anglo-American dispersed ownership structure and one share-one vote doctrine is superior over Continental European

[57] C. Clerc. *et al*, (eds), *op. cit.,* p 189
[58] T. Donaldson, L.E. Preston. The stakeholder theory of the corporation: concepts, evidence and implications. – The Academy of Management Review, 20/1995 No 1, p 68
[59] The Takeover Bids Directive Assessment Report. *op. cit.*, p 32
[60] B. Sjåfjell. 2009, p 280
[61] The Takeover Bids Directive Assessment Report. *op. cit.*, p 32.

blockholders[62] while the promotion of shareholder primacy in the Directive is clearly against the historical stakeholder-model common in Continental Europe. It has been left unconsidered that promoting the shareholder primacy could have detrimental effects for other parties than the shareholders[63] and could set aside long-term objectives of the company. As the reasoning behind the preference of Anglo-American approach to the Continental European model is vague, the European legislators have taken relatively great risk by trying to force one system on another and have not taken into consideration the theoretical differences and empirical studies.

[62] B. Sjåfjell. 2009., p 322-324
[63] B. Sjåfjell. 2011, p 664

2. Board neutrality rule – Article 9

2.1. Formulation of the board neutrality rule

The basic board neutrality rule has been stipulated in Article 9 (2) in the Directive by obliging the board of the target company to obtain prior authorisation of the general meeting before taking any action that may frustrate the bid.

According to the board neutrality rule the board of the target company is neutralized for the time of the offer period in order to prevent them from taking any actions which could influence the outcome of the bid. Such a requirement was stipulated based on various objectives the rule was aimed at fulfilling.

2.2. Initial objectives of the board neutrality rule

2.2.1. Unified regulation of the board's role during the takeover bid

The adoption of the Directive was important for establishing legal certainty and the European Community wide clarity and transparency on the takeover bids process.[64] Because of that harmonized legal regulations were essential to be introduced across Europe[65] so that all the Member States would imply similar unified rules regarding the board's role during the takeover bid and the adoption of post-bid defensive measures. Board neutrality rule is specifically aimed at forming a unified regulatory framework for the role of the target company's board during the bid in connection with the actions or defensive measures the board could undertake to frustrate the bid.

2.2.2. Facilitation of takeovers and the market for corporate control

The most important objective of the board neutrality rule is to facilitate takeovers and through that the market for corporate control which in could promote solving the agency conflict and reduce agency costs. The board neutrality rule is aimed at making takeovers more easier as it is known that defensive measures on behalf of the board could turn a takeover impossible to be carried out as well as more money- and time-consuming.[66] Removing the anti-takeover measures that the board might set to fend off hostile bidders would benefit to the outcome of

[64] Directive on Takeover Bids Recital 3; The Takeover Bids Directive Assessment Report. *op. cit.*, p 26
[65] The Takeover Bids Directive Assessment Report. *op. cit.*, p 26; B. Sjåfjell, 2009, p 296
[66] B. Sjåfjell, 2009, p 302 and p 368

takeovers and enhance the market for corporate control.[67] As a consequence, the neutral board is incapable of fending off hostile takeovers. Therefore, if the tool of market for corporate control works in practice as it should in theory, the board-management threatened to lose their job in case of a successful takeover concentrates on fulfilling the interests of the shareholders.

2.2.3. Solving agency problem between the managers and the shareholders

The board neutrality rule is aimed at solving the agency problem between the managers and shareholders where the board in the defensive measures concept of agency issues should be treated as managers[68]. The board and the managers are supposed to act in the interests of the shareholders. Nevertheless, according to widely accepted notion the self-interested board is believed to be so intensely in conflict with the interests of the shareholders that it is strongly believed to affect their independent decision-making ability which in turn would generate agency conflict.[69] Because of the latter, and taking into account that agency conflict is especially common in companies with dispersed ownerships, it was the core objective of the board neutrality rule „/---/ to discipline the management of dispersed ownership /---/“[70] and the board neutrality rule was supposed to have strong rational in companies where „ /---/ the share capital is dispersed among several shareholders /---/“[71].

The level of dispersed ownership companies in United Kingdom constitutes approximately 90% of all the companies.[72] The relevant records for Continental Europe indicate considerable increase of dispersed ownerships during a period from 1996 to 2006 – for example in Germany an increase from 26% to 48%, in France from 21% to 37% and in Italy from 3% to 22%.[73] Though statistically the Continental European companies have become more dispersed in shareholding they could be still classified as concentrated. Based on the previous statistics agency conflict between managers and shareholders has been especially relevant in United Kingdom and as the passivity rule stipulated in the United

[67] F. Comez, M.I. Saez, Chapter 14: The Enforcement of Management Passivity Duty in Take-over Law: Class Action or Government Action? in Backhaus, J.G., Cassone, A. and Ramello, G.B. The Law and Economics of Class Actions in Europe: Lessons from America – Cheltenham: Edward Elgar Publishing 2012, p 263
[68] B. Sjåfjell, 2009, p 121
[69] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 248; Comez/Saez, *op. cit.* p 263
[70] A. White. Reassessing the Rationales for the Takeover Bids Directive's Board Neutrality Rule. – European Business Law Review, 2012/25 No 23, p 789
[71] C. Clerc *et al*, (eds), *op. cit.*, p 79
[72] C. Clerc *et al*, (eds), *op. cit.,* p 79
[73] A. White, *op. cit.*, p 792

Kingdom City Code[74] had been ascertained to promote takeover market it was attached as a grounding principle to the takeover defences regulation. Board's passivity requirement was relatively unfamiliar in Continental Europe before the adoption of the Directive.

European legislators have taken strong but rather controversial position in disapproving the blockholdings while promoting the dispersed ownership structure, easier takeovers and the market for corporate control to solve the agency issues, which are actually encouraged by the bid itself.[75] With that they have absolutely been brushing aside the arguments how dispersed ownerships and shareholders' coordination problems generate agency problems themselves that should be in theory solved by the doctrine of market for corporate control which has no practical evidence of validity.

2.2.4. Promoting shareholder primacy and their ultimate decision-making power

In addition to the prohibition of the board-managers to undertake any actions that could frustrate a bid, the decision-making power as part of a greater shareholder primacy theory should be ultimately held by the shareholders of the target company[76]. Though the decision-making power over the defensive measures could be for some period of time delegated to the board-management[77] so that they could seek for a white knight or try to influence the opinion of the shareholders, it is seen „/---/ necessary for the proper functioning of the market for corporate control and for facilitation of acquisition of control /---/"[78] to leave the decision-making to the shareholders. Having its roots in the United Kingdom City Code the Directive has taken its view towards strict board neutrality rule which would grant the shareholders the right to decide whether to accept the offer from the bidder promoting by this the Anglo-American view of shareholder rather than Continental European stakeholder-model.

[74] The City Code on Takeovers and Mergers. London: The Panel of Takeovers 1985 (11th edition 20.05.2013). – Available: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf, (20.01.2014);The passivity rule in the United Kingdom City Code is corresponding to the board neutrality rule in the Directive on Takeover Bids.

[75] C. Kirchner, R.W. Painter, Towards a European Modified Business Judgment Rule for Takeover Law. - European Business Organizations Law Review, 1/2000 No 2 and D. Kershaw, *op. cit.*, p 268; The agency problem between the managers and the shareholders is dominant in dispersed ownerships. By promoting dispersed ownerships and takeovers such activity in itself generates the agency conflict keen to be solved by the legislators.

[76] C. Clerc. *et al*, (eds), *op. cit.*, p 169

[77] C. Clerc. *et al*, (eds), *op. cit.*, p 169.

[78] B. Sjåfjell, 2009, p 417

2.3. Regulatory interpretations of the board neutrality rule

2.3.1. Diverse interpretation of the board in the board neutrality rule

Diverse interpretation of the board is caused by differences of governing bodies in various companies that could be subject to the board neutrality rule. Whereas the two-tier governance system consists of the board of directors and the supervisory board the one-tier board system (common in United Kingdom but available also in the Netherlands) consists of the board of directors, where the directors can be divided into executive directors, who run the company on the daily basis, and non-executives, who have the supervising duty over the executives.[79] The latter creates multiplicity of subjects potentially falling under the scope of the board neutrality clause and generates necessity for unified definition of the board in the meaning of the board neutrality rule.

The Directive gives merely one solid explanatory notice on defining the subject of the board neutrality rule – Article 9 (6) states that the supervisory board should be interpreted to fall under the scope of the non-frustration clause. More concerns accrue from the term "*board"* having rather vague meaning and creating misconception in interpretations. In United Kingdom the term *"board"* in the board neutrality rule context refers to both executives and non-executives – managers and the directors of the board. In Estonia it refers to the members of the management and the management board.[80] In the Netherlands it refers simply to the target company[81] without further explanation. In Germany it refers to the board of management[82] and in France it refers to the board of directors[83]. Based on the previous it could be firmly stated that the term "*board"* in the Directive on Takeover Bids has no clear and unified interpretation among the national laws of the Member States.

Nevertheless, the board neutrality rule should be aimed to be applied to all the directors and managers of the company as well as to the supervisory board. It could be reasoned with a fact that all of these governing bodies influence the operations and development of the company and because of that affect the benefits the shareholders of the

[79] W.J.L. Calkoen. The One-Tier Board in the Changing and Converging World of Corporate Governance: A comparative study of boards in the UK, the US and the Netherlands. The Netherlands: Wolters Kluwer 2011, p 331

[80] Väärtpaberituru seadus. - RT I 2001, 89, 532 ... RT I, 23.12.2013, 33, § 171 (1)

[81] Dutch Civil Code (Burgerlijk Wetboek). The Netherlands 1992. – Available: http://www.dutchcivillaw.com/ and http://www.wetboek-online.nl/site/home.html, (15.02.2014), Book 2:359 (1) (a)

[82] Wertpapiererwerbs- und Übernahmegesetz (WpÜG) (Securities Acquisition and Takeover Act), 20 December 2001, Federal Law Gazette I p. 3822. – Available in english: http://www.bafin.de/SharedDocs/Aufsichtsrecht/EN/Gesetz/wpueg_en.html, Section 33 (1)

[83] Code monétaire et financier, partie législative (French Monetary and Financial Code), 1.11.2010. – Available: http://www.legifrance.gouv.fr/Traductions/en-English/Legifrance-translations,(12.04.2014), Article L433-2

company could have. This rather broad view on the scope of the board neutrality rule is in accordance with the objective of solving the agency problem – it has been generally accepted that the agent in the latter context should be referred to the managers and the board jointly as the members of the board have similar conflicting interests to those the managers have[84].

2.3.2. Interpretation of restrictions on board's actions during the takeover bid

The general principle laid down in Article 3 (1) (c) requesting the right for the shareholders to decide on the merits of the bid is put in practice in Article 9 (2) by prohibiting the board to undertake any frustrating actions and vesting the decisional power to the shareholders.

According to Articles 9 (2) and 6 (1) the time period when the neutrality rule applies and the board is required to obtain prior authorization to its action that could result in frustrating the bid should be interpreted to start when the bid is made public and last until the results of the bid have been made public or the bid lapses. Shareholder authorization has to be granted during the aforementioned active offer period indicating the pre-bid authorization to be invalid.[85] Further to the general rule, specific notion should be given to additional possibility for the Member States who wish to require more rigorous board neutrality. The latter alludes to situation where the board is aware of the bid to be in the air[86] but it has not been made public yet. Such possibility would leave the board with a chance to carry out actions which could frustrate the bid when the bid is finally launched. The term "*for the purpose*" in the board neutrality rule refers that the authorization could only be granted for the purpose of the specific takeover bid launched and for certain measures proposed by the board.[87] The authorization does not apply to hypothetical offers that might occur in the future. The shareholders can truly decide on the merits of the bid if they are aware of the conditions of the bid[88] meaning that the authorization can be given only on an informed basis for the bid that has been made public. Because of the broad time period during which the authorization is required, the lack of possibility to obtain prior mandate and the requirement of supermajority

[84] Sjåfjell, B. 2009, p 121
[85] Davis/Schuster/Ghelcke, *op.cit.,* p 6
[86] J.Wouters, P. van Hooghten, M. Bruyneel. The European Takeover Directive: A commentary. in P. V. Hooghten, (eds). The European Takeover Directive and Its Implementation, Oxford University Press, New York, p 43
[87] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 234
[88] Recital 13 of the Directive on Takeover Bids

vote for an authorization[89] it is clearly troublesome for the board to undertake any actions in their own interests.

The board is prohibited of taking any action that could frustrate the bid. It refers to all operations which are „/---/ not carried out in the normal course of business and are not in conformity with the normal market practices /---/"[90] and especially the board neutrality rule is aimed at preventing the target board to put in place poison pills or sales of substantial assets[91]. Nevertheless, actions of the board that are carried out in part of its normal business activities[92] do not fall under the prohibition clause. In such case, if the board of the target company succeeds to prove that the operation is and would be carried out part of the normal course of business of the target company rather than as a defensive measure it would not be caught by the board neutrality rule. However, the possibility for an action to fall within the scope of the prior explanation is rather exceptional.

There are however few possibilities left for the target board to influence the outcome of the bid. One of these is stipulated in Article 9 (2) which allows seeking alternative bids. According to this, the board is permitted to look for a third contestable bidder or a white knight that would create an alternative solution for the shareholders in a hostile bid context and would support the enhancement of the price offer as the alternative bidder could be willing to pay more.[93] Seeking a white knight is also known to discourage the first bidder from initially launching the bid as the competing bidder would benefit from the free-riding and the friendly white knight usually succeeds as the friendly party is willing to pay more due to the beneficial potentiality and synergy gains.[94] However, if a desirable rival bidder has been identified the board neutrality applies again[95] as the Directive only permits the seeking for the board but not acting upon it. The latter does not leave the board with a lot of opportunities – the board has a chance to inform the shareholders about the consequences and characteristics of a hostile bid and the board could also try to persuade the shareholders to adopt defensive measures if there are sufficient reasons to believe the bid to have destructive effects on the target company.

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[89] M. Ventoruzzo, *op cit,* p 215

[90] Wouters/ Hooghten/Bruyneel, *op. cit.,* p 40

[91] V. Edwards. The Directive on Takeover Bids – Not Worth the Paper It's Written On?. – European Company and Financial Law Review, 2004/1 No 4, p 436; Poison pill is a post-bid defensive measure that usually implicates where the shareholders are given chance to buy shares in the target company on a lower price if the acquirer purchases certain amount of shares.

[92] Recital 16 of the Directive on Takeover Bids

[93] Bukart/Panuzi, *op.cit.*; White knight is a post-bid defensive measure which implicates an alternative friendly bidder willing to buy shares in the target company.

[94] B. Sjåfjell. 2011, p 687

[95] B. Clarke. Reinforcing the Market for Corporate Control. – European Business Law Review, 22/2011 No 5, p 523 (B. Clarke 2011)

It has been stated that the Member States generally devise rules which could protect the incumbent management and the board.[96] Also shareholders in dispersed ownership companies see the delegation of decision-making powers to the board-management as a solution to the coordination problems they confront. The delegation of decision-making power does not violate in itself particularly the right of the shareholder to decide on the merits of the bid as the shareholders have chosen the agents who decide on their behalf themselves. It is even acknowledged that the managers make better decisions regarding the company's businesses as they are better informed of the company's position[97] and they are specialised on running the daily businesses of the company.

If the board neutrality rule is applied, it does not leave a lot for the company's board or management to do if they want themselves or consider it to be necessary to frustrate the bid. One of the possibilities is to seek for alternative bid which is nonetheless restricted only to the seeking part. The most influential tool for frustrating the bid in a situation where the neutrality rule applies to the board is the persuasion and giving an opinion on the bid to the shareholders over the actual impacts the takeover could involve.

2.3.3. Board's opportunity to grant its opinion on the bid

Another possibility for the board to influence the outcome of the bid is through giving its opinion on the bid. The latter is stipulated in Article 9 (5) granting the board a large scale procuration in the strict passivity rule context. Such an empowerment rests upon the expertise the board holds in the target company as the board is aware of the company and its business affairs the best. The opinion of the board grants valuable information for the shareholders[98] to be sufficiently informed on the effects of the bid when deciding whether to accept or reject it and it is the duty of the board of the offeree company to advise them in this respect.[99]

By fulfilling its obligation to inform the shareholders about the characteristics and effects of the bid the board neutrality rule has not imposed total passivity requirement on the board of the target company. Though the opinion represented by the board is not binding to the shareholders and the board has no real opportunity to follow their opinion in practice[100] the board's opinion performs an important role in persuasion of the shareholders not to accept the bid. The reasons for the persuasion vary – the price offered by the bidder undervalues the

[96] L. Enriques. European Takeover Law: The Case for a Neutral Approach – European Business Law Review, 2011/22 No 5, p 638
[97] Comez/Saez, *op. cit.* p 263
[98] Wouters/ Hooghten/Bruyneel, *op. cit.*, p 44
[99] Article 3 (1) (b) and Recital 17 of the Takeover Directive
[100] B. Sjåfjell. 2009, p 405; Wouters/ Hooghten/Bruyneel, *op. cit.,* p 44

company, the acquiring company has not taken into account the interests of the employees, the future plans for the target company after being taken over are vague or have not been communicated by the acquirer leaving the target board and the shareholders without crucial information. Empirical studies have constantly found that the opinion of the board is the most important variable influencing the outcome of a takeover.[101] Because of that the board's opinion could work as a frustrating action though not falling under the prohibition clause of Article 9 (2). Due to the latter the effectiveness of the board's opinion should not be underestimated.

Nonetheless, Article 9 (5) lacks some crucial elements which make it incapable to function properly in the board neutrality context. For example, there is lack of prerequisite for the directors of the board to be independent when giving an opinion or a requirement for the directors to shift themselves from giving an opinion if a conflict of interests occurs. [102] Lack of such prerequisites indicate that the legislators have only come halfway in the neutrality requirement as the directors could give false impression in their opinion about the actual characteristics of the bid due to their conflict of interests or self-motivation.

2.3.4. Board's role as a balancing power in the company

The board's normative role is to balance the interests and powers of various parties inside the company[103] by foremost taking into consideration and promoting the long-term interests of the company. The latter should consist of the interests of the stakeholders such as employees, shareholders.[104] It also refers to long-term economic interests of the company such as the continuous positive turnover, securing the long-term investments and the revenue derived from it as well as sustainable development of company's strategies. The board's role as a balancing body is effectuated in Article 3 (1) (c) requiring the board to act in the interests of the company as a whole. Even so, the implication could have a dual meaning – would it refer to the interests of the shareholders or all the stakeholders.

In respect of these circumstances the views inside Europe regarding the definition of what should be interpreted as the company's interests diverge formidably. From the Anglo-American legal system point of view company's interests as a whole indicate the shareholders' interests as a whole but the Continental European approach refers to much

[101] B. Clarke. 2009a, p 118
[102] B. Clarke. 2011, p 526
[103] B. Sjåfjell. 2009, pp 46-47
[104] B. Sjåfjell. 2011, p 681

wider concept.[105] There the interests of the company would refer to the interests of all the stakeholders. It has been addressed by various studies whether the mandate of the management and the board should only consider maximising shareholder value or should they protect the firm-specific investments and the long-term value of the company as a whole.[106] The conclusion on this behalf is rather unambiguous. As the legislation in overall promotes the shareholder value maximization[107] then the company's interest in Article 3 (1) (c) in the Directive should be in the light of shareholder primacy and the board neutrality interpreted narrowly referring only to the interests of the shareholders. Because of that the board neutrality rule does not allow the proper balancing of interests of all the stakeholders[108].

Based on the prior, the Directive tends to promote firmly the view of shareholder-model common in United Kingdom, leaving the stakeholder-model prevailing in Continental Europe out of consideration. This approach is hard to be understood to represent the values and interests of all the Member States as it is rather hindering the general company law conceptions of one of the concerned parties.

2.3.5. Takeover defences falling under Article 9

Article 9 is aimed at altering the powers of the board after the bid has been made public to undertake any actions that could frustrate it, as the takeovers have been seen beneficial at least in the short-term perspective and because facilitation of takeovers is one of the underlying objectives of the Directive. It might seem that there is little the board is able to do to fend off a hostile bidder.

First of all, Article 9 (2) allows specifically seeking an alternative bidder or a white knight though the rule allows only the seeking and forbids the board to carry on with any actions once the alternative bidder has been found. Because of this it cannot be agreed that the allowance of seeking alternative bidder is a full defensive measure in terms of a white knight concept that the Directive permits. In addition, defensive measures like poison pills, golden parachutes or other post-bid defences could be adopted only based on the shareholder's decision[109] during the offer period. Article 9 (2) implicates explicitly a prohibition to issue

[105] B. Sjåfjell. 2011, p 647
[106] C. Clerc. *et al*, (eds), *op. cit.,* p 189; The Takeover Bids Directive Assessment Report. *op. cit.*, p 29
[107] B. Sjåfjell. 2009, p 405
[108] C. Clerc. *et al*, (eds), *op. cit.,* p 173; The Takeover Bids Directive Assessment Report. *op. cit.*, p 347
[109] Davis/Schuster/Ghelcke, *op.cit.,* p 6 ; Wouters/ Hooghten/Bruyneel, *op. cit.*, p 43

new shares and especially when the new shares are issued to a friendly third party – white squire defence.[110]

The formerly enumerated ordinary defensive measures might not fall under the board neutrality requirement, even during the offer period, if they are carried out as a normal course of business or satisfies the normal market practice criterion[111]. Nonetheless, there are no specific requirements setting out what could be considered as a normal course of practice and the use of such strategies have to be analysed on a case-by-case basis. Even though, it is rather an exception to classify an ordinary takeover defence under a business strategy.

One of the tools for the board to affect the outcome of the bid is by advising the shareholders as a part of their daily duty and by giving their opinion under the Article 9 (5). The advice by the target company's board is the key factor for the bid to be successful.[112] The board is also left with a possibility to persuade the shareholders to decide in a certain way leaving relatively strong influential tools for the board to affect the outcome of the bid in a desired direction. It has also been pointed out that the board could appeal to the national competition authority and the board could act in a way that would put a veto to the further success of the takeover processes by refusing to show the books and other documents of the company to the potential acquirer.[113]

There are relatively limited possibilities for the board to adopt ordinary defensive measures, such as poison pills, pac-man[114] defence, white squire, golden parachutes[115] and so long, during the offer period, as it is extensively hard to prove them being part of the normal business strategy of the company. The sanction for the infringements from the rule is determined by the Member State (Article 17). Though there are other eligible measures for the target company's board to influence the bid these measures are not equally efficient, leaving the board at least to some extent to the role of a bystander.

[110] B. Sjåfjell. 2011, p 687; White squire is a post-bid defensive measure where similarly to the white knight defence a friendly third party would be willing to purchase but small amount of shares in a target company
[111] Wouters/ Hooghten/Bruyneel, *op. cit.*, p 41; Davis/Schuster/Ghelcke, *op.cit.,* p 7
[112] Davis/Schuster/Ghelcke, *op.cit.,* p 5
[113] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 235-236
[114] Pac-man defences is where the target company launches counterbid to the initial bidder
[115] Golden parachutes are where the removal of the target company's managers is subject to high compensation.

2.4. The controversial implementation of the board neutrality rule

2.4.1. Overall implementation of Article 9

According to the recent Commission's Report 19 Member States have implemented the board neutrality rule into their legal system.[116] From these 19 Member States that applied the board neutrality requirement in most of the cases the similar rule already existed in the national law and only in few countries it was a new rule[117] indicating that adopting the rule did not have strong influence.[118] From these countries applying the board neutrality rule thirteen have applied the reciprocity exception[119] - six of which apply mandatory board neutrality rule and seven have opted out of the rule but made the reciprocity available for companies decided to opt back into the rule voluntarily[120].

Nevertheless, the board neutrality rule has not been applied by numerous Member States representing mainly countries with the strong stakeholder-model – the Netherlands, Belgium, Poland, Germany, Luxemburg, Hungary and Denmark. The latter markets form a significant part in the overall European Union capital market presenting vigorous resistance to the board neutrality rule. Reciprocity rule according to the Article 12 (3) is applied in all of these countries though there has been no case where such a rule has been used in practice.[121]

In overall the implementation has not achieved the desired harmonization.[122] Firstly, the significance of markets opting out of the rule is substantial. Secondly, there is no evidences showing opting into the rule on the reciprocity basis where the Member States has not applied the board neutrality. Thirdly, from the opt in Member States several have introduced reciprocity who also form a significant part of the overall EU market – i.e. France, Spain and Italy. The European Commission has found in its Report that the board neutrality rule has been a relative success[123] alluding to the considerable number of Member States

[116] The Takeover Bids Directive Assessment Report. *op. cit.*, p 42

[117] C. Clerc. *et al*, (eds), *op. cit.,* p 78 was stating that the rule was new in Cyprus, Finland and Greece which are relatively small markets in the EU.

[118] Report on the implementation of the Directive on Takeover Bids, COM 2012 347 final, Brussels 28.6.2012, p 3. - Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf, (15.01.2014)

[119] Reciprocity clause in Article 12 (3) allows the target companies to opt out from Articles 9 and 11 when they are under attack by a bidder not applying these restrictions.

[120] Report on the implementation of the Directive on Takeover Bids, COM 2012 347 final, Brussels 28.6.2012, p 3

[121] C. Clerc. *et al*, (eds), *op. cit.*, p 78;The country to use the reciprocity has to opt in to the rule first on the voluntary basis.

[122] Report on the implementation of the Directive on Takeover Bids, SEC (2007) 268, Brussels 21.02.2007. - Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf, (15.01.2014)

[123] The Takeover Bids Directive Assessment Report. *op. cit.*, p 358

having transposed the board neutrality rule into their national laws on the mandatory basis. The latter argument is not quite accurate as there are number of nuances interfering to make such straight-forward conclusion.

2.4.2. Implementation in United Kingdom

The basis for adopting the board neutrality rule in the Directive on Takeover Bids was the success of the passivity rule in the United Kingdom in preparing a conducive ground for an active takeover market. The basic board neutrality rule in the United Kingdom City Code on Mergers and Acquisitions is effectuated in Rule 21.1 being identical to Article 9 (2) in the Directive which is also the reason why the implementation of the board neutrality rule had no impact on the existing defensive measures regulation in the United Kingdom.[124]

Despite that, the United Kingdom City Code has amended the passivity requirement more tighten by obligating the board to give the shareholders who are empowered to decide on the merits of the bid sufficient information and advice so that they would be properly informed (Rule 23.1). By that it has been clearly stated that the shareholders' decision upon the bid should be done in a properly informed conditions and should not be motivated entirely on their own short-term interests of earning quick profit. Sufficient information consists of the board's obligation to issue their opinion on the bid to the shareholders and to obtain additional independent advice.

In the obligation of the board to issue an opinion on the bid the United Kingdom City Code has set an additional requirement that if the directors of the board as an adviser to the shareholders have a conflict of interest the person concerned should be excluded from stating the opinion (Rule 25.2). Additionally, United Kingdom City Code has imposed a strict requirement for the directors of the board to obtain independent advice from a third party if it is found necessary (Rule 3.1). Regretfully these requirements are not available under the defensive measures regulation of the Directive on Takeover Bids.

In United Kingdom the directors of the board have a fiduciary duty to act in the good faith and in the best interests of the company[125] where the interests of the company refer to the interests of the shareholders not to the interests of all the stakeholders. Though United Kingdom has historically promoted the shareholder primacy theory it could be that the hostile takeover of British company Cadbury by a foreign corporation of Kraft Foods in 2010

[124] Davis/Schuster/Ghelcke, *op.cit.*, p 38 were stating that the BNR score for United Kingdom is the same both in pre- and post-Directive.

[125] D. Kershaw, *op.cit.*, p 282-283 ; Section 172(1) of The Companies Act (c 46), London 8.11.2006. - Available: http://www.legislation.gov.uk/ukpga/2006/46/contents, (15.02.2014)

influenced their views about strict shareholder primacy as the takeover resulted in the amendments of takeover laws in United Kingdom in 2011. Hostile takeover of Cadbury indicated clearly that the shareholders concentrated on the offered price only and there was nothing the board could do to block the unwanted takeover or protect the interests of other stakeholders without breaching their fiduciary duties.[126] The takeover of nationally important company was decided by the shareholders whose purpose of interests were limited to earning short-term profit[127] rather than to contribute to target company's long-term development.

The theory of market for corporate control and the shareholder primacy have been taken as the basis for the Directive on Takeover Bids having its roots in the Anglo-American legal system and in United Kingdom takeover regulation. In theory, aforementioned doctrines work efficiently, at least in countries with companies of dispersed ownership and shareholder primacy doctrine prevailing. In practice the results indicate that hostile takeovers hit companies in United Kingdom at the same rate whether there is good or poor performing by the management.[128] The latter shows that the market for corporate control does not explicitly function in practice as it does in theory. If the underlying theories of defensive measures regulation in the Directive on Takeover Bids do not work efficiently in practice even in the legal environment they were developed it is impossible to argue in favour of them in other markets.

2.4.3. Implementation in the Netherlands

Contrary to the United Kingdom and the shareholder model prevailing there legal regulation in the Netherlands has concentrated on the stakeholder-model. The Dutch Corporate Governance Code[129] II. 1 stipulates that the management board shall be guided in its activities by the interests of the company and takes into consideration the interests of the company's stakeholders. It would mean that the management board and the supervisory board

[126] B. Clarke. Director's Duties in a Changing World – Lessons from the Cadbury Plc Takeover. – European Company Law, 2010/7 No 5, p 205-206; Section 172(1) of The Companies Act (c 46), London 8.11.2006. Available: http://www.legislation.gov.uk/ukpga/2006/46/contents, (15.02.2014)

[127] Lord Mandelson – Mansion House Speech, 1. March 2010. – Available: http://www.politicshome.com/uk/article/6120/lord_mandelson_mansion_house_speech.html, (23.03.2014).

[128] Mayer/Renneboog/ Franks. *op. cit*., in M. Becht. Reciprocity in Takeovers. – European Corporate Governance Institute No 14/2003, p 10. – Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=463003, (15.01.2014)

[129] Dutch Corporate Governance Code. The Netherlands: The Dutch Corporate Governance Code Monitoring Committee 1.01.2009. Available: http://commissiecorporategovernance.nl/download/?id=606, (15.02.2014)

would predicate on a wider perspective taking into account the interests of the shareholders, employees as well as other interested parties such as customers and creditors[130].

Because of this, it is not striking that the Netherlands has opted out of the board neutrality rule based on a possibility provided by Article 12 of the Directive on Takeover Bids. Even so, they have made for the companies who apply unprotected corporate regime according to Article 2:359b (1-3) Book 2 of the Dutch Civil Code available reciprocity clause according to Article 12 of the Takeover Directive and Article 2:359b (4) Book 2 of the Dutch Civil Code. There are no significant differences in the formulation of the board neutrality rule between the Dutch Civil Code and the Directive on Takeover Bids. As the unprotected corporate regime is optional for a corporation, the rule is that the board is not required to be neutral once the takeover bid has been made public. Besides the general principal stipulated in the legislation there is relatively profound case law in this regard setting out the principles for the target board's role in a case of a takeover.

The most essential judgment creating the underlying principles of board's powers to adopt defensive measures in case of a hostile takeover was by the Dutch Supreme Court the Rodamco North America (RNA) case[131] where the court introduced the RNA clause. According to the RNA clause the directors of the target company may take ad hoc defensive measures[132] if these measures are used temporary, they are proportionate to the threat posed to the company and its stakeholders and the aim of the measures adopted is to preserve the status quo of the company.[133] The judgment set out remarkable rules governing the board's authority of Dutch listed companies and the RNA clause is widely used currently as well.

In addition to the Rodamco North America case, there are few other cases that have changed formidably the views on the board's role in hostile takeovers. In the case of ABN AMRO, where the board used the so-called crown jewel defence by selling one of its attractive assets, the Supreme Court found that the board of directors does not need an approval from the general meeting to carry out such a defence.[134] The ABN AMRO case from

[130] P. Dortmund, *et al*. Country status reports on defensive measures against hostile takeovers and the impact of the 13th EC Directive. – European Company Law, 2004/1 No 1, pp 22-25

[131] Dutch Supreme Court, JOR 2003/110, 18.04.2003. – Available: http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2003:AF2161, (20.02.2014)

[132] P. Davis, *et al.* Corporate Boards in European Law: A Comparative Analyis. New York: Oxford Uniersity Press 2013, p 438

[133] Dutch Supreme Court, JOR 2003/110, 18.04.2003. – Available: http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2003:AF2161, (20.02.2014); P. Davis., *et al,* 2013, p 438; McCahery/Vermeulen, *op. cit.,* p 11

[134] Dutch Supreme Court, JOR 2007/178, 13.07.2007. - Available: http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2007:BA7970 and http://www.rechtspraak.nl/Organisatie/Hoge-Raad/Supreme-court/Summaries-of-some-important-rulings-of-

2007 has given cause to a discussion that there has been a revolution in the Dutch company law[135] and that the Dutch corporate law is moving towards the management friendly Delaware law[136]. Similar rulings as in ABN AMRO case were done in ASMI International N.V. case in 2010[137] and in Stork case 2007[138]. Based on the described cases it can be said that there has been developed a strong case law setting the borders within what the target company's board may act[139] when faced with a hostile takeover. Dutch listed companies are subject to strong protective measures available for the board undertake without the authorization from the general meeting[140]. Therefore it is not easy to succeed in launching a hostile bid for a Dutch company.

In the latter perspective one special defensive measure widely used by Dutch companies is the issuance of protective preference shares to a friendly special-purpose foundation when there is a takeover threat.[141] If such a protective measure is put in place, it would dilute the bidder's voting power and make it more expensive to acquire control over the target company.[142]The power to issue such preference shares to a friendly foundation is usually vested in the management board.

Dutch companies can be argued to be well protected against hostile takeovers as they have developed significantly effective measures to fend off hostile bidders and such power is delegated largely to the board of the target company.[143] The Netherlands therefore has taken absolutely opposite approach regarding the board neutrality than the United Kingdom representing the Continental European standpoint of stakeholder protectionism rather than shareholder primacy. In addition, the agency conflict between the managers and shareholders is not seen as severe as in the United Kingdom and in the Directive on Takeover Bids, whereas the managerial usage of defensive measures during the bid is greatly promoted. For a

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the-Supreme-Court/Pages/Summary-of-the-Courts-ruling-of-13-July-2007-in-ABN-AMRO-cases.aspx, (20.02.2014)

[135] C. de Groot, A. van Nood, F. Lambert. The ABN AMRO ruling: Some Commentaries. – European Company Law, 2007/4 No 4

[136] D. Quinn. Dutch Treat: Netherlands Judiciary Only Goes Halfway Towards Adopting Delaware Trilogy in Takeover Context. - Vanderbilt Journal of Transnational Law, 2012/41 No 4, p 1211

[137] Dutch Supreme Court, JOR 2010/228, 9.07.2010. – Available: http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2010:BM0976, (20.02.2014)

[138] Dutch Supreme Court, JOR 2007/42, 17.01.2007. - Available: http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2010:BM0976, (20.02.2014)

[139] W.J.L. Calkoen, *op. cit.,* p 329

[140] A.M. Pacces. Rethinking Corporate Governance: The Law and Economics of Control Powers. New York: Routledge 2012, p 47

[141] Public takeover bids in the Benelux. Loyens&Loeff N.V. 2011. – Available: http://www.loyensloeff.com/nl-NL/News/Publications/Books/Documents/Public%20takeover%20bids%20in%20the%20Benelux_X.pdf, p 84, (22.03.2014)

[142] A.M. Pacces, *op. cit.,* p 200

[143] J. Bekkum. *et al*. Corporate Governance in Netherlands. – Electronic Journal of Comparative Law, 2010/14, p 23. – Available: http://www.ejcl.org/143/art143-17.pdf (17.01.2014)

conclusion, the implementation of the Directive had no significant impact on the existing defensive measures regulation in the Netherlands.[144]

2.4.4. Implementation in Estonia

Estonia has implemented the board neutrality rule but has not made it subject to the reciprocity therefore Estonian legislators have demanded strict neutrality from the management body (supervisory and management board together) in case the takeover bid has been made public (Securities Market Act § 171 (1)). The rule also extends to period before the takeover bid has been formally launched (SMA § 171 (4)). Nevertheless, the implementation of the Directive has not had any significant effect on Estonian board neutrality regulation.[145]

The board neutrality clause, stipulated in § 171 (3) of the SMA, allows the target company's shareholders to give an authorization to the board to carry out actions in the capacity of protective measures which are prohibited to be applied for a longer period than necessary. As the authorization by the general meeting of the shareholders requires at least two-thirds of the votes represented at the general meeting to be in favour (SMA § 171 (5)) it could be rather troublesome for the management body to persuade such a large scale of shareholders to grant the authorization for protective measures. Because of the latter, a takeover of an Estonian company could turn out to be relatively simple especially as Estonia has not implemented reciprocity clause to the board neutrality and the companies cannot opt out when they are subject to a takeover bid by a company not applying such rule itself.

Hitherto there are no official cases in Estonia stating a hostile takeover bid being launched – the reasons for this lie partly in the small financial market of Estonia and the small number of companies listed on the NASDAQ OMX Tallinn.[146] Another reason for the lack of hostile takeovers is that as Estonian companies are relatively concentrated and under the control of blockholders the acquisitions are generally carried out through friendly negotiations. Because of the controlling blockholder the monitoring costs of the managers are marginal in comparison with dispersed ownership companies and the opportunistic behaviour of the management body is not creating severe agency problems in companies.

[144] Davis/Schuster/Ghelcke, *op.cit.,* p 38 is stating that the BNR score of Dutch defensive measures regulation is the same pre- and post-bid.
[145] Davis/Schuster/Ghelcke, *op.cit.*, p 38 is stating that the BNR score is the same pre- and post-bid.
[146] There is currently only 13 companies listed on the NASDAQ OMX Tallinn stock exchange with few more companies on a Secondary List of NASDAQ OMX Tallinn.

2.5. The conformity between the initial objectives and the actual impacts of the board neutrality rule

2.5.1. Actual impacts of the board neutrality rule

For the analysis whether the initial objectives set to the board neutrality rule have fulfilled their objectives through the regulation and its implementation and thereof are in conformity with the actual impacts the rule has created the latter impacts have to be detected. The assumptions over the actual impacts and effects the board neutrality rule has had or would have vary. These allegations generally concentrate on few effects though the conclusions over the impacts should be done in an aggregated whole.

Outcomes on the regulation regarding defensive measures against hostile takeovers:

- Board neutrality rule has been made available as a rule for all the Member States and companies within these states.

Firstly, the board neutrality rule as part of the Directive has to be implemented into the laws of the Member States and is mandatory to be followed for the companies. Corporate governance codes, which generally regulated the takeover bids process among other corporate law issues, had been normally adopted as standards or recommendations.[147] The latter is denoting that they are not required to be followed on a mandatory basis but should be taken rather as a good business practice. Adoption of the Directive on Takeover Bids changed previously recommendable restrictions into mandatory rules.

Secondly, though the board neutrality rule is not entirely mandatory in the Directive but is subject to the optionality and reciprocity exceptions then even if the Member State has decided to opt out from the board neutrality rule the companies within that Member State have left with an opportunity to opt back into the rule on the voluntary basis if found necessary. As a result, the board neutrality rule is more widely available both for the Member States and for the companies and with that the companies are more open to takeovers than before the adoption of the Directive.[148]

- Board neutrality rule has not had as significant impact as expected.

Firstly, the implementation of the board neutrality rule has been moderate according to Figure 3 in the Annex. Though the European Commission has implied that the

[147] Lysandrou/Pra. *op. cit.*, p 211
[148] Davis/Schuster/Ghelcke. *op. cit.,* p 33

implementation of the board neutrality rule has been a relative success[149] such conclusion made is inconsiderate. In a more profound observation the results indicate that firstly, the regulation has not had significant impact as most of the opt in countries already had similar rule in their takeover regulation[150] and there are a significant number of countries that made reciprocity available. Secondly, the rule has been opted out by a particular community of Member States that support the stakeholder-model and form a considerably vast part of the overall financial market in Europe. Thirdly, though the countries opting out have also made available reciprocity there are little evidence of the usage of it.

In further, the board neutrality rule has not made takeover regulations more bidder-friendly as was expected. According to the statistics represented on Figure 4 in the Annex show that the board neutrality rule has been stayed relatively the same after the adoption of the Directive in companies forming 61% of the capital market, in companies forming 37% of the capital market the board neutrality rule has developed towards less bidder-friendly and only in companies forming 2% of the capital market the board neutrality has changed more bidder-friendly. The latter represents the accurate implementation influence as the comparison on a number of Member States level would show more positive results.

- <u>Adopted board neutrality rule has loopholes in its regulation.</u>

The most important loopholes could be pointed out when taking under the consideration Article 9 (5) which stipulates the requirement to draw up an opinion. The United Kingdom City Code, based on which the Directive adopted the board neutrality rule, has taken an approach that the directors of the board giving the opinion or advising the shareholders over the merits of the takeover bid should stand down in case they have self-interests in transaction but the Directive does not impose the directors to be independent or stand down in case of conflicting interests.[151] The regulation does not require the board to give the shareholders sufficient information which could implicate to involving additional independent advice but requires only drawing up an opinion of their own. In addition, the definition of the subject to the board neutrality rule is legally ambiguous and the role of the board is unclear in various Member States. Moreover, the board neutrality rule is argued to be incomplete as it applies to actions that are likely to frustrate the bid but leaves out measures creating pro-bid biases such

[149] The Takeover Bids Directive Assessment Report. *op. cit.*, p 358
[150] C. Clerc. *et al*, (eds), *op. cit.,* p 78
[151] B. Clarke. 2009a, p 189; B. Clarke. 2011, p 526

as stock options[152] where the board itself is favouring a potentially destructive takeover transaction.

Outcomes on the board of the target company:

- Neutralizing board's ability to act – strong negative impact on the negotiation position of the board[153] and turning the board powerless to act if the takeover is not beneficial.

Firstly, the board neutrality rule neutralizes the board's ability to act as an equal negotiator in takeovers. A strong negotiation position of the target company could have positive impact on the price offered by the bidder and would give the board of the target company a chance for better communication to ascertain the actual intentions of the bidder. That in turn would have a beneficial effect on the information completenesswhich is communicated to the shareholders of the target company. Though in case of a hostile bid, where the offer is done directly to the shareholders of the target company by which the negotiation position of the board is tried to be circumvented by the potential acquirer already, the target company's board with the board neutrality rule is left with no negotiation position at all.

Secondly, the board is neutralized to act in a protective manner if the takeover is believed not to be beneficial. In general the aim of the takeover would be receiving gains from the restructuring and the post-bid synergies the transaction is believed to possess. Nonetheless, in certain takeover situations the intentions of the bidder may not be so clear-cut and the fear of unknown evolutions in the future may demand for interference from the board. The situation is referred to also as a toothless defence since there are no effective mechanisms for the board to resist a hostile bid.[154] In Some Member States, such as the Netherlands, the function of the board is believed to be the protection of company's long-term values and balancing the interests of all the stakeholders. If the board neutrality rule would be mandatory, it would have severe destructive effects on the Member States like the Netherlands espousing similar position.

- Regulation of the board's role in different Member States is controversial.

The summary comparison of the implementation of the Directive in United Kingdom, the Netherlands and Estonia indicated that the role of the board during the takeover has been viewed in different Member States differently even though the aim of the Directive was

[152] The Takeover Bids Directive Assessment Report, *op. cit.*, p 355

[153] Such impact has been pointed out by a number of authors. Qv: B. Sjåfjell. 2009, p 412; S. Bhagat, R. Romano. Empirical Study of Corporate Law in A.M. Polinsky, S. Shavell. (eds). Handbook of Law and Economics. Amsterdam: Elsevier 2007, p 75

[154] C. Clerc. *et al*, (eds), *op. cit.*, p 89

firmly the neutralization of the board. While the regulation in United Kingdom and Estonia required strict board passivity the situation in the Netherlands is opposite and the case law has granted comprehensive authorization for the boards of the target companies to adopt defensive measures in a case of hostile takeovers. The Netherlands together with other stakeholder-model supportive Member States have opted out of the board neutrality rule and granted the board of the target company extensive balancing power inside the company.

Outcomes on the companies part of the takeover transaction:

- Takeovers including hostile takeovers are not beneficial to all companies.

According to a study target companies in United Kingdom secure significantly higher returns from takeovers than their counterparts in Continental Europe[155] indicating that takeovers are more beneficial in the formerly mentioned Member State. Moreover hostile takeovers are resisted by the target company, namely the interested parties inside of the company such as the shareholders, the management and other stakeholders. It could be also resisted by the government and the social community as a whole. The reasons for the resistance vary enormously and are unpredictable but because of the resistance a hostile takeover of a company has always negative impacts on an entity resisting the bid. As the terms of a takeover are not based on a mutual understanding or on a negotiated contract[156] the transaction would have unpredictable effects on the target company or on the economy of the Member State where the company is incorporated. Hostile takeovers have been seen beneficial in United Kingdom[157] for serving the underlying theories of solving the agency problem between the shareholders and the managers through the market for corporate control. In Continental Europe hostile takeovers have been treated with extreme caution as the Member States are afraid their companies to be vulnerable to hostile bidders especially regarding foreign bidders.

- Directive has made companies more vulnerable.

Vulnerability results from the board neutrality rule since the board is disabled to actively engage in activities that could frustrate the bid and as the authorization from the general meeting generally is time-consuming, there might not be efficient tools for fending off a hostile bidder if needed. The need to fend of hostile bid could result from various reasons besides the theory of managerial self-interest – protecting company because of its importance

[155] Martynova/Renneboog. 2011a, p 248
[156] B. Sjåfjell. 2009, p 117
[157] Martynova/Renneboog. 2011a, p 248

on national economy, protecting stakeholders' interests jointly with these of the shareholders, protecting the long-term interests of the company itself. The takeover cases from United Kingdom and the Netherlands indicated directly that hostile takeovers are unwelcomed in the some Member States. This is why the facilitation of them could have destructive impacts on national economies. Though, the reciprocity clause available for the target companies to opt out the board neutrality if the bidder is not subject to this requirement applicability of the option is also for the shareholders to decide and because of this troublesome to apply.

- Hostile takeovers have long-term negative impacts on the target companies.[158]

Based on the underlying presumption of takeover benignancy it is assumed that takeovers including hostile takeovers are beneficial both for the acquiring and target companies. The latter approach has been strongly argued as though takeovers have positive returns in short-term perspective the studies concentrating on long-term economic impact on companies show severe negative indication – concentrating on a six months period after the completion of the takeover both cross-border and domestic bids show negative returns.[159] Hostile takeovers, where the offer is done directly to the shareholders without consultations with the managing bodies, the incentives of the bidder could be unclear. The effect of the board neutrality rule is that it drives towards the shareholder's blind-voting and promotes the decision-making on the short-term benefits for the shareholders. [160] If the decision-making power is solely left to the shareholders it could have lasting negative results on the target company and its stakeholders.

- Implementation of the board neutrality rule does not support the competitiveness of companies

Takeover benignancy presumption is undermined also when analysing the competitiveness of companies in Member States implementing the Directive. Figure 5 in the Annex, indicating the competitiveness of companies in connection with their implementation of the Directive, shows that companies in the Netherlands, Belgium and Germany which have a low score of implementation are among of the Member States with highest competitiveness index. The same result for Estonia with one of the highest implementation scores holds at the same time one of the lowest competitiveness indexes.

[158] Martynova/Renneboog. 2011a, p 248
[159] Martynova/Renneboog. 2011a, p 227
[160] B. Sjåfjell. 2011, p 673

2.5.2. Reasoning behind the outcome results

The reasoning for the failure of the board neutrality rule lie in the controversial underlying theories and the initial objectives set to the board neutrality rule based on the former. The board neutrality rule was adopted in the Directive based on the passivity rule in use in the United Kingdom takeover law and by that the previously mentioned theories and objectives were transposed jointly with the rule.

The problem of the board neutrality rule lie in the fact that these theories and objectives are determined to operate effectively in Anglo-American shareholder-model and dispersed corporate governance system but not in Continental European stakeholder-model and concentrated corporate system. Figure 2 in the Annex indicates the differences between Anglo-American (United Kingdom) and Continental European approaches most accurately. Anglo-American shareholder-model promotes shareholder primacy and shareholder value maximization while in Continental Europe the drive towards shareholder primacy would have negative effect as they promote the consideration of interests of all the stakeholders.[161] In Anglo-American dispersed ownership companies the monitoring costs of the management would be excessive because of the agency conflict between the managers and the shareholders. In turn in Continental European concentrated companies the agency conflict between the managers and the shareholders is marginal or non-existent[162] and the agency conflict is rather arising between controlling and non-controlling shareholders[163]. As a result from the previous the role of the board in Continental European stakeholder-model companies should be balancing different interests inside the company and because of that takeover defences are allowed to a certain extent. In comparison in United Kingdom the board is not allowed to adopt defensive measures without the prior authorization from the shareholders and the decision-making power is entirely vested to the shareholders.

When it comes to the underlying theory of market for corporate control then the theory is not intended to work in Continental Europe and the fact is that there are vague indications in overall for the theory to work in practice. European Commission has stated in its Report in 2007 that the board neutrality rule holds back the European market for corporate control rather than facilitates it.[164] Moreover, competing bids, allowed under Article 9 (2), tend to undervalue the company[165] which concludes in failure of market for corporate control.

[161] B. Sjåfjell. 2011, p 647 and p 679
[162] Davis/Schuster/Ghelcke, *op.cit.,*p 13
[163] Martynova/Renneboog. 2011a**,** p 216-217
[164] Report on the implementation of the Directive on Takeover Bids, SEC (2007) 268, Brussels 21.02.2007
[165] Comez/Saez. *op. cit*., p 274

Evidence for a clash between the Anglo-American rooted board neutrality rule and Continental European balancing role of the board can also be taken from the implementation results in the Member States. The board neutrality rule has been opted out by the Continental European Member States with strong stakeholder-model such as the Netherlands, Belgium and Germany. By adopting the board neutrality rule in the Directive the European legislators have been diverted from considering Continental European approach. Instead they have led to a blindfolded presumption that the underlying theories and objectives rooted in the Anglo-American approach are the right solutions for achieving the similar liquid capital market in Continental Europe as it is in United Kingdom.

Because of the severe underlying differences in the conceptions the board neutrality rule in its current form seems to be impracticable. For the board neutrality rule to work properly in different Member States would presuppose more thorough harmonization of the corporate law in overall.

2.5.3. The conformity between the initial objectives and the actual impacts

If the board neutrality rule is implemented to the national laws of a Member State the objectives could be achieved to some extent. Based on the current analyse the board neutrality rule has had moderate success in fulfilling its objectives.

The objective to establish unified regulation of the board's role in case of post-bid defensive measures was achieved to the extent that the board neutrality rule was made available as a rule in the Directive mandatory to be implemented to the national laws. Also the board neutrality rule is available to all the Member States and companies. Even so, the board neutrality rule and by this the role of the board does not possess clear legal certainty as there are loopholes in the regulation and the impact of the board neutrality rule has not been as significant as expected. Moreover, the board neutrality rule has strong negative impact on the negotiation position of the board and the board is made powerless to protect the company where the takeover is hostile. It could also have severe negative impacts on company's long-term values. Additionally, the role of the board differs between Member States representing the stakeholder-model and Member States representing the shareholder-model. As the Directive has taken the latter as the basis for the defensive measures regulation it could have severe negative impacts on companies from stakeholder oriented Member States.

The objective of facilitating takeovers and the market for corporate control could be achieved to some extent in Member States where the board neutrality rule has been implemented on the mandatory basis. Nevertheless, the facilitation of takeovers could have

several other outcomes not firmly positive. It has been pointed out in the outcome analysis that takeovers including hostile takeovers are not beneficial to all companies. Moreover, hostile takeovers have long-term negative impacts on target companies. By facilitating takeovers the Directive has made companies more vulnerable to hostile takeovers and less competitive.

The objective of solving the agency problem between the managers and shareholders could be achieved in companies with dispersed ownership where the agency conflict between the former is existing. In companies of concentrated ownership agency problem between the managers and the shareholders is not relevant.

As a conclusion there is some conformity between the initial objectives set to the board neutrality rule and the actual impacts the board neutrality rule has or would have if implemented. Nevertheless, the board neutrality rule has numerous destructive side-effects especially on companies representing the Continental European stakeholder-model.

3. Breakthrough rule – Article 11

3.1. Formulation of the breakthrough rule

The basic breakthrough rule has been stipulated in Article 11 (2) – (4) in the Directive on Takeover Bids.

Article 11 (2) is intends to break through restrictions imposed on the transfer of securities provided in the articles of association. It also applies to restrictions on the transfer of securities provided in other contractual agreements – those between the target company and its shareholders and between the shareholders themselves.

Article 11 (3) intends to break through restrictions imposed on the voting rights provided in the articles of association. The rule also applies in contractual agreements between the target company and its shareholders and between the shareholders themselves. The article also applies the one share-one vote principle by requiring multiple-vote securities to carry one vote each at the general meeting deciding over the adoption of post-bid defensive measures.

Article 11 (4) stipulates that if the bidder has attained 75% of securities carrying voting rights, the restrictions set out in Articles 11 (2) and (3) apply. The article also requires one share-one vote principle at the first general meeting deciding over the amendment of the articles of association or removing or appointing directors to the board.

The breakthrough rule prevents the usage of pre-bid defensive measures set in target companies. Such a requirement was stipulated based on various objectives the rule was aimed at fulfilling.

3.2. Initial objectives of the breakthrough rule

3.2.1. Facilitation of takeovers and the market for corporate control

Though the doctrine of market for corporate control is most relevant in case of the board neutrality rule analysis it should not be left unnoticed in the breakthrough rule. The breakthrough rule is designed to eliminate corporate governance arrangements[166] with an objective to facilitate takeovers. The role of a potential acquirer is to seek and purchase underperforming companies with an aim to replace the inefficient board and the managers[167] - with that creating the necessary prerequisites to the market for corporate control[168].

[166] B. Clarke. Takeover Regulation – through the Regulatory Looking Glass. – German Law Journal, 2007/8, No 4, p 396. – Available: http://www.germanlawjournal.com (22.01.2014)
[167] B. Sjåfjell. 2009, p 410
[168] B. Sjåfjell. 2009, p 301

The market for corporate control is most clearly stipulated in Article 11 (4) prohibiting the usage of any extraordinary rights of shareholders concerning the appointment or removal of the board members if the bidder has acquired certain threshold of shares (75 %) in the target company. By that the breakthrough rule aims to regulate the ability of the shareholders to appointment or remove the directors and managers of the target company.[169] Though supporting the market for corporate control does not pertain to the main objectives of the breakthrough rule, the facilitation of takeovers and the promotion of such course shall in itself invest into more efficient market for corporate control.

3.2.2. Supplementing the restrictions set by the board neutrality rule

The board neutrality rule was aimed at affecting the post-bid defensive measures which could be undertaken by the board of the target company to fend off an uninvited bid presumed to be launched in a hostile manner. Pre-bid defensive measures were initially left intact though such division would not support the board neutrality rule to have any particular effect. As it was assumed that the adoption of the post-bid defensive measures is limited the companies would adapt pre-bid measures[170] then the regulation of pre-bid defensive measures would be most relevant in the context where the board neutrality has been required.[171] Based on the prior the breakthrough rule was established to uphold the board neutrality rule in its effectiveness and support the functioning of the rule in the intended manner[172].

Further, the supplementing function of the breakthrough rule is best constituted in Article 11 (3) providing to break through the pre-bid defences of restrictions on voting rights in the general meeting where the usage of post-bid defensive measures are decided upon. In concurrence of the board neutrality and breakthrough rule the adoption of post-bid defensive measures depends on the equalized decision-making right of all the shareholders. Though Article 3 (1) (a) in the Directive regulates the shareholder's treatment issue it only requires to treat the shareholders of the same class equally. Article 11 has taken the equalization principle further by requiring that the restrictions on voting rights or other control enhancing mechanisms shall not apply when deciding over the post-bid defensive measures adoption.

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[169] C. Clerc. *et al*, (eds), *op. cit.,* p 90

[170] G. Ferrarini, G.P. Miller. A simple theory of takeover regulation in the United States and Europe. – Cornell International Law Journal, 2009/42 No 3, p 327

[171] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 246

[172] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 260

3.2.3. Solving agent – principal conflict

Board neutrality rule was purposed to settle the agency problem between the managers and the shareholders of the target company and the breakthrough rule adds another layer to it. Facilitating takeovers, applying the one share-one vote principle and breaking through control enhancing mechanisms when deciding over the application of post-bid defences (Article 11 (3)) or over the removal and appointment of the board members (Article 11 (4)) could benefit to the reduction of agency costs.[173] This in turn would support solving the agency problem between the managers and the shareholders of the target company.

Breakthrough rule is primarily targeted at solving another agency problem vital for companies with concentrated ownership structure. In the essence of the breakthrough rule are controlling shareholders in a company with concentrated ownership holding a position which enables them to entrench their position and to fend off unwanted bidders[174]. They are believed to act opportunistically in the interests of their own rather than in the interests of all the shareholders. By that the non-controlling shareholders are incapable to express their opinion on potential bids and the controlling shareholders may use their position to decline a bid which they do not find profitable or longed-for themselves. To equalize the positions of non-controlling and controlling shareholders the one share-one vote principle is introduced[175] according to which controlling shareholders cannot use their disproportionate control in the ratio to the actual shares they own in the company.

3.2.4. Enabling easier entry for potential acquirers

As the aim of the bidder is acquiring control in the target company it could be confronted by pre-bid defensive measures that make the attempt nearly impossible to achieve. As the European legislators have seen in takeover facilitation a positive economic and value enhancing phenomenon, at least for target shareholders[176], it has been found that the process of acquiring should be made easier for the potential acquirers where pre-bid defensive measures are laid down. The breakthrough rule facilitates takeovers of companies where such impregnable measures existed and grants entry for a bidder wishing to acquire control where

[173] C. Rose. *op cit*, p 128
[174] M. Ventoruzzo. *op cit,* p 183
[175] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 257
[176] J.A. McCahery, *et al., op. cit.,* p 65

existing control structures of the target company did not.[177] Easier entry for potential acquirers would make companies more attractive as the frustrating measures fending off a potential bid are eliminated and would increase the takeover market and takeover's potentiality. The rule is aimed at targeting most vigorously companies with dominant blockholders by diluting their power into dispersed ownership where the acquisition of control does not depend on the persuasion of the dominant blockholder.[178]

3.2.5. Eliminating control enhancing mechanisms

Attaining control in the target company is the key element in takeover transaction. For the easier acquirement of control existing control enhancing mechanisms, creating inequality between the ownership and the actual control the shareholders preserve in the company, should be eliminated.[179] Controlling blocks of shareholders and control enhancing mechanisms constitute clear structural barriers to takeover in case the controllers are unwilling to support a shift of control in the company.[180] Due to this they work efficiently as tools for blocking takeovers. Control enhancing mechanisms possess great importance as they exist both in concentrated as well as in dispersed companies and by that could transform even dispersedly owned company into a company with concentrated control structures. The objective to eliminate control enhancing mechanisms is driven by the ambition to facilitate takeovers, dispersed ownership and equality between ownership and control.

The control enhancing mechanisms indicate to the freedom of contract principle[181] – per contra to one share-one vote doctrine strongly promoted by the Takeover Bids Directive – where the control is arranged based on the mutual agreement between the shareholders. The argument against control enhancing mechanisms is strongly supported by a recent study stating that these mechanisms are widely spread among European companies – in Scandinavia, in Continental Europe but even in dispersed ownership companies in the United Kingdom.[182] Figure 8 in the Annex represents the review of the significance of control enhancing mechanisms in European Member States. It indicates that the most common mechanisms available are pyramid schemes, cross-shareholdings, non-voting preference

[177] B. Sjåfjell. 2009, p 303 and 390
[178] B. Clarke. 2007, *op.cit.,* p 39
[179] J. Winter, *et al., op.cit.*
[180] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 238
[181] Shearman & Sterling LLP. Proportionality between ownership and control in EU listed companies: Comparative Legal Study. 2007 External study commissioned by the European Commission. – Available: http://www.ecgi.org/osov/documents/study_report_en.pdf, (12.01.2014), p 6
[182] C. Rose. *op cit*, p 128;

shares and shareholder agreements. At the same time Figure 10 indicates that despite the availability their actual applicability by the companies is slightly lesser.

Irrespective of the accurate percentage of companies applying the mechanisms, in conclusion the situation presents a clear progress towards widespread usage of control enhancing mechanisms. According to Figure 9 these mechanisms are common not only in countries well-known for their concentrated ownership but also in dispersed ownership Member States such as the United Kingdom. For example from analysed thirteen control enhancing mechanisms ten are available in both in United Kingdom and the Netherlands at the same time there are less than eight mechanisms in Estonia, Germany and number of other countries.

3.2.6. Converging ownership structures into dispersed ownerships

European Commission has strongly supported the position that blockholdings and concentrated ownerships are inferior to dispersed structure[183] and the latter has been argued to possess positive impact for easier acquirement of control in a takeover transaction.[184] Because of the prior and by taking into account the main objective of the Commission to facilitate takeovers it is clear that the ownership structures among European companies should be converged into dispersed structures – high concentration of capital constitutes a clear structural barrier to takeovers[185] and the control is not available for a purchase if the controller does not agree to the takeover[186]. Blockholders could decline to accept the bid by a reference to their own opportunistic interests[187] with that making it almost impossible to achieve successful outcome for the takeovers.

Ownership concentration is especially relevant in Continental European companies as pursuant to a recent study the median of largest blockholding in United Kingdom companies is 11.09 % whereas the relevant percentage in Continental Europe amounts as high as 47.23 %.[188] To facilitate the market of takeovers, make blockholder control contestable[189] and

[183] B. Sjåfjell. 2009, p 322.
[184] B. Clarke, 2009b, p 16
[185] Comez/Saez, *op. cit.*, p 271
[186] C. Gerner-Beuerle, D. Kershaw, M. Solinas. Is the Board Neutrality Rule Trivial? Amnesia About Corporate Law in European Takeover Regulation. – European Business Law Review, 2011/22 No 5, p 564
[187] M. Ventoruzzo, *op cit,* p 210
[188] M. Köhler. *op. cit.,* p 5
[189] B. Clarke. 2011, p 523

support financial liquidity in Europe ownership in companies of Continental Europe have to be converged into dispersed[190].

Though dispersed ownership possesses a variety of greatly negative effects and consequences the European legislators have not considered them to have any relevant impact. In turn rather narrow focus has been set on promotion of dispersed ownership and with that also on easier acquirement of companies and facilitation the market of takeovers as a whole.

3.2.7. Proportionality between risk-bearing and control

The underlying objective of the breakthrough rule was a proportionate allocation between the cash flow rights and control the shareholder holds in the company.[191] In other words share capital having an unlimited right to participate in the profits of the company should be in proportion to the risk this capital is carrying.[192] Proportionality means that if a person bears a risk of 1% then he has to own 1% of votes as well.[193] In the context of the breakthrough rule the proportionality is therefore important between the shares and the actual control the shareholder holds in the company.

The disproportionality is usually established by certain control enhancing mechanisms[194] which create an effective tool for blocking takeovers and due to that are in the essence of the breakthrough rule's objectives. The breakthrough rule is aimed at balancing the freedom of contract to agree upon certain control restrictions and rights on the one hand and on the other hand to take into account the proportionality principle[195]. Because of the latter some control enhancing mechanisms are caught under the breakthrough rule while the others are not. In addition to restricting the rights of transfer of securities or voting rights the principle of one share – one vote has been introduced to specifically alter the disproportional ownership-control structure in the company into proportionate and dispersed.

Balancing the control and ownership has been seen positive. Nevertheless, the breakthrough rule removes the shareholder's right to veto bids they disfavour[196] although it is at the same time among the objectives of the board neutrality rule. It seems to establish a clash of principles where the board neutrality rule promotes the shareholder primacy in

[190] McCahery/Vermeulen, *op. cit*, p 10
[191] Shearman & Sterling LLP, *op. cit.*, p 4; G. Tsagas. EU Takeover Regulation: one size can't fit all. – International Journal of Private Law, 2011/4 No 1, p 175.
[192] J. Winter, *et al., op.cit*
[193] Wouters/ Hooghten/Bruyneel, *op. cit*, p 7
[194] Shearman & Sterling LLP study, *op. cit.*, p 4
[195] C. Clerc. *et al*, (eds), *op. cit.*, p 142
[196] B. Sjåfjell. 2009, p 389

decision-making over the merits of the bid and at the same time restricting their control enhancing voting rights to decide in the breakthrough rule.

3.3. Regulatory interpretations of the breakthrough rule

3.3.1. Breaking through the restrictions on transfer of securities and voting rights

Breakthrough rule should supplement the limitations placed on the post-bid defensive measures regulation in Article 9 of the Directive by adding another layer constituting restrictions also to pre-bid defensive measures[197]. Pre-bid defensive measures are ordinarily referred to different control enhancing mechanisms or other restrictions on the transfer of securities, on voting rights or on rights regarding the removal and appointment of board members in the target company. Article 11 governs all of the prior cases making it relatively complex provision.

Article 11 (2) regulates the restrictions set to the transfer of securities which could be provided in the articles of association or in contractual agreements between the shareholders or between the shareholders and the target company. Abolishing such restriction for the duration of the offer period shall have positive effects for the acquirer by making a purchase of shares in the target company easier than when the restrictions would be present. Nonetheless, it would alter the ordinary rights of the shareholders agreed upon without analysing the actual consequences more profoundly.

Article 11 (3) supplements the board neutrality rule in Article 9 by adding to the restriction of the board to take any frustrating actions and to the shareholders' decision-making power a requirement that disproportionate restrictions are not applied in the general meeting of the shareholders where post-bid defensive measures are decided upon. The provision is aimed at granting all the shareholders of the target company an equal possibility to exercise their decision-making power upon the merits of the bid. That in turn should contribute to solving the agency problem between the controlling and non-controlling shareholders. The latter is especially vital when taking into account the one share-one vote principle added to the Article 11 (3) second section.

The most important provision in the breakthrough rule is stipulated in Article 11 (4) stating that after the acquirer has purchased a certain threshold (75%) in the target company restrictions referred to in paragraphs (2) or (3) do not apply. With that the acquirer should be

[197] D. DePamphilis. *op. cit.*, p 73

able to break through existing control structures of the target company.[198] The most important requirement thus which supplements once again the board neutrality rule in Article 11 (4) provides that the shareholders cannot use any extraordinary rights concerning the appointment or removal of the board members. As a consequence a new owner, possessing 75% or more of the voting shares, is in a position to hold an absolute control in the target company and is able to decide over the composition of the board or the management.[199]

The regulation in Article 11 (4) concerning the replacement of the board and the managers strengthens the market for corporate control aimed at achieving by the board neutrality rule. It should also contribute to solving the agency problem between the managers and shareholders of the target company.

3.3.2. Problematic interpretation of the equitable compensation

Equitable compensation has been stipulated in the Directive Article 11 (5) to recoup any loss the shareholders of the target company have been suffered due to the restrictions set in Article 11 (2)-(4). The compensation clause derives from the underlying objective of shareholder primacy in the Directive according to which the shareholders are entitled to a superior right to exercise their decision-making power in all issues arising in the company. In specific cases the breakthrough rule nullifies or limits the superior right of the shareholders and because of this the equitable compensation has been introduced. Though the equitable compensation principle seems to settle the loss of rights of the shareholders a dispute emerges in determining the amount of the compensation and the subject liable for the payment.

The amount has been interpreted to represent fair compensation for the loss of voting rights.[200] In some countries (such as Austria) it has been stipulated that the compensation paid to the shareholders has to be equitable and reasonable, in other states (such as Hungary) the minimum compensation has to be determined in the articles of association of the offeree company and the equitable price could also be determined by the certain supervisory authority (in Germany and the Netherlands).[201] Even if above mentioned calculation is believed to function it is incomprehensible based on which grounds such evaluation could be done so it could be determined to be fair for shareholders who have lost their supreme right. In addition, the proportionality principle should also be taken into consideration when restricting the

[198] M. Bennedsen, K.M. Nielsen. The Impact of a Break-Through Rule on European Firms. – European Journal of Law and Economics, 2004/17 No 3, p 260
[199] Bennedsen/Nielsen, *op. cit.,* p 260; B. Sjåfjell. 2009, p 303
[200] Wouters/ Hooghten/Bruyneel, *op. cit*, p 58
[201] C. Clerc. *et al*, (eds), *op. cit.*, p 81

rights of the shareholders. The restrictions on shareholder's rights should be proportionate to the advantages gained.

Moreover, based on the regulation it is unclear who is obliged to pay the equitable compensation to the shareholders – the acquirer, the target company or any other third party. In the former case the requirement to pay the compensation by the acquirer could function as barrier to takeovers because the transaction is made more money-consuming to the acquirer. Recouping requirement from the target company does not possess any reasonable grounds. The interpretation of the person liable for compensating could be defined unambiguously unclear and there appears not to be any legal certainty in this behalf.

3.3.3. Takeover defences falling under Article 11

The main incentive for the breakthrough rule was neutralizing control enhancing mechanisms in the target company for a certain period of time and promoting dispersed ownership structure. Though Article 11 (2) – (4) define a great variety of circumstances where breakthrough rule applies not all the control enhancing mechanisms and other arrangements which could function as defensive measures are caught by the breakthrough rule.

Breakthrough rule affects only these control structures which possess multiple classes of shares where the number of votes attached to these shares varies.[202] The most influential impact the breakthrough rule shall have is on certain control structures which are commonly used among European companies. The best example is dual class shares (A/B shares) that are applied in at least 20% of European listed companies with that making it by far the most common control mechanism. [203] Adding dual class shares to the breaking through regulation brought along heavy resistance. The latter is explainable by the economic analysis indicating that 14-22% of European companies applying dual-class shares would incur a control loss in case of the breakthrough rule and the percentage of potential control loss is even higher.[204]

Besides the numerous mechanisms caught by the breakthrough rule there are also plenty of exceptions to the rule. Firstly, Article 11 (6) excludes such securities where restrictions on voting rights are compensated by a specific pecuniary claim[205] referring to certain preference shares[206] where the shareholders lack of voting rights but are subject to the payment of dividends. In addition, by Article 11 (7) are excluded from the breakthrough rule

[202] Bennedsen/Nielsen. *op. cit.,* p 260
[203] C. Rose. *op cit*, p 127; B. Sjåfjell. 2009, p 392
[204] Bennedsen/Nielsen. *op. cit.*, p 261 and 277
[205] Article 11 (6) of the Takeover Bids Directive; V. Edwards, *op. cit*., p 437
[206] G. Tsagas. *op. cit.*, p 175

cases where the Member States own shares in the target company or special rights are subject to the national law – the former also referred to as golden shares[207]. As the golden shares are not prohibited by the breakthrough rule the Member States are able to effectuate golden shares to preserve their interests in company's decisions[208]. In recent years the European Court of Justice however has declared the golden shares to be illegal in several cases[209] as it allows the Member States to influence company decisions, including fending off foreign bidders – constituting a clear barrier to the facilitation of takeovers. Nevertheless, only 2% of European largest companies have golden shares[210].

Two other control enhancing mechanisms which are not caught under the breakthrough rule but have a significant segment of usage by European companies – pyramid structure and cross-shareholdings. Pyramid structures are widely spread as according to Figures 8, 9 and 10 in the Annex they are allowed in all Member States and are actually used in 75% of the Member States with that being the most common control enhancing mechanism. Pyramid structures enhance the control of blockholders significantly as their power of voting and the amount of shares owned in the company are disproportionate.[211] As the pyramid schemes are not caught under Article 11 and at the same time are allowed in all of the Member States it could be opined that pyramid schemes shall be taken as an alternative to other control enhancing mechanisms prohibited by the breakthrough rule. According to Figures 9 and 10 in the Annex cross-shareholdings allowed by all of the Members States and used by 31% of them could also operate as effective anti-takeovers mechanisms if their amount is sufficiently significant[212].

Finally, in addition to the prior examples an attention should be brought to an observation in Article 11 (2)-(4) which do not apply to agreements entered into with third parties[213]. Article 11 can break through only those agreements concluded between the shareholders themselves or the shareholders and the target company indicating directly that all other agreements are not subject to restrictions.

For a conclusion it is important to notice that the breakthrough rule represents a controversial selection of control enhancing mechanisms being caught under Article 11 at the same time leaving other mechanisms unbroken. It cannot be argued that the mechanisms prohibited by the breakthrough rule would in any circumstance be more destructive than the

[207] G. Tsagas. *op. cit.*, p 175
[208] B. Sjåfjell. 2009, p 391
[209] ECJ (Fist Chamber), 8 July 2010, Case C-171/08, *Commission v. Portugal*
[210] Wouters/ Hooghten/Bruyneel, *op. cit.*, p 54
[211] C. Clerc. *et al*, (eds), *op. cit.*, p 184
[212] C. Clerc. *et al*, (eds), *op. cit.,* p 184
[213] Wouters/ Hooghten/Bruyneel, *op. cit*, p 54

others. Though when taking into account the initial objectives set to the breakthrough rule the shares carrying disproportionate amount of voting rights are under special attention together with measures promoting managerial entrenchment. The sanction for the infringements from the rule is determined by the Member State (Article 17).

3.4. The controversial implementation of the breakthrough rule

3.4.1. The overall implementation of Article 11 among Member States

The implementation of the breakthrough rule is in no doubt a failure as only three Member States have transposed a mandatory rule into their legal system – Estonia, Latvia and Lithuania.[214] Baltic States constitute only 1 % of listed companies in the European Union[215] indicating the absolute marginal influence the rule has accomplished with the adoption of the Directive. Breakthrough rule was relatively unknown in European Member States as before the adoption of the rule in the Directive there was no such mandatory rule in any of the Member States though some of the Member States have rules prohibiting only few pre-bid defences.[216] France has transposed the rule partially other countries have left deciding upon the breakthrough rule to the companies with or without reciprocity[217] - there are no indications of any company opting into the rule[218]. Based on the previous it could be claimed that the implementation of the breakthrough rule has not been successful granted the number of countries making the rule mandatory and the lack of interests by the companies to opt in on a voluntary basis.

3.4.2. Implementation in United Kingdom

United Kingdom's role in forming and influencing the defensive measures regulation in the Directive is incontestable – especially in the case of the board neutrality rule but also when it comes to breakthrough rule and its objective's regarding dispersed ownership and one share-one vote principle. United Kingdom supported the adoption of the breakthrough rule strongly but decided to opt-out of the rule because of the threat opting into rule would have imposed on the few of the biggest companies in the United Kingdom.[219] Companies in the United Kingdom have always represented dispersed ownership structures and because of this

[214] The Takeover Bids Directive Assessment Report, *op. cit.,* p 355
[215] B. Clarke, 2009b, p 14
[216] Davis/Schuster/Ghelcke, *op. cit.*, p 20
[217] C. Clerc. *et al*, (eds), *op. cit.*, p 80
[218] Davis/Schuster/Ghelcke, *op. cit.*, p 20 ; C. Rose. *op. cit.*, p 127
[219] A.M. Pacces, *op. cit.*, p 48

it is inconvenient to be a controlling shareholder in the company as by exceeding the 10% threshold the shareholder would be confronted by a number of requirements.[220]

Despite the dispersed ownership the availability of different control enhancing mechanisms in United Kingdom is remarkable. According to the study most of the control enhancing mechanisms are not prohibited in the national law, nonetheless the market practice does not particularly encourage the adoption of control enhancing mechanisms.[221] Even so, United Kingdom has opted out of the breakthrough rule and not made it mandatory though the companies have been left with an opportunity to apply it on voluntary basis.

3.4.3. Implementation in the Netherlands

The Netherlands, representing the Continental European viewpoint in reference to the board neutrality rule, did not change its position towards the takeovers also in implementation of the breakthrough rule. The Netherlands did not implement a mandatory breakthrough rule to the takeover regulation but made it optional for the companies to opt into the rule under the unprotected corporation doctrine stipulated in Dutch Civil Code Article 2:359b. Moreover, similarly to the regulation in the Directive of the equal or fair compensation for the loss of shareholder's rights there is no specification to the subject being obliged to decide on the grounds of such compensation nor the entity obligated for the payment. With the latter the fair compensation requirement lacks actual practical tools to operate effectively and indicates a loophole in the law.

The breakthrough rule did not have a chance of success in the Netherlands because of their firm ambition to protect large Dutch companies with a high percentage of control enhancing mechanisms at their disposal. According to the statistics represented on Figure 9 in the Annex the Netherlands possesses ten control enhancing mechanisms out of thirteen analysed with the highest usage of multiple voting rights shares, depository certificates, pyramid structures and priority shares. These pre-bid defensive measures in conjunction with the preference shares issued to a friendly foundation under the post-bid defences form a strong defensive measures packet available to listed companies to fend off bidders and to protect economically important companies and their long-run business interests.

The grounds for allowing such a large scale defensive measures lie in their approach towards takeovers and especially hostile takeovers. The activity of hostile takeover market in

[220] A.M. Pacces, *op. cit.,* p 192; M. Becht. *op.cit.*, p 10 is stating that in FTSE 100 companies have very few blockholders but it increases among Midcap and Smallcap companies.
[221] Shearman & Sterling LLP, *op. cit.*, p 8; Figure 12 in the Annex

the Netherlands has been rather active since the adoption of the Directive and Dutch listed companies have constantly been attractive to a number of potential acquirers launching bids to economically, historically and nationally important companies. The latter has influenced the formation of negative approach towards the takeover facilitation objective as the takeovers have not been viewed particularly positive in a long-term perspective. Because of this the Netherlands represents an antipathetic position mainly favoured by Continental European Member States, where concentrated ownership, control enhancing mechanisms and protection of large listed companies has been seen preferable. On the contrary the approach supported both by the Directive and the United Kingdom dispersed ownership and facilitation of takeovers is superior and beneficial in comparison with the former viewpoint.

2.1.1. Implementation in Estonia

Estonia is one of three Member States which has transposed the breakthrough rule into the takeover law on a mandatory basis. The breakthrough rule has been regulated in § 171^1 in the Securities Market Act (SMA) transposing the breakthrough rule as it is stipulated in Article 11 of the Directive. Nevertheless, the requirement for equal compensation for the loss of rights in case the rights of the target shareholders have been broken through has not been included to SMA § 171^1. SMA § 176 (2) only refers that a target person or any other person suffered damage from the takeover bid could demand for compensation without concretizing whether the equal compensation for shareholders pertains to that provision.

The reasoning behind the transposition of Article 11 to the SMA on a mandatory basis is vague and ambivalent. Implementation of the breakthrough rule lacked any reasonable explanation in the explanatory memorandum.[222] It stated only that the adoption of Article 11 would make acquisitions easier and target companies in Estonia more vulnerable to takeovers[223] based on which it could be assumed that the legislators adopted Directive's initial objective to facilitate takeovers.

Shareholder concentration in Estonian listed as well as other companies is high. More than half of the listed companies have a controlling owner of more than 50% of the shares, followed by another two companies with shareholder ownership over 40% of the shares.[224] The latter statistics is even more concentrated in companies not listed on the stock exchange.

[222] Väärtpaberituru seaduse ja sellega seonduvate seaduste muutmise seaduse eelnõu juurde (Memorandum of the Securities Market Act), 1.11.2007. – Available: http://www.riigikogu.ee/?op=emsplain&page=pub_file&file_id=df63393d-2391-cb03-4b3c-1b0a104f30b3&

[223] Memorandum of the Securities Market Act*, op.cit.*

[224] OECD (2011), Corporate Governance in Estonia 2011, Corporate Governance, OECD Publishing. – Available: http://dx.doi.org/10.1787/9789264119079-en, (17.03.2014)

Figure 7 in Annex indicates clearly that companies on small capital markets of Estonia and Latvia are highly concentrated and with large blockholdings. Though, various control enhancing mechanisms are not widely spread among Estonian companies[225] the concentration is so high that takeovers are unlikely to occur. At this juncture, takeover depends entirely on blockholder's decision and the market of takeovers is troublesome to evolve. For the latter reason to facilitate takeover activism on Estonian market the breakthrough rule was implemented.

Based on the prior it could be argued that as the market of takeovers in Estonia is very small and there are no example cases of hostile takeovers the Estonian legislators have left the negative impacts of the defensive measures restrictions unnoticed and concentrated on adopting the set regulation in the Directive. However, investors who comprehend that their rights could be affected by the breakthrough rule could be less interested in investing into the companies and markets where it may occur.[226] This could implicate that Estonian companies might not be as appealing to potential investors as the companies in Member States where the breakthrough rule has not been implemented. Even though it is clear that listed companies in Estonia are more vulnerable to unwanted bids than in most of the other Member States it is rather unlikely the present regulation to change before the practice of hostile takeovers evolves on Estonian market.

3.5. The conformity between the initial objectives and the actual impacts of the breakthrough rule

3.5.1. Actual impacts of the breakthrough rule

Breakthrough rule was intended to be adopted jointly with the board neutrality rule to establish complete package of restrictions on both post- and pre-bid defensive measures. The initial objectives set to the breakthrough rule had to contribute to facilitation of takeovers, dispersion of ownership structures and equalizing ownership and control as these were expected to involve positive impacts. Actual impacts resulting or possibly resulting from the breakthrough rule may not meet the initial objectives set and due that the breakthrough rule would not have the effect expected. It is also rather questionable whether these objectives are beneficial to all the companies and Member States.

[225] Shearman & Sterling LLP study, *op. cit.*
[226] B. Sjåfjell. 2009, p 396

- Low implementation score by the Member States because of economic protectionism.

Low interest towards the adoption of the breakthrough rule among Member States derives clearly from the economic protectionism – desire to protect nationally and economically important companies from being taken over by foreign hostile bidders.[227] Even United Kingdom, who was one of the main supporters of the breakthrough rule, decided to opt out of the rule for the protection of some of its biggest companies.

- Controversy between the objectives for the shareholders in board neutrality and breakthrough rule.

Board neutrality rule was aimed at maximizing shareholder value and vesting the ultimate decision-making power over the course of the bid to the shareholders. Moreover, Article 3 (1) (a) specifically states that shareholders of the same class have to be treated equally but it does not require in itself equal treatment of all the shareholders of target company but only between the shareholders of one class. It is doubtful if breaking through the rights of controlling shareholders is proportional to the support of the power of non-controlling shareholders. Solving agency issue between controlling and non-controlling shareholders was one of the objectives of Article 11 and the rule was aimed at diluting controlling stakes into more dispersed ownership by which the position of a non-controlling shareholder would be more equalized with the controlling shareholder.

The breakthrough rule seems to go too far with the equalization by contrasting with the objectives set to the board neutrality rule[228] leaving aside proportionality between restrictions and the potential benefits gained from them. it also goes ahead from the general principle in Article 3 (1) (a) by requiring equal treatment of all the shareholders. Such action is inadmissible for the controlling shareholders as their rights would be heavily and inadequately affected by the equalization process and it is unclear to what extent the rights of the shareholders should be extended if they're at the same time restricted.

- Dispersed ownership structure lacks of evidence of being more beneficial and superior to blockholdings.

European legislators have taken a strong position in supporting dispersed ownership over blockholdings among European companies though concentrated ownerships are more widely spread among European Member States. The grounds for the promotion of dispersed

[227] M. Gatti. Optionality arrangements and reciprocity in the Takeover Directive. in J Grant. European Takeovers: The Art of Acquisition. London: Euromoney Books 2005, pp. 103-116.
[228] C. Clerc, e*t al*, (eds), *op. cit.*, p 81

ownership derive from the objective to facilitate takeovers and the underlying presumption of takeover benignancy as takeovers are expected to appear more often and are easier to be carried out specifically in dispersedly owned companies.

Nevertheless, it has been extensively argued that there are no evidences supporting the position of the Directive based on which the blockholder structures are assumed to be bad.[229] Moreover, there are indications that in long-term and for stronger shareholder commitment concentrated ownership is more beneficial and dispersed ownership is beneficial only in short-term.[230] The latter goes together with the economical evidence from the takeover analysis as takeovers have also been seen beneficial only in short-term and having rather negative impacts in long-term. In addition, one of the main tools forming a part of the breakthrough rule was one share-one vote principle which is natural for dispersed companies in United Kingdom but not for blockholding companies in Continental Europe.[231]

The Directive has concentrated entirely on the short-term benefits without further long-term impact analysis and imposing dispersed ownership on all the companies of European Member States though it might bring along destructive impacts in concentrated companies. The underlying problems in the Directive is the narrow focus on few theories and incentives while leaving others aside and not taking into account the criticism over negative impacts the application of those objectives could lead to.

- <u>There are uncertainties in the breakthrough rule influences.</u>

According to the analysis of the equitable compensation regulation in the Directive and its implementation in the Member States it could be stated that there is lack of legal certainty in various factors of it. First of all there are no indications in the Directive of the subject who is obliged to pay the equitable compensation to the shareholders. Moreover, it is not analysed more thoroughly to what extent the rights of the shareholders could be broken through as the proportionality principle has been left without consideration. Resulting from the previous there is vast uncertainty[232] regarding the payment of equitable compensation and the proportionality in breaking through the rights of the shareholders.

- <u>Under the breakthrough rule are caught only some control enhancing mechanisms.</u>

The main concern regarding the application of the breakthrough rule emerged in a dispute over the scope of the rule. According to the regulation some of the control enhancing

[229] B. Sjåfjell. 2009, p 322
[230] W. Carlin C. Mayer. Finance, Investment and Growth. – Journal of Financial Economics, 2003/69 No 1, p 193
[231] C. Rose. *op cit*, p 136
[232] B. Sjåfjell. 2009, p 391

mechanisms are caught under the rule whereas others are not[233] and the division is not based on their destructive characteristics as could be expected. Nonetheless, it has been pointed out that the breakthrough rule is not aimed at prohibiting blockholdings altogether but rather those where the misalignment between control rights and cash flows exist.[234]

Breakthrough rule is incomplete as it applies only to some control enhancing mechanisms[235] and therefore goes only halfway in the regulation and fulfilling its objectives. Breakthrough does not apply to pyramid structures, cross-shareholdings, golden shares and preferred shares but is especially targeted at breaking through dual-class shares widely applied in a number of European countries.[236] Due to that the influence the breakthrough rule would have on some European companies is large and destructive while having no impact on other companies. The prohibition of some control enhancing mechanisms could lead to the usage of mechanisms which are not caught under the rule – for example widely allowed pyramid structures which are seen harmful[237] and effective tools for blocking takeovers.

In conclusion, it is difficult to explain why the legislators have decided to apply the breakthrough rule and the one share-one principle on a selective basis.[238] The latter division which is a problem in itself creates other issues and deviations as well. Therefore, the selective targeting of control enhancing mechanisms could bring along negative effects and with that more concerns than solutions.

- <u>Companies could apply other measures to avoid restrictions deriving from the rule.</u>

Closely connected with the previous impact of selective targeting of defensive measures the companies in Member States could because of this and for the reason to avoid the breakthrough in a whole adopt different measures.

Firstly, if the control enhancing mechanisms used in a company are caught under the breakthrough rule the company most likely would attempt to find alternative mechanisms to preserve the exclusive position of controlling shareholders. It has been widely suggested that if the scenario mentioned previously emerges the companies would introduce and recognise these mechanisms not being under the scope of the breakthrough rule such as pyramid

[233] K. Geens, C. Clottens. One Share One Vote: Fairness, Efficiency and EU Harmonisation Revisited in Geens, K., Hopt, K.J. The European Company Law Action Plan Revisited: Reassessment of the 2003 Priorities of the European Commission. Leuven:Leuven University Press 2010, p. 21
[234] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 261-262
[235] C. Clerc. *et al*, (eds), *op. cit.*, p 123
[236] C. Rose. *op cit*, p 137
[237] C. Rose. *op cit*, p 137
[238] C. Clerc. *et al*, (eds), *op. cit.*, p 158

schemes and cross-shareholdings.[239] That in turn would make breakthrough rule irrelevant as the companies have been left with a chance to use other mechanisms independent from Article 11.

Secondly, it has also been argued that the breakthrough rule making the companies more vulnerable to takeovers would influence the companies to incorporate outside of the Member States applying restrictions on pre-bid defensive measures.[240] Unfortunately, incorporation outside of the Member State or outside of Europe could impose negative impacts on economy and expected returns from the business operations.

Thirdly, Article 11 (4) promotes practices by Member State companies according to which controlling shareholders would increase the shareholdings above the 25%[241] making the requirement non applicable and unachievable in the company. Negative effects resulting from such practice is analysed in further.

- Breakthrough rule promotes empire-building and creates lock-in effect.

Despite the aim of dispersing ownership structures with one share-one vote principle in European companies the breakthrough rule could rather drive the results in the opposite direction – shareholders would increase their ownership even further as they are afraid of losing their position and that could lead to even higher ownership concentration.[242] Because of this, breakthrough rule is capable of altering initial objective into entirely opposite direction staying far from what was intended.

Moreover, the most influential from Article 11 is its subsection (4) which sets a certain threshold needed to be acquired for breaking through pre-bid established rights – the bidder has to acquire 75%. For circumventing restrictions stipulated in Article 11 (4) shareholders who are not interested in an easy takeover and of exiting the company would increase their stake in a company over 25%[243]. It would render the possibility for the acquirer to trigger Article 11 (4)[244]. If the shareholders are increasing their holdings in a company it will lead them to empire building and would lead to higher concentration in the company by facilitating lock-in effect[245]. Higher concentration and increasing blockholdings clearly did not represent the initial objective of the breakthrough rule and based on the analysis it could be argued that breakthrough rule possesses possibilities of opposite effects.

[239] C. Rose. *op cit*, p 137; C. Clerc. *et al*, (eds), *op. cit.,* p 81; B. Clarke, 2009a, p 186
[240] B. Clarke, 2009a, p 186; Bennedsen/Nielsen, *op. cit.,*p 277
[241] B. Clarke, 2009a, p 186
[242] C. Clerc *et al*, (eds), *op. cit.*, p 126
[243] B. Clarke. 2009a, p 186
[244] B. Sjåfjell. 2009, p 395
[245] B. Sjåfjell. 2009, p 395

- Breakthrough rule would create unequal level playing field.

Breakthrough rule would facilitate takeovers and neutralize control enhancing mechanisms and with that make European companies vulnerable to hostile takeovers especially to companies outside of the European Union[246] or Member States which have not implemented the restrictions on defensive measures in their national law. Equal level playing field expects the companies to be in a competitive position to protect themselves against hostile bids but the results deriving from the breakthrough rule tend to have opposite effect.

- Impacts the breakthrough rule would have on companies differ greatly based on their ownership structure and control enhancing mechanisms they possess.

The breakthrough rule would have diverse impacts on companies in different Member States.[247] It would depend on whether ownership structures are dispersed or concentrated and which control enhancing mechanisms are widespread among Member States' companies. According to Figure 4 in the Annex breakthrough has especially strong influence on companies with concentrated ownership as well as on companies with control enhancing mechanisms. Ownership concentration is higher in companies of Continental Europe and Scandinavia while the ownership structure in United Kingdom is dispersed, because of this the companies in the former are more heavily affected by the rule and the control loss is more serious.[248]

Breakthrough rule would have the most significant effect on companies with dual-class shares which are used by relatively large number of companies and is common type of ownership in a large number of European Member States[249]. Though the analyse indicates that approximately 14-22% of companies making use of dual-class shares would be faced with potential loss[250] the actual effects have not been so severe as it has not been implemented by nearly none of the Member States except Baltic countries.

- Breakthrough rule could have positive impact for potential acquirers if implemented.

If the breakthrough rule is applied in a Member State or voluntarily by a certain company it will contribute to neutralizing pre-bid defensive measures which enjoy strong obstructive effect on potential bids. As the companies are more easily acquirable under the rule it should

[246] C. Rose. *op cit*, p 137
[247] C. Clerc. *et al*, (eds), *op. cit.*, p 126
[248] Bennedsen/Nielsen, *op. cit.*, p 261
[249] M. Faccio, L.H.P. Lang. The ultimate ownership of Western European corporations. – Journal of Financial Economics, 2002/65 No 3, p 378
[250] Bennedsen/Nielsen, *op. cit.,* p 261

facilitate takeover activity and add greater feasibility to an entry for a bidder and successful completion of the takeover transaction.

Figure 3 in the Annex indicates that breakthrough rule has had very high impact especially on companies with concentrated ownership which supports the argument that the effects of the rule depend on the market structure[251]. Nevertheless, the impact analysis indicates that the breakthrough rule has not had any significant impact mainly due to a small number of Member States implementing Article 11 and because of this it is difficult to make fundamental and unambiguous arguments. Based on the current information the impact could be defined as insignificant or even negative on the European market[252]. Even so, certain conclusions could be done based on the statistics of implementation, economic indicators and also assumption on the effects if the rule would be mandatory in Member States. Studies over the latter indicate that breakthrough rule has most likely negative impacts rather than positive – the impact could be positive only for acquirers but not for the target company or its shareholders.

Moreover, legislators have done a bold move when setting aside control enhancing mechanisms representing the freedom of contract as there are no firm indications over positive effects of the one share-one vote principle[253] and control enhancing mechanisms are subject to relatively significant regulation in Member States[254].

Apart from the breakthrough rule the ownership structures have been stayed relatively same with few exceptions. Though it has been shown in a recent study that dispersion in listed companies has risen in Continental European Member States the blockholdings still form a strong and firm majority – dispersion has been strong in France (from 21% in 1996 to 37% in 2006) and Germany (from 26% in 1996 to 48% in 2006)[255] but in Belgium and the Netherlands ownership is still under blockholders' control[256]. Companies in United Kingdom are historically dispersed.[257]

[251] C. Clerc. *et al*, (eds), *op. cit.,* p 120
[252] Report on the implementation of the Directive on Takeover Bids, SEC (2007) 268, Brussels 21.02.2007
[253] C. Rose. *op cit*, p 138
[254] Shearman & Sterling LLP, *op. cit.*, p 9
[255] A. White, *op. cit.,* p 792
[256] L. Laeven, R. Levine. Complex Ownership Structures and Corporate Valuations. – Review of Financial Studies, 2008/21 No 2, p 579
[257] A. White, *op. cit.,* p 793

3.5.2. Reasoning behind the outcome results

As was the case in the board neutrality rule the legislators have taken the same superior position in formulating the breakthrough rule where the objectives are driven by theories common in Anglo-American legal system with United Kingdom ahead of it in Europe without taking into account market practices in Continental Europe. It has been strongly assumed by European legislators that because the capital and takeover market in United Kingdom is liquid and well-functioning the dispersed ownership should be promoted as it is profitable while blockholdings common in Continental Europe are bad[258]. Nonetheless, there are no empirical grounds stating the blockholder control to be bad per se[259].

Dispersed ownership is seen beneficial for facilitating takeovers, takeovers in turn are seen profitable for both the acquiring and acquired company and also for solving agency issues and because of the latter promotion of the prior is justified and clearly beneficial. The actual situation does not uphold this sequence of thoughts as it rather implicates that takeovers are not particularly beneficial, agency problems are different in different ownership structures and shareholder's short-term interests are destructive in overall for the company if not assisted by the board's balancing power.

In addition to the conflict between Anglo-American and Continental European viewpoints the resistance against the breakthrough rule comes from its objective to diminish the rights of the shareholders control. It was endurable that the board of the company was neutralized under the board neutrality rule at least for some, nonetheless, the companies would become especially vulnerable if the rights of the shareholders would be neutralized as well. Companies are not in particularly supportive and interested in easy takeover process whilst it is hostile and they have not been left with effective blocking tools. Moreover, breakthrough rule gives clear indications of Member State's economic protectionism views as they as well as the shareholders of potential target companies are not interested in large listed companies with clear national economic importance being acquired by foreign companies which could remark the relocation of the company.

With such controversy and obscurity of scope the breakthrough rule is argued of not having a chance of being successful in the first place[260] and based on the analysis of the initial objectives, the underlying theories, its regulation and diverse implementation and the actual

[258] B. Sjåfjell. 2009, p 320

[259] B. Sjåfjell. 2009, p 320; M. Becht, P. Bolton, A. Röell. Corporate Governance and Control – European Corporate Governance Institute Working Paper No 02/2002. Available: http://www.wu.ac.at/iqv/mitarbeiter/gugler/cg_bechtboltonroell.pdf, (15.01.2014)

[260] B. Sjåfjell. 2009, p 303

impacts the breakthrough rule has had or could have if applied this argument is clearly accurate.

3.5.3. The conformity between the initial objectives and the actual impacts

The underlying theory behind the adoption of the objectives has been the view that facilitation of takeovers, including hostile takeovers, is good for creating more liquid financial and capital market and for both acquired and acquiring companies' development. Based on the facilitation of takeovers are adopted other side-objectives which should support the achievement of the initial aim – solving agency theory, enabling easier entry for potential acquirers, eliminating mechanisms as tools for blocking takeovers, promotion of dispersed ownership and proportionality between risk-bearing and control.

If the breakthrough rule would be adopted in a Member State the objectives set to the rule could most likely be achieved. Nevertheless, as only three Member States have implemented the rule it has had rather insignificant impact in overall and there are no clear indications whether the breakthrough in the present form is actually capable of fulfilling the objectives set to it. Even if the breakthrough rule is able to achieve its objectives the rule could have numerous destructive side-effects on European companies and would bring along severe economic and legal issues if implemented on a mandatory basis in all of the Member States. The latter is also the reason for marginal implementation results. Based on the current implementation it could be firmly stated that the regulation on pre-bid defensive measures against hostile takeovers has not fulfilled its objectives.

The analysis of the actual impacts of the breakthrough rule if it is implemented on a mandatory basis showed profound negative results (side-effects) for a large part of listed companies in Europe. In addition, the breakthrough rule has some regulatory loopholes, it is incomplete and some of the objectives set to the rule cannot have beneficial results in all Member States as the corporate control structures among Member States vary tremendously. One structure does not fit for all the companies and the legislators should be careful before establishing these goals without further analysis of their effects on companies in different Member States.

As a conclusion there is lack of conformity between the initial objectives set to the breakthrough rule and the actual impacts the breakthrough rule has or would have if implemented. Moreover the breakthrough rule has numerous destructive side-effects if implemented in the current form and the implementation statistics shows failure of application.

4. Optionality and reciprocity clause - Article 12

4.1. Formulation of the optionality and reciprocity clauses in Article 12

The basic optionality clause has been stipulated in Article 12 (1) – (2) and reciprocity clause in Article 12 (3) in the Directive on Takeover Bids.

The optionality clause in Article 12 (1) and (2) grants the Member States the right not to require the restrictions on defensive measures set out in Articles 9 and 11 but the Member States have to reserve an option in their national laws for the companies to opt into these restrictions voluntarily if they wish.

The reciprocity clause in Article 12 (3) allows the Member States to exempt the companies to apply the restrictions of Articles 9 and 11 from applying them if the bidding company does not apply the same rules.

The optionality and reciprocity clauses regulate the usage of post- and pre-bid defensive measures. Such a requirement was stipulated based on various objectives the clauses were aimed at fulfilling.

4.2. Initial objectives for including Article 12

4.2.1. Establishing a level playing field

The main objective of Article 12 was to ensure a level playing field for all the Member States so that no Member State or company would be disadvantaged – Article 12 had to allow flexibility for both of them.[261]

First of all, the level playing field was previsied to be created between different Member States. The board neutrality and breakthrough rule adopted in the Directive were continually opposed by numerous Member States mainly because of diverse underlying theories, corporate governance systems and control structures prevailing in those states. The adoption of the Directive depended largely on adding the optionality arrangement which allowed the Member States to opt out of either of the rules regarding takeover defences if the mandatory implementation of the rule would not be supported. The optionality arrangement was aimed at creating at least some consideration in the Member States over their existing takeover laws and would contribute to establishing the level playing field between the states.

Secondly, the level playing field had to be established between companies of different Member States for cross-border takeovers.[262] The objective was expected to be achieved by

[261] W. Magnuson. *op. cit.*, p 235-36

[262] Based on the Figure 6 in the Annex a relavant number of takeovers are carried out as cros-border transactions

introducing reciprocity rule which allowed companies applying either Article 9 or 11 or both of them to opt out if the company would become a target for another company not applying similar rules (Article 12 (3)). The reciprocity clause should grant the companies a chance to protect themselves against the bidders not subject to Article 9 or 11 and with that create considerable level playing field.

Thirdly, the most argued level playing field was aimed to be created between companies of Member States and companies outside of European Union such as United States where the occurrence of hostile takeovers is common and the takeover market active and promoted.[263]

4.2.2. Some regulation is better than no regulation

The adoption process of the Directive certified evidently that there were too many opposing positions among European Member States and imposition of a unified regulatory regime governing defensive measures against hostile takeovers would be difficult to establish. One of the potential solutions for preserving the possibility to adopt the board neutrality and breakthrough rule as part of the Directive on Takeover Bids was assumed to lie in adding Article 12 to the Directive. Though there was firm and relatively high probability that the Member States would make use of such optional arrangements extensively some regulation of defensive measures was believed to be better than lack of any common regulation.

4.3. Regulatory interpretations of the optionality and reciprocity clause

4.3.1. The scope of optionality arrangement granted

Because of numerous different factors as shown in the analysis of the board neutrality and breakthrough rule the views on their application diverge greatly among Member States. As a result the optionality arrangement was added to the hostile takeover defences regulation in the Directive. The optionality is divided between two layers complementing each other – optionality clause is stipulated in Article 12 (1) with an additional mandatory requirement in Article 12 (2) if the Member State decides to apply the first subsection.

The first layer in the optionality clause grants the option-power to the Member States which portrays specific characteristics of corporate control in a certain Member State[264].

[263] Based on the Figure 6 in the Annex approximately 20% of takeover bids in the European Union are launched by a non-EU bidder

[264] C. Clerc. *et al*, (eds), *op. cit.*, p 174

According to Article 12 (1) in the Directive the Member States are free to choose whether to require companies with a registered office within their territories to apply the board neutrality and/or breakthrough rule. Optionality thus applies to both post- and pre-bid defensive measures where in the alternative situation their usage would be extensively restricted. Article 12 (1) in other terms constitutes the first layer by allowing the Member States to implement both board neutrality and breakthrough rule (full opt-in), either of the rules (partial opt-out) or maintain their national defensive measures regulation by allowing both pre- and post-bid defensive measures (full opt-out).[265] Optionality clause has been relatively popular among Member States and has been widely used in case of both rules.

The second layer has been added in Article 12 (2) by requiring the Member States to make it possible for the companies to opt in to the board neutrality and breakthrough rule on a voluntary, so called counter-option[266], basis if the Member States have not made either of the rules mandatory.[267] With that the option-power is vested into the companies. Inside of companies the decision-making is vested to the shareholders of the company (Article 12 (2)) verifying the shareholder's right to decide which defensive measures the company should be able to apply if the bid is launched.

The optionality clause leaves Member States enough considerable space to decide whether to implement the rules regarding defensive measures regulation or not. On the one hand, the optionality clause was the only chance for the legislators to achieve the adoption of the Directive in the present constitution. On the other hand, it made the regulation optional and by that diluted its intended impact enormously as the Member States were free from restrictions to choose their course of action. The optionality clause granted optional alternative also for companies in those Member States not applying a mandatory defensive measures regulation to opt in. Nonetheless, such course of business would be highly unlikely to occur as it would alter the company more vulnerable in reference to hostile takeovers. The multiplex system of optionality clause influenced greatly the obscurity of implementation and the complicatedness of regulation. Even so, the optionality clause has been the key element in defensive measures regulation both in case of the board neutrality but especially in case of the breakthrough rule which has been implemented only by three Member States.

[265] Wouters/ Hooghten/Bruyneel, *op. cit*, p 61
[266] Davis/Schuster/Ghelcke, *op.cit.,* p 21
[267] Wouters/ Hooghten/Bruyneel, *op. cit*, p 61

4.3.2. Reciprocity rule adding more controversy

Reciprocity clause added further complexity to the takeover defences regulation which had already been made optional by Article 12 (1) and (2)[268]. It grants the bidder a chance to break through structural mechanisms that would otherwise protect the board and the management.[269] Reciprocity rule added the third layer to the defensive measures application which in turn could be again divided between the choice of the Member States and of the companies.[270]

In the first part, according to Article 12 (3) the Member States are allowed to decide whether to implement reciprocity clause[271] - to allow companies applying Article 9 (2) and (3) and/or Article 11 to opt out of the rules if they become subjects to an offer by the company not applying similar rules. If the Member States do not make use of this, the companies have no further options and they are in any case subject to restrictions set forth in Articles 9 and 11.

In the second part of the layer, if the Member State has decided to allow reciprocity, the choice over the application of the rules if the company becomes a target for another company which is not subject to similar restrictive rules is vested to the shareholders of the target company. The target company could opt out of either of the rules if it becomes a target for a bidder not applying those rules. According to Article 12 (3) the authorization from the shareholders should not be given more than 18 months prior to the bid. Reciprocity is also available for companies where the rules are not mandatorily set by the Member State but the company itself has opted in to one or both of the rules and if the Member State has allowed reciprocity such company is subject to the exception allowed under Article 12 (3).

Reciprocity (as well as optionality arrangement) clause would grant the companies a possibility to maintain and employ their current takeover regulation at least within certain scope. Optional arrangements available in Article 12 are difficult to be executed in companies with dispersed ownership.[272] The latter could be reasoned with shareholder's coordination problems. As a result the optional clauses are easily adoptive rather in companies with more concentrated ownership structure. In addition, though the reciprocity rule adds more level playing field for target companies it changes the regulation scenery more unclear and bedim without legal certainty for numerous interested groups.

[268] B. Sjåfjell. 2009, p 425
[269] B. Clarke. 2011, p 529
[270] Davis/Schuster/Ghelcke, *op.cit.*, p 21
[271] Davis/Schuster/Ghelcke, *op.cit.*, p 25-26
[272] Davis/Schuster/Ghelcke, *op.cit.*, p 26

4.4. Controversial usage of Article 12 in Member States

The optionality clause under Article 12 (1) and (2) could be stated to having been successful as the Directive's adoption depended entirely on adding the exemption to the board neutrality and breakthrough rule as they were not acceptable by numerous Member States. Nevertheless, the adoption of Article 12 in the Directive on Takeover Bids added diverse optionality and reciprocity layers for both Member States and for companies and with that turned the implementation scenery into rather complex set of options.

Optionality provision in Article 12 (1) and (2) has been clearly successful[273] - in case of a board neutrality rule eight Member States have opted out of Article 9[274] and only three countries in breakthrough rule have not used the opt out clause[275]. Though, it is doubtful for the companies to use the second layer of optionality clause to opt in to the defensive measures regulation voluntarily if the state has not made the rule mandatory as it would change the company easily acquirable to hostile bidders.

Reciprocity exception based on the statistics could also be stated having been relatively successful as 13 Member States[276] have transposed the clause to their national laws as a possibility for the companies to protect themselves towards hostile bidders not subject to similar restrictive rules. Besides the implementation score the assumptions on the actual usability of the reciprocity clause in practice by the companies indicate rather vague results.

As an example regarding the previously analysed Member States of the United Kingdom, the Netherlands and Estonia – the implementation patterns in these Member States indicate most profoundly the complexity and diversity the adoption of optionality and reciprocity rule have brought along.

Estonia has opted in to both board neutrality and breakthrough rule and has not applied the reciprocity rule by that making the companies in Estonia especially easy to acquire through a hostile takeover.[277] The United Kingdom has opted in to the board neutrality rule but out of the breakthrough rule and has similarly to Estonia not applied reciprocity and with that applied strict board neutrality restriction on companies' boards.[278] The Netherlands and Germany representing the Continental European companies with stakeholder-model have opted out both of the board neutrality and breakthrough rule and made the reciprocity rule

[273] McCahery/Vermeulen, *op. cit,* p 5
[274] Davis/Schuster/Ghelcke, *op.cit.,* p 31
[275] Report on the implementation of the Directive on Takeover Bids, COM 2012 347 final, Brussels 28.6.2012, p 3
[276] Report on the implementation of the Directive on Takeover Bids, COM 2012 347 final, Brussels 28.6.2012, p 3
[277] Wouters/ Hooghten/Bruyneel, *op. cit.,* p 55
[278] Wouters/ Hooghten/Bruyneel, *op. cit.*, p 55

available.[279] Based on the former it could be stated that the optionality and reciprocity clauses have made the implementation of the board neutrality and breakthrough rule very controversial and complex.

4.5. The conformity between the initial objectives and the actual impacts of Article 12

4.5.1. Actual impacts and results from the optionality and reciprocity clause

Article 12 in the Directive, though not regulating any underlying theories and objectives, is the most controversial provision of the harmonized takeover regulation. On the one hand, it was a necessary tool for the legislators initially to enforce the Directive on Takeover Bids and to establish unified takeover regulation to some extent among European Member States. On the other hand, it neutralized the Articles of board neutrality and breakthrough rule which intended to be mandatory and by that removing the effects the rules were intended to possess.

- Made the adoption of the Directive possible and required the Member States to revise their defensive measures regulation.

Before the adoption of the Directive defensive measures against hostile takeovers were controversially regulated or there was lack of regulation in this regard. United Kingdom had relatively developed takeover regulation in comparison with other Member States but the activity on the takeover market[280] clearly indicated the need for minimum unified understandings over defensive measures in all of the European Member States. Moreover, Member States where the regulation over defensive measures was minimal or non-existent corresponding rules were introduced based on the Directive. If the implementation of Directive's regulation was not imposed to the national takeover regulation on a mandatory basis it was at least included as an option because of Article 12 (3).

- Neutralized initially mandatory provisions and interrupted the harmonization process.

Article 12 clarified the implementation of the underlying Articles 9 and 11 regulating the usage of post- and pre-bid defensive measures. Initially the board neutrality and breakthrough rule were foreseen to be stipulated in the Directive on a mandatory basis for all the Member States. Also both of the rules should have been transposed to the Member State's national legal system jointly to have complete impact and requested effect on takeover activity and on

[279] Wouters/ Hooghten/Bruyneel, *op. cit.,* p 55
[280] Figure 1 in Annex; The Takeover Bids Directive Assessment Report, *op. cit.,* p 284

the usage of defensive measures against hostile takeovers. The mandatory restrictions on defensive measures ought to have harmonized different national approaches towards takeovers[281] and defences used by the companies to fend off uninvited bidders.

Attaching optional provision of Article 12 altered greatly the effects the defensive measures restrictions initially were intended to have and the harmonizing power of the Directive[282]. For the European legislators whose interest were to promote shareholder primacy and dispersed ownership, solve director's agency problems and facilitate takeovers adding Article 12 to the defensive measures regulation was certainly an unwelcomed alteration in course of developing European takeover regulation. Despite this, optionality and reciprocity clauses by altering the harmonized European takeover regulation possessed a highly needed solution for preserving uniqueness of takeover regulations and market practices of different Member States.[283] As the analyses of board neutrality and breakthrough rule already indicated then due to the controversy between Member States the defences regulation in the Directive would have had destructive impacts. Because of this, they would have been unacceptable in numerous Member States while in others (such as United Kingdom and apparently Estonia) these provisions were awaited.

- Article 12 made the takeover defences regulation more complex.

Complexity of the defensive measures regulation has been argued to be the main negative impact of Article 12. Articles 9 and 11 of the Directive indicated to be more complicated and unclear than initially expected. The analysis of the board neutrality and breakthrough rule revealed its multiplex and controversial regulation and the actual impacts the rules have in different Member States mostly because different market economies, practices and theories prevailing in those states. Article 12 without doubt made possible the attachment of Articles 9 and 11 to the Directive in the first place but at the same time it clearly amended the implementation scenery of the rules. The optionality and reciprocity clauses added another level of complexity and confusion[284] to already fairly unclear regulation takeover defences.

- Reciprocity rule in Article 12 (3) created limited level playing field.

The scope of the reciprocity rule regulated in Article 12 (3) is vague. Firstly, it is unclear whether the target company could apply the reciprocity rule also when the bidder is not from

[281] B. Clarke, 2009a, p 191
[282] A. Johnston. The European takeover Directive: Ruined by Protectionism or Respecting Diversity. – Company Lawyer, 2004/25 No 9
[283] A. Nilsen. *op.cit*
[284] B. Sjåfjell. 2009, p 427; A. Johnston, *op. cit.*, p 271

another Member State where the application of Articles 9 and 11 should be clear but is from a third country outside of the European Union[285]. Besides the level playing field among the companies of Member States it was especially important to create one for these takeover transactions occurring between companies from United States and Europe as there was fear of hostile takeover escalation by United States bidders. Currently it is unclear whether European companies are subject to reciprocity rule if a hostile takeover is announced to their company by the United States counterpart though it is believed that in such circumstances the application of Article 12 (3) should be decided on case-by-case approach.[286]

Another question arises whether the target company could apply reciprocity rule if there is more than one bidder and if some of the bidders apply rules from Articles 9 and 11 and others do not.[287] The target company should be able to opt out of the board neutrality rule against the bidder who is not subject to these restrictions itself though against other bidders the target company is not allowed to make usage of exception under Article 12 (3). It is unclear how the target companies should act in such circumstances and there is little reference for explanations.

- Article 12 disables the board neutrality and breakthrough rule to fulfil their objectives.

Both the board neutrality and breakthrough rule were subjects to several objectives when included to the Directive though their fulfilment depended largely on complete implementation to Member State's national takeover laws. Optionality rule diluted the possible impact of Article 9 and 11 to a great extent as because of the optionality arrangement it was not mandatory for the Member States to adopt the rules and according to the statistics Article 12 (1) has been popular in the implementation process of either of the rules[288]. Therefore it is clear that the impact the optionality clause has had on board neutrality and breakthrough rule is destructive to the fulfilment of their objective.

Reciprocity rule in Article 12 (3) was aimed at decreasing the opt out effect the optionality clause could have by regarding companies a possibility to opt back in to the rules. Reciprocity clause, though allowed by numerous Member States, has not had desired outcome as the incentives of controlling shareholders are weak or non-existent in restricting their own rights of defensive measures and therefore reciprocity is not an efficient tool.[289] The reciprocity arrangement has had opposite effect by increasing management's power to carry out

[285] Davis/Schuster/Ghelcke, *op. cit.,* p 24
[286] B. Clarke, 2009a, p 194
[287] Davis/Schuster/Ghelcke, *op. cit.*, p 24
[288] Report on the implementation of the Directive on Takeover Bids, COM 2012 347 final, Brussels 28.6.2012, p 3
[289] Davis/Schuster/Ghelcke, *op.cit.*, p 42

frustrating actions[290] and has promoted the prevalence of economic protectionism in case of cross-border hostile takeovers[291]. The outcome of Article 12 (3) is that there is little interest towards adopting the restrictive provisions of Articles 9 and 11 both by Member States and based on the possibility provided by the reciprocity also by companies.

4.5.2. The conformity between the objectives and the actual impacts

Optionality and reciprocity rule certainly have made it possible to adopt the Directive in the present form where board neutrality and breakthrough rules are subject to several controversial issues creating opposition by many Member States. Because of the latter a full and mandatory adoption of Articles 9 and 11 was out of question. Article 12 made it possible to harmonize or at least make it available for the companies in Member States to apply the defensive measures regulation on a voluntary basis – as a result some regulation was seen better than no regulation regarding defensive measures against hostile takeovers.[292]

Despite the previous Article 12 was rather a necessary compromise than calculated and negotiated provision with certain objectives and positive impacts. Though optionality and reciprocity clauses do not affect the content of the board neutrality and breakthrough rule the implementation of these rules wield great importance on the effects resulting from them. Due to the prior Article 12 has had significant impact on the implementation of the board neutrality and breakthrough rule and on the effects they have on defensive measures usage in hostile takeovers. As a result optionality clause in Article 12 (1) has had harmful impact on the level playing field and has undermined the objectives of the takeover defences regulation in the Directive.[293] Though Article 12 has created some level playing field both for the Member States and the companies the scope of it is limited. There is also lack of clearance of the applicability of optional exceptions in cases of a third country bidder and multiple bidders.

In conclusion it could be stated that the optionality and reciprocity rules are to some extent in conformity with the objectives set to the rules and have been relatively successful compromises acceptable for different interest groups inside the European Union. Nevertheless, Article 12 has brought along other rather negative impacts. The most substantial is the fact that the optionality and reciprocity rules are behind the reasons for the board neutrality and breakthrough rule not to achieve the objectives set to them.

[290] B. Clarke, 2009a, p 109
[291] F. Wooldridge. Some important provisions and implementation of the Takeover Directive. – Company Law 2007/28 No 10, p. 293
[292] B. Clarke, 2009a, p 174-197
[293] B. Clarke. 2009a, p 188

5. Conclusive arguments and possible changes to the defensive measures regulation

5.1. Validity of the hypothesis

The hypothesis set to the thesis was following:

- The initial objectives set to the defensive measures regulation are in conformity with the actual outcomes of the regulation.

Based on the analysis of the defensive measures against hostile takeovers regulation in the Directive on Takeover Bids conclusions on the validity of the hypothesis could be declared.

The conclusion of the board neutrality rule analysis was that there is some conformity between the initial objectives set to the board neutrality rule and the actual impacts the board neutrality rule has or would have if implemented in the Member State. Nevertheless, the board neutrality rule has numerous destructive side-effects especially on companies representing the Continental European stakeholder-model and has been opted out by various Member States.

The conclusion of the breakthrough rule analysis was that there is lack of conformity between the initial objectives set to the breakthrough rule and the actual impacts the breakthrough rule has or would have if implemented. Moreover the breakthrough rule has numerous destructive side-effects if implemented in the current form and the implementation statistics shows failure of application.

The conclusion of the optionality and reciprocity clause was that the optionality and reciprocity clauses are to some extent in conformity with the objectives set to the rules and have been relatively successful compromises acceptable for different interest groups inside the European Union. Nevertheless, Article 12 has brought along other rather negative impacts such as undermining the fulfilment of objectives set to the board neutrality and breakthrough rule.

As a conclusion it could be asserted that the hypothesis set was invalid. The conformity between the initial objectives and the actual outcomes in all three cases – board neutrality rule, breakthrough rule and optionality and reciprocity clause – is existent to some extent or not existent. The scope of conformity depends greatly on the implementation statistics. Moreover in the analysis of all three Articles the regulation and implementation has or would have negative or even destructive side-effects.

By reference to the former the present takeover defences against hostile takeovers regulation is clearly unefficient, incomplete and would have destructive influences for companies, Member States and overall values.

5.2.Reasoning behind the results from the hypothesis

The outcome of the hypothesis analysis was that the initial objectives set to the defensive measures regulation are not in conformity with the actual impacts and have numerous destructive side-effects. The reasoning behind the results from the hypothesis lies in the underlying theories based on which the initial objectives and the defensive measures regulation had been established. Namely the underlying theories possess weak evidence of effective functioning in practice and their positive effects are empirically difficult to prove.

The presumption of takeover benignancy is partially invalid. Takeovers tend to have positive effect in short-term[294] and for these shareholders who decided to sell their shares as the share price is higher during the offer period than before or after the bid.[295] Studies concentrating on the long-term results show rather inconclusive or negative effects on the target company[296] - especially on the shareholders not selling their shares[297] and on other stakeholders. The effects of a hostile takeover tend to be especially negative in the long-term[298] in comparison with those of negotiated deals[299]. Facilitation of takeovers in overall would also bring along more hostile takeovers which are certainly destructive and against the interests of both the companies and the Member States. The Directive on Takeover Bids has not succeeded in promoting value-enhancing takeovers[300] and the Commission should evaluate the actual impacts the rules could have before imposing a mandatory regulation based on the Anglo-American corporate theories on all the member States[301].

Secondly the market for corporate control is an idealistic theoretical conception rather than real-life practical tool as suggested by the Directive. The market for corporate control is argued to have disciplining effect on the managers in the target company. Nonetheless, there are numerous opinions in dissent to the disciplining effect. Firstly, it is argued that

[294] M. Martynova, L. Renneboog. A century of Corporate Takeovers: What Have We Learned and Where Do We Stand?. - Journal of Banking and Finance, 2008/32 No 10, p 2153

[295] B. Sjåfjell book. 2009, p 333

[296] M. Martynova, L. Renneboog. Takeover Waves: Triggers, „Performance and Motives. – Tilburg University Discussion paper No 2005-107, pp 21-22. – Available: http://arno.uvt.nl/show.cgi?fid=53839, (31.01.2014)

[297] S. Deaking, *et al.* Implicit contracts, takeovers and corporate governance: In the shadow of the city code. – ESRC Centre for Business Research, University of Cambridge Working Paper 254-2002, p 36. – Available: http://www.cbr.cam.ac.uk/pdf/WP254.pdf, (30.03.2014)

[298] A. White, *op. cit.,* p 794; B. Sjåfjell. 2009, p 335

[299] Martynova/Oosting/Renneboog. *op. cit.*, p 19

[300] M. Humphery-Jenner. The Impact of the EU takeover directive on takeover performance and empire building – Journal of Corporate Finance 18/2012 No 2, p 256

[301] E. Wymeersch. The takeover directive, light and darkness. – Ghent University Financial Law Institute Working Paper, 2008/01. – Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086987, (11.04.2014)

underperforming companies are not particularly those targeted in case of takeovers.[302] The reason of being taken over could rather be the size of a company or fear of becoming a target itself.[303] There is also little evidence of improved performance of companies after a takeover[304] and most empirical studies have failed to prove an efficient disciplinary role of takeovers.[305] Even if there is disciplinary effect, the threat of a hostile takeover does not permit the managers to protect company's long-term incentives.[306] The share price of a company does not always reflect the actual performance of the managers[307] as there could be numerous other factors influencing the price. The aim behind a hostile takeover could be different from the one promoted by the market for corporate control theory[308] indicating clearly the lack of proof regarding the doctrine.

The roots of shareholder primacy model originate from the Anglo-American shareholder-oriented model where the highest objective of the managers is shareholder value maximization. In the defensive measures regulation the shareholder primacy theory indicates additionally to the shareholder's right to decide on the course of the bid. The continual battle between Anglo-American shareholder-model and Continental European stakeholder-model undermines the ability to adopt unified legal approach.[309] The Directive on Takeover Bids focused strictly on the shareholder primacy[310] without taking into account the Continental Europe stakeholder-model and the role of the board.

In addition, the Directive has taken a position that dispersed ownership is superior to concentrated ownership. Even so, it has been indicated that concentrated ownerships are beneficial for long-term investment whereas dispersed ownerships inversely are beneficial for short-term investments.[311] Dispersed ownership in connection with the shareholder primacy promotes clearly short-termism which does not leave enough possibilities to uphold company's long-term values.

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[302] Bukart/Panuzi, *op. cit.;* B. Clarke, 2009b points out in addition that MCC has not lead to share price reductions in company's with poor management.
[303] B. Sjåfjell. 2009, p 330.
[304] B. Sjåfjell. 2009, p 330
[305] M.A. O'Sullivan. Contest for Corporate Control. Corporate Governance and Economic Performance in the United States and Germany. Oxford: Oxford University Press 2000, p 169
[306] L. Enriques, *op.cit.*, p 626
[307] G. Tsagas, *op. cit.*, p 179
[308] Franks/Mayer/Renneboog, *op. cit.* p 210
[309] N. Waddington. The Europeanisation of Corporate Governance in Germany and in UK. – University of Sheffield ESRC/UACES Series of Seminars on EBPP 2004. – Available: http://aei.pitt.edu/6119/, (23.03.2014)
[310] W.W. Bratton, M.L. Wachter. The case against sharheolder empowerment. – University of Pennsylvania Law Review, 158/2010, p 653
[311] Carlin/Mayer, *op. cit.,* p 193.

Harmonization of defensive measures regulation was one of the underlying ideas unfortunately the process has failed[312] as the Directive has turned the positions of different companies more uneven[313]. Though the optionality and reciprocity rules have made the defensive measures regulation more flexible[314] it also created legal uncertainty in various factors[315]. The failure of harmonization lies mostly on the controversy of underlying theories and the defensive measures regulation established based on that.

5.3.Introducing possible changes to the defensive measures regulation

Preliminary analysis gives firm evidence for the need to bring clear change to the present defensive measures regulation and to review the underlying theories and objectives set to the regulation. Opinions in reference to the direct recommendations how the Directive defensive measures regulation could be changed in a positive direction varies.

Firstly, based on the previous analysis it could be claimed that amending the Directive defensive measures regulation should begin with looking over the underlying theories and initial objectives based on which the present defensive measures against hostile takeovers regulation was adopted. The analysis of the board neutrality, breakthrough rule and optional arrangements indicated that the initial objectives set are not in conformity with the actual outcomes of the rules, moreover the rules may bring along severely destructive side-effects. As noted previously, circumventing these side-effects could not be done entirely by changing the rules but by changing the conceptual framework.[316]

Most importantly, the differences between Member States and the interests of the Member States and the companies should be recognized. There should be found balance between the shareholder primacy and protection of stakeholders.[317] Also, as takeovers indicate not to be merely beneficial the interests of the Member States and companies regarding the protection of companies against hostile takeovers should be allowed. Concentrated ownership should not be taken as negative per se[318] as the results do not support the assumption. The companies should be rather left with a chance to decide their ownership and control structure themselves as the breakthrough rule clearly indicates such desire. Solving agency problem through the market for corporate control does not implicate to actually function properly in

[312] G. Tsagas, *op. cit.*, p 171
[313] Lysandrou/Pra. *op. cit.,* p 204
[314] Wouters/ Hooghten/Bruyneel, pp. 3-76
[315] Humphery/Jenner, *op. cit.,* p 256
[316] C. Clerc. *et al*, (eds), *op. cit.*, p 109
[317] C. Clerc. *et al*, (eds), *op. cit.,* p 114
[318] B. Sjåfjell. 2009, p 320; Becht/Bolton/Röell. *op.cit.*

practice. For the solution of the agency conflict between the shareholders and managers alternative method should be devised. Agency conflict between the controlling and non-controlling shareholders could be solved by granting non-controlling shareholders further rights for protecting their interests. Diluting the control structure, transforming concentrated ownerships into dispersed and disproportionate restrictions of shareholder's rights through the breakthrough rule are not exceptionally positive. Resulting from the previous it has been suggested to take a neutral approach towards defensive measures regulation[319] in a way that it would not hamper nor promote takeovers though the current one size fits all approach[320]. For that it has been suggested that so-called menu rules could be adopted[321] which would create solution possibilities for all the companies.

On the regulatory basis there are various suggestions how the board neutrality could be regulated. One of the possible solutions debated over is vesting the optionality solely on company level after adopting the board neutrality rule on a default basis.[322] This would put the responsibility to persuade shareholders to opt out of the rules on the management of the company[323] or by making mandatory provisions less easily avoidable[324]. Stricter board neutrality rule would not likely contribute to solving the side-effects the rule may evoke. Despite this, the board neutrality rule could be modified into a weaker form[325] by adopting a joint decision-making power for the shareholders and the managers[326] or by leaving the adoption of the board neutrality rule to each company itself to decide[327]. Additionally, it has been suggested to introduce a modified business judgment rule in Europe comparable to the business judgment rule in United States where the decisions of the management is measured in the spectrum of their fiduciary duties and the rule should apply also to the shareholder.[328]

In reference to the breakthrough rule and the optionality and reciprocity issues there is not many suggestions how their regulation should be amended. Breakthrough rule in the current form is definitely unacceptable and before discussing its amendments the underlying theories behind the rule should be overlooked. Coming to the optionality arrangements, the optionality and reciprocity rules are not the correct solutions for making defensive measures regulation acceptable and applicable for all the Member States as is believed in the existing Directive.

[319] G. Tsagas, *op. cit*, p 181
[320] L. Enriques, *op. cit.*, p 630
[321] L. Enriques, *op. cit.*, p 639
[322] Davis/Schuster/Ghelcke, *op.cit.*
[323] M. Clerc *et al*, (eds), *op. cit.*, p 174
[324] McCahery/Vermeulen, *op. cit*, p 13
[325] C. Clerc. *et al*, (eds), *op. cit.*, p 114
[326] P. Davis, K. Hopt. Control Transactions. in R. Kraakman, *et al,* (eds). The Anatomy of Corporate Law: A Comparative and Functional Approach. New York: Oxford University Press 2009, p 238
[327] B. Sjåfjell. 2009, p 425
[328] Kirchner/Painter, *op. cit.*

The regulation of defensive measures should be rather changed on a more concept based. The transformation should occur on the board neutrality and breakthrough rule level as the current rules are due to their controversial underlying theories, incompleteness and preference of Anglo-American views unacceptable in various Member States. Optionality and reciprocity clauses are solutions for a short-term period allowing the Member States to maintain their existing takeover regulations. Nonetheless, these clauses have frustrated the aim of achieving common regulatory framework for the whole European takeover market.

As a conclusion the controversy of defensive measures regulation in the Directive on Takeover Bids is ongoing and the report by the European Commission[329] did not provide any actual solutions to the current situation. Based on the analysis of the thesis it could be strongly stated that there is clear need for more deliberated defensive measures against hostile takeovers regulation as hostile takeovers have great influence on the Member States and the companies.

It could be recommended to start the amendment of the regulation by overlooking different approaches to the defensive measures regulation among European Member States. Based on the results of the thesis it is clear that the views of the Member States regarding how defensive measures should be regulated diverged greatly. In addition, Member States had diverse views concerning the impacts the defensive measures regulation could have – some Member States supported the facilitation of all takeovers while others saw the need of protecting national companies. Amendments to the regulation could be done after a thorough analysis of different viewpoints where the changes would take into account these views.

[329] Report on the implementation of the Directive on Takeover Bids, COM 2012 347 final, Brussels 28.6.2012

CONCLUSION

Articles 9, 11 and 12 in the Directive on Takeover Bids were aimed at creating a unified legal framework for defensive measures against hostile takeovers regulation in all European Member States. The European legislators took numerous legal and economic theories for granted to establish the defensive measures regulation – takeover benignancy, solving agent – principal conflict, the market for corporate control doctrine, supremacy of dispersed ownership, one share-one vote principle and shareholder primacy. Based on the aforementioned underlying theories the initial objectives to Articles 9, 11 and 12 were established. The initial objectives were ambitious and they were presumed to be achieved through the adopted regulation. The hypothesis set to the Directive on Takeover Bids was – the initial objectives set to the defensive measures regulation are in conformity with the actual outcomes of the regulation. Through analysing the objectives set to Articles 9, 11 and 12, their regulation and the implementation conclusions and the validity of the hypothesis could be presented.

Article 9 stipulated the board neutrality rule which regulated the actions of the target company's board during the (hostile) bid period. It prohibited the board to put in use any defensive measures or conduct any actions which would result in frustrating the bid. The objectives set to the board neutrality rule were – unified regulation of board's role, facilitation of takeovers and the market for corporate control, solving agency problem between the managers and the shareholders, promoting shareholder primacy and their ultimate decision-making power. Based on the analysis of the current board neutrality regulation and the implementation of the rule in Member States the conclusions regarding the hypothesis could be done. The analysis indicated that there is some conformity between the initial objectives set to the board neutrality rule and the actual impacts. Nevertheless, the board neutrality rule would also have numerous destructive side-effects especially on companies in Continental Europe. The reasoning indicated that the failure of the board neutrality rule to fulfil the objectives set to it lie in the controversial underlying theories and the board neutrality rule itself. Both of them represent the viewpoint of the shareholder-model prevalent in United Kingdom and Anglo-American legal system while not taking into account the views of Continental Europe and the stake-holder model.

Article 11 stipulated the breakthrough rule which was aimed at breaking through the pre-bid defensive measures the companies could implement to make the company almost

impossible to acquire or at least more money and time consuming. The breakthrough rule was a subject to several objectives formulated based on the underlying theories – facilitation of takeovers and the market for corporate control, supplementing the restrictions set by the board neutrality rule, solving agency conflicts between the managers and the shareholders and between controlling and non-controlling shareholders, enabling easier entry for potential acquirers, eliminating control enhancing mechanisms, converging ownership structures into dispersed ownership and creating proportionality between risk-bearing and control. According to the analysis of the breakthrough rule regulation and implementation the conclusions over the hypothesis could be done. The analysis indicated that there is lack of conformity between the initial objectives set to the breakthrough rule and the actual impacts the breakthrough rule has or would have if implemented. In addition, the breakthrough rule would have numerous destructive and negative side-effects if implemented in a Member State. The reasoning behind the breakthrough rule to fail lies similarly to the board neutrality rule in the controversial underlying theories and the breakthrough rule itself as it promotes the Anglo-American viewpoint while setting aside the Continental European position. Moreover, by targeting the rights of the shareholders and making the companies especially vulnerable – as in addition to neutralizing the board the shareholders of the target company are neutralized as well – the rule had no chance of being successful.

Article 12 regulates the usage of Articles 9 and 11 by that making the regulation even more complex. Article 12 (1) and (2) regulates the optionality clause based on which the Member States are free to choose whether to implement the rules stipulated in Articles 9 and 11 mandatorily or if not the Member States are obligated to make these rules at least available for the companies. Article 12 (3) regulates the reciprocity clause which allows the companies, if allowed by the certain Member State, to opt out of the applied rules if they become a target for a bidder not applying these rules. The objectives set to the optionality and reciprocity clauses were establishing a level playing field and to accomplish the adoption of defensive measures regulation as part of the Directive. According to the analysis of the optionality and reciprocity clauses regulation and implementation as well as taking into consideration the influence the rule has had on the board neutrality and breakthrough rule the conclusions over the hypothesis could be done. The analysis indicated that the optionality and reciprocity rules are to some extent in conformity with the objectives set to the rules and have been necessary compromises for adopting the Articles 9 and 11 in the current form. Nevertheless, the optionality and reciprocity rules have undermined the objectives and implementation of the

board neutrality and breakthrough rule and have supported the creation of the level playing field only to some extent.

Based on the conclusions made on Articles 9, 11 and 12 it could be stated that the hypothesis set to the thesis was invalid. The existence of the conformity between the initial objectives and the actual impacts of Articles 9, 11 and 12 is present only to some extent or not present at all. The reasoning behind such outcome results on the hypothesis lies in the controversial underlying theories which tend to promote the Anglo-American shareholder-model or tend to be invalid and not having sufficient evidence to operate conjointly.

Based on the latter conclusions there is a clear need for a change in the present takeover defences regulation. Though there are some suggestions regarding the regulation of the board neutrality rule in Article 9 there is lack of any credible proposals to the regulations of Article 11 and 12. As a conclusion it could be stated that amendments of the present Articles of the Directive would not be sufficient as the problem of the Articles does not lie only in their formulation in the Directive or in the initial objectives and the actual impacts. The problem is rather in the underlying theories based on which the takeover defences regulation was established. The most important transformation needed is the one in the viewpoint supported by the Directive. The analysis indicated firmly that the Directive has promoted the theories prevailing in the United Kingdom and Anglo-American legal system while leaving other viewpoints common in Continental Europe unnoticed.

The European Commission's viewpoint in the Assessment Report published in 2012 was in regarding the defensive measures against hostile takeovers regulation in the Directive uncommonly disinterested in amending the present regulation. Moreover, though there was placed some attention on the failure of the present regulation, there was little consideration bestowed upon the controversy of the underlying theories as these theories have been seen impeccable and improper. Nevertheless, the regulation of defensive measures against hostile takeovers in the present form is irrelevant and there is a need for a change. In this regard an alteration has to start from the understandings over the underlying theories and their invalidity and the necessity of taking into account the position of the Continental Europe.

RESÜMEE

Ülevõtmispakkumiste direktiivis vaenulike ülevõtmiste kaitsemehhanismide regulatsioonile seatud esialgsete eesmärkide vastavus tegelikele tulemustele.

Euroopa ülevõtmispakkumiste direktiivi Artiklid 9, 11 ja 12 reguleerivad ülevõtmispakkumise eelsete ja järgsete kaitsemehhanismide kasutamist vaenulike ülevõtmispakkumiste korral.

Ülevõtmispakkumiste eesmärgiks on pakkuja soov omandada kontroll sihtemitendis, mis on saavutatav piisava osalushulga omandamisel. Sellest tulenevalt on ülevõtmispakkuja positsioonil, mis võimaldab tal teostada kontrolli sihtemitendi juhtimisorganite tegevuse ning äriliste otsuste üle. Vaenulik ülevõtmine on ülevõtmispakkumine, mis tehakse otse sihtemitendi aktsionäridele, vältides seega ettevõtte ülevõtmistehingu läbiviimist sihtetmitendi juhtimisorganitega läbirääkimiste tulemusel saavutatud kokkuleppe alusel. Ülevõtmispakkumise vaenulikkus tuleneb vastuseisust ülevõtmistehingule sihtemitendi juhtorganite, töötajate, aktsionäride või teiste ettevõtte huvigruppide poolt või liikmesriigi poolt, kus sihtemitendi aktsiad on noteeritud. Põhjused, miks eelnevalt mainitud huvigrupid on ülevõtmispakkumise vastu, seisnevad erinevate huvigruppide mitmekesisuses ning ülevõtmispakkumisest tulenevatest mõjudest nende huvidele. Samuti võivad vastuseisu põhjused seisneda muudes negatiivsetes asjaoludes või mõjudes, mida ülevõtmistehingu läbiviimine evib – ülevõtmistehingu protessi informatsiooniline asümmeetria, ülevõtmispakkuja potentsiaalne kuritahtlik eesmärk või sihtemitendi ning liikmesriigi soov säilitada sihtettevõtte ühtsus ja pikaajaline areng. Samuti osutavad mitmed uuringud ettevõtete omandamisel ülevõtmispakkumiste, eriti vaenulike ülevõtmispakkumiste korral selle negatiivsetele mõjudele pikaajalises perspektiivis. Tulenevalt eelnevast soovivad teatud huvigrupid – äriühingute kontrolli turu (*market for corporate control)* teooria kohaselt eelkõige sihtettevõtte juhtorganid – oma huvide kaitseks rakendada kaitsemehhanisme, mis muudaksid ettevõtte ülemineku nii ajaliselt kui rahaliselt kulukamaks ning seetõttu potentsiaalsele ülevõtmispakkujale ebasoovitavaks.

Tulenevalt kaitsemehhanismide regulatsioonile seatud eesmärkidest, Artiklite 9, 11 ja 12 regulatsioonist ning erinevatest õiguslikest ja majanduslikest uurimutest võib väita, et Euroopa ülevõtmispakkumiste direktiivi kaitsemehhanismide regulatsioon on vaidlust tekitav. Nimelt on ebamäärane, kas kaitsemehhanismide regulatsioonile seatud eesmärgid on vastavuses regulatsiooni ja selle rakendamise reaalsete mõjudega. Juhul kui ei ole, siis millisel

viisil peaks kaitsemehhanismid vaenulike ülevõtmiste suhtes olema Euroopa Liidu tasandil reguleeritud.

Sellest tulenevalt on magistritöö eesmärgiks analüüsida, kas Artiklitele 9, 11 ja 12 seatud esialgsed eesmärgid on vastavuses reaalsete mõjude ja tagajärgedega tulenevalt kaitsemehhanismide regulatsiooni õiguslikust tõlgendamisest ja kaitsemehhanismide rakendamise analüüsist. Vastavalt eesmärgile on magistritööle seatud järgnev hüpotees:

- Vaenulike ülevõtmiste vastastele kaitsemehhanismidele seatud eesmärgid on vastavuses regulatsiooni tegelike tulemustega.

Magistritöö keskendub ennekõike kaitsemehhanismide regulatsiooni analüüsile ülevõtmispakkumiste direktiivis. Töös viidatud liikmesriikide kaitsemehhanismide regulatsiooni seadusrakendused on lisatud võrdluse ning regulatsiooni mõjude põhjaliku analüüsi eesmärgil. Tuginedes Artiklite 9, 11 ja 12 analüüsile on magistritöö kokkuvõtvas faasis tehtud ettepanekud kaitsemehhanismide regulatsiooni võimalikeks muudatusteks.

Ülevõtmispakkumiste direktiivi Artiklis 9 sätestatud sihtettevõtte juhtorganite neutraalsuskohustus *(board neutrality rule)* reguleerib sihtemitendi juhtorganite tegevust alates sihtemitendi suhtes ülevõtmispakkumise tegemisest. Nimelt on sihtemitendi juhtorganitel võimalus teha otsuseid või tegevusi, mis võivad mõjutada ülevõtmispakkumise õnnestumist ja on väljaspool ettevõtte igapäevast majandustegevust – võtta kasutusele ülevõtmispakkumise suhtes kaitsemehhanismid. Seega reguleerib Artikkel 9 ülevõtmispakkumise järgsete *(post-bid)* kaitsemehhanismide rakendamist.

Vastavalt Artikkel 9 regulatsioonile on piiratud sihtemitendi juhtorganite võimalusi ja õigusi kohaldada ülevõtmispakkumise järgseid kaitsemehhanisme, mille kasutusele võtmine võib tuleneda nii eesmärgist kaitsta ettevõtet vaenuliku ülevõtmispakkuja vastu kui kaitsta oma isiklikke huvisid. Agendiprobleemi *(agency problem)* kohaselt eksisteerib ülevõtmispakkumise tehingu korral sihtemitendi juhtorganite ja aktsionäride vahel huvide konflikt. Selle kohaselt on aktsionäride huvi ülevõtmispakkumise tehingust kasu saamine ning sihtemitendi juhtorganitel soov säilitada oma positsioon ka ülevõtmispakkumise järgselt. Viimane on selgitatav äriühingute kontrolli turu *(market for corporate control)* teooria kontekstis. Teooria alusel on ülevõtmispakkumised ja eriti vaenulikud ülevõtmispakkumised suunatud ennekõike ettevõtetele, kus juhtorganite tegevuse tõttu on ettevõtte aktsiate väärtus langenud. Sellisel juhul on ettevõtte omandaja eesmärgiks sihtemitendi juhtorganite asendamine pärast ülevõtmispakkumise õnnestumist.

Artiklis 9 sisalduvale juhtorganite neutraalsuskohustusele *(board neutrality rule)* olid seatud eesmärgid, mille täitmine sooviti saavutada ülevõtmispakkumiste direktiivis sätestatud regulatsiooniga. Esiteks, oli Artikkel 9 eesmärgiks sihtemitendi juhtorganite kohustuste ühtse regulatsioon loomine pakkumise järgsete kaitsemehhanismide kasutamisesks. Teiseks, oli Artikkel 9 eesmärgiks ülevõtmispakkumistehingute ja äriühingute kontrolli turu hõlbustamine. Eelnev eesmärk tuleneb asjaolust, et ülevõtmispakkumisi (ka vaenulikke ülevõtmispakkumisi) on nähtud positiivsena ennekõike seetõttu, et on kasulikud sihtemitendi aktsionäridele ning ülevõtmispakkumised aitavad kaasa äriühingute kontrolli turu arengule. Kolmandaks, oli Artikkel 9 eesmärgiks agendiprobleemi lahendamine ettevõtte juhtkonna ja aktsionäride vahel vastavalt äriühingute kontrolli turu teooria toimisele praktikas. Neljandaks, oli Artikkel 9 eesmärk aktsionäride ülimuslikkuse *(shareholder primacy)* printsiip ja lõpliku otsustuse tegemise õiguse edendamine. Viimast võib nimetada juhtorganite neutraalsuskohustuse kõige tähtsamaks eesmärgiks. Seda seetõttu, et sihtemitendi aktsionäridele otsustuse tegemise õiguse andmine ülevõtmispakkumiste korral ning aktsionäride huvide kaitse ülimuslikkus on positiivsed aktsionäride huvide kaitse mudeli *(shareholder-model)* kohaselt. Aktsionäride huvide mudel on võetud kaitsemehhanismide regulatsiooni aluseks.

Sihtettevõtte juhtorganite neutraalsuskohustuse regulatsiooni tõlgendamisel on tekkinud mitmeid küsitavusi. Esmalt on ebaselge sihtemitendi juhtorganite koosseis, kellele passiivsuskohustus rakendub ülevõtmispakkumise perioodil. Artikkel 9 (6) on andnud täpsustuse, et juhtorganite neutraalsuskohustus laieneb ka sihtemitendi nõukogule. Vaidlus juhtorganite koosseisu juures tekib pigem neutraalsuskohustuse laienemise üle sihtemitendi juhatusele *(board)* ja sihtemitendi tegevjuhatusele *(management)*. Tõlgendamisel tuleb arvesse võtta, et aktsionäride suhtes võivad oma huvidest lähtuvalt ja oportunistlikult tegutseda kõik eelpool mainitud juhtorganite liikmed ning et neutraalsuskohustuse üheks peamiseks eesmärgiks on sihtemitendi aktsionäride huvide igakülgne kaitse. Seega võib neutraalsuskohustuse tõlgendamise põhjal väita, et kohustus laieneb nii sihtettevõtte tegevjuhtidele, juhatusele kui nõukogule.

Lisaks eelnevale on tekitanud vaidlusi, milline on neutraalsuskohustuse ulatus. Ühelt poolt nõuab neutraalsuskohustuse regulatsioon ülevõtmispakkumiste direktiivis (ja näiteks ka Suurbritannia ettevõtete ülevõtmiste regulatsioon) sihtettemitendi juhtorganite ja nende liikmete ranget passiivsust ülevõtmispakkumise perioodil. Rangele neutraalsuskohustusele on lisatud teatud erandid. Nendeks eranditeks on näiteks olukorrad, kus juhtorgan on suuteline tõestama, et tegevus või tehtud otsus on kooskõlas sihtemitendi tavapärase äritegevusega või turu praktikaga. Samuti on lubatud sihtemitendi juhtorganitel otsida alternatiivseid pakkujaid

ja esitada omapoolne arvamus ülevõtmispakkumise kohta. Range neutraalsuskohustus peaks looma eeldused aktsionäride ülimuslikkuse doktriini toimimisele ja aktsionäride huvide kaitse mudeli edendamisele. Seesugune vaade on ennekõike levinud Anglo-Ameerika õigussüsteemis, mille esindajaks Euroopas on Suurbritannia, ja mille alusel kehtiv neutraalsuskohustus direktiivi lisati.

Vastukaaluks eelnevale esindab arvukas hulk Mandri-Euroopa liikmesriikidest vaadet, mille kohaselt peaks sihtemitendi juhtorganite ja ennekõike juhatuse kohustus olema tasakaalustada erinevate ülevõtmispakkumisest mõjutatud gruppide huvisid – huvigruppide huvide kaitse mudel *(stakeholder-model)*. Antud seisukoht on jäetud neutraalsuskohustuse lisamisel ülevõtmispakkumiste direktiivi arvestamata. Kuna aga mudel on laialdaselt toetatud paljude Mandri-Euroopa liikmesriikide poolt, siis tingis vastuolu neutraalsuskohustuse muutmise valikuliseks.

Lisaks erisustele juhtorganite neutraalsuskohustuse regulatsioonis on vastuoluline ka selle rakendatavus Euroopa Liidu liikmesriikides. Vastavalt Artiklile 12 on liikmesriikidel õigus jätta neutraalsuskohustus kohustuslikus korras rakendamata, kuid liikmesriigid peavad jätma sihtemitentidele võimaluse neutraalsuskohustust rakendada vabatahtlikkuse alusel. Tulenevalt eelnevast on 19 liikmesriiki teinud sihtemitentide juhtorganite neutraalsuse kohustuslikuks. Samas ei ole arvestatav hulk Mandri-Euroopa suurte kapitaliturgudega liikmesriikidest, kes toetavad balansseeriva juhtorgani rolli ja huvigruppide huvide kaitse mudelit, neutraalsuskohustust kohustuslikus korras rakendanud – Saksamaa, Holland, Belgia, Luxemburg, Poola, Taani ja Ungari.

Tulenevalt eelnevast on neutraalsuskohustuse regulatsioonil arvukalt erinevaid tagajärgi ja negatiivseid kõrvalmõjusid. Selle tulemusel võib väita, et esialgsed eesmärgid on vastavuses Artiklist 9 tulenevate tegelike mõjudega üksnes teatud ulatuses ning seda juhul, kui sihtemitendi juhtorganite neutraalsuskohustust on liikmesriigis rakendatud. Sellegipoolest on sihtemitendi juhtorganite neutraalsuskohustusel ja rakendamisel mitmed negatiivsed kõrvalmõjud – seaduslüngad, vaenulikud ülevõtmised ei ole pikas perspektiivis kasutoovad, passiivsuskohustus on muutnud Euroopa ettevõtted haavatavaks vaenulikele ülevõtmistele ning passiivsuskohustus mõjutab eriti tugevalt Mandri-Euroopa kontsentreeritud aktsionäride struktuuriga ettevõtteid. Lisaks on sihtemitendi juhtorganitelt võetud võimalus pidada läbirääkimisi ülevõtmistehingu tingimuste üle või võtta kasutusele meetmeid ülevõtmispakkumiste suhtes, mis tõenäoliselt ei ole kasulikud. Viimane on eriti aktuaalne Mandri-Euroopa liikmesriikides, mis pooldavad erinevate huvirühmade huvide kaitsmise mudelit ja tasakaalustamist ülevõtmispakkumiste ajal sihtettevõtte juhtorganite poolt.

Ülevõtmispakkumiste direktiivi Artiklis 11 on sätestatud piirangute kohaldamise ja eriõiguste kasutamise keeld. Artikkel 11 reguleerib kaitsemehhanismide kasutamist, mis on kehtestatud või eksisteerivad sihtemitendis enne ülevõtmispakkumise tegemist – ülevõtmispakkumise eelsed kaitsemehhanismid *(pre-bid defences)*. Nende eesmärgiks on nurjata vaenulik ülevõtmispakkumine ja muuta sihtemitendi omandamine ajaliselt ja rahaliselt kulukaks.

Ülevõtmispakkumise eelsed kaitsemehhanismid on eelkõige erinevad piirangud, mis on seatud aktsiate või hääleõiguse võõrandamisele. Samuti erinevad kontrolli tõhustamise mehhanismid *(control enhancing mechanisms)*, mis annavad aktsionäridele suurema kontrolli ettevõttes, kui on nende omatav aktsiate hulk. Seesuguste kontrollimehhanismide kasutatavus liikmesriikide ettevõtetes on märkimisväärne. Lisaks on nähtud tõket ettevõtete ülevõtmistele kontsentreeritud aktsionäride struktuuris, mistõttu peeti vajalikuks ka seesuguste struktuuride muutmine hajutatuks ja ülevõtmistele vastuvõtlikumaks.

Ülevõtmispakkumise direktiivi Artiklile 11 seati mitmed eesmärgid, mille täitmine sooviti saavutada ülevõtmispakkumiste direktiivis sätestatud regulatsiooniga. Esiteks oli Artikli 11 eesmärgiks ülevõtmispakkumiste ja äriühingu kontrolli turu *(market for corporate control)* hõlbustamine. Teiseks oli Artikli 11 eesmärgiks sihtemitendi juhtorganite neutraalsuskohustuse poolt seatud piirangute täiendamine. Ühelt poolt täiustas Artikkel 11 kaitsemehhanismide ulatust, mille kasutamisele ja rakendamisele laieneb ülevõtmispakkumise perioodil keeld. Samuti on Artikkel 11 erilise tähtsusega olukorras, kus ülevõtmispakkumise järgsed kaitsemehhanismid on keelatud, sest eelduslikult võtavad ettevõtted sellisel juhul kasutusele mehhanismid, mis keelatud ei ole. Kolmandaks oli Artikli 11 eesmärgiks agendiprobleemi *(agency problem)* lahendamine sihtemitendi juhtorganite ja aktsionäride ning vähemus- ja enamusaktsionäride vahel. Neljandaks oli Artikkel 11 suundatud erinevate kaitsemehhanismide neutraliseerimisele, mis muudavad ülevõtmise raskeks – kontrolli tõhustamise mehhanismide kõrvaldamine, hajutatud aktsionäride struktuuri edendamine ja proportsionaalsuse kehtestamine kapitali ja tegeliku kontrolli vahel, mida aktsionärid sihtemitendis omavad. Viimati nimetatud eesmärgid olid seatud selleks, et luua potentsiaalsetele omandajatele lihtsam ligipääs sihtemitendi kontrollile.

Artikkel 11 tõlgendamine on problemaatiline sarnaselt Artiklile 9. Esiteks ei ole selgelt määratletud Artikli 11 kohaldatavuse ulatus. Nimelt on Artikli 11 poolt keelatud teatud kontrolli tõhustavad mehhanismid samal ajal kui teised ei ole. Selline valikuline regulatsioon ei ole õigustatud, sest samasuguse mõjuga on ka need mehhanismid, mis ei ole reguleeritud Artikliga 11. Lisaks sellele soodustab regulatsioon ka hajutatud aktsionäride struktuuri arengut, mille kasulikkus võrreldes kontsentreeritud aktsionäride struktuuriga ei ole tõestatud.

Samuti on ebamäärane õiglase kompensatsiooni maksmise regulatsioon. Nimelt ei ole täpsustatud, millistel alustel tuleks otsustada kompensatsiooni suurus ning kes on kohustatud maksma kompensatsiooni.

Lisaks vastuolulisele regulatsioonile näitab Artikli 11 ebaõnnestumist ka selle rakendamisstatistika – Artikkel 11 on kohustuslikuks tehtud vaid kolmes liikmesriigis. Liikmesriikide huvi puudumine artikli rakendamise vastu seisneb seisneb peamiselt asjaolus, et see muudaks mitmed liikmesriikide suurettevõtted kergesti ülevõetavaks, mis ei ole liikmesriikide huvides – protektsionism liikmesriigile majanduslikult oluliste ettevõtete suhtes.

Vastavalt Artikli 11 regulatsiooni ja rakendamise analüüsile võib väita, et Artiklile 11 seatud eesmärgid ei ole vastavuses antud artikli tegelike mõjudega juhul, seda on rakendatud või rakendatakse liikmesriigis. Enamgi veel, Artikli 11 rakendamine võib kaasa tuua mitmeid negatiivseid kõrvalmõjusid, mis põhjendab liikmesriikide marginaalset huvi selle rakendamise suhtes. Põhjuseid selleks on mitmeid, kuid ennekõike võib välja tuua asjaolu, et kehtestatud regulatsioon on mittetäielik ja ebaselge. Samuti on küsitav, kas artiklile seatud eesmärgid omavad kasu toovat väärtust kõigile ettevõtetele ja liikmesriikidele. Põhjendused eelnevale tulenevad ühelt poolt sellest, et Artiklis 11 toodud regulatsioon soodustab üksnes hajutatud aktsionäride struktuuriga ettevõtteid, samal ajal kui kontsentreeritud aktsionäride struktuuri (valdav Mandri-Euroopa ettevõtete seas) on nähtud selgelt negatiivselt. Kuna Artikli 11 mõjul muutuvad ettevõtted haavatavaks ülevõtmispakkumistele, ei ole liikmesriigid taolisest arengust huvitatud tulenevalt protektsionistlikust hoiakust riigi suurettevõtete suhtes.

Lisaks Artiklitele 9 ja 11, mis reguleerivad otseselt ülevõtmispakkumise eelsete ja järgsete kaitsemehhanismide kasutamist, keskendub Artikkel 12 eelnevate artiklite rakendamise reguleerimisele nii liikmesriigi kui ettevõtete tasandil. Artikli 12 peamisteks eesmärkideks oli võrdsete võimalustega ala *(level playing field)* loomine nii Euroopa ettevõtete vahel kui ka Euroopa Liidu ja kolmandate riikide ettevõtete vahel. Samuti oli Artikli 12 lisamine ülevõtmispakkumiste direktiivi tarvilik kompromiss, mis andis võimaluse võtta Artiklid 9 ja 11 vastu direktiivi osana. Nimelt oli direktiivi vastuvõtmine viibinud pikalt tulenevalt liikmesriikide negatiivsest vastureaktsioonist kaitsemehhanismide regulatsioonile.

Artikkel 12 sätestab kaks võimalikku klauslit Artiklite 9 ja 11 rakendamiseks. Esmalt sätestab Artikkel 12 (1) ja (2) valikulisuse klausli (*optionality clause),* mille kohaselt ei ole liikmesriik kohustatud ettevõtetele tegema kohustuslikuks ei Artiklit 9 ega 11. Samas on liikmesriik kohustatud tegema võimalikuks ettevõtetele nendes sätestatu rakendamise vabatahtlikult, kui viimased seda vajalikuks peavad. Artikkel 12 (3) sätestab vastastikkuse klausli *(reciprocity clause)*, mille kohaselt on ettevõtetel, kui liikmesriik on vastastikkuse

klausli rakendamise siseriiklikus õiguses võimalikuks teinud, võimalus mitte kohaldada Artiklit 9 ja 11, kui ülevõtmispakkuja vastavaid reegleid ei kohalda.

Ühelt poolt oli Artikli 12 lisamine direktiivi vajalik selleks, et saavutada direktiivi vastuvõtmine ning ülevõtmispakkumiste suhtes ühtse regulatsiooni kehtestamine Euroopa Liidus. Teisalt neutraliseeris käesolev artikkel Artiklite 9 ja 11 kohustusliku kohaldamise nõude ning seega ka loodetud tulemused. Samuti muutis Artikkel 12 kaitsemehhanismide kasutatavuse keerukaks ning vastuoluliseks. Lisaks ei ole Artikkel 12 suutnud luua täielikku võrdsete võimalustega ala. Ebamäärasus tekib olukorras, kus sihtemitendi suhtes on tehtud mitu ülevõtmispakkumist erinevate liikmesriikide ettevõtete poolt. Samuti siis kui sihtemitendile on teinud ülevõtmispakkumise ettevõte kolmandast riigist, mille puhul on pole kindel, kas liikmesriigis kehtivad reeglid sarnased Artiklitele 9 ja 11.

Kokkuvõtlikult võib väita, et Artikkel 12 tulemused on teatud määral vastavuses seatud eesmärkidega. Samas esineb artiklis ebaselgust ning probleeme artikli rakendatavusega. Artikkel 12 oli kahtlemata vajalik kompromiss direktiivi vastu võtmiseks. Siiski ei saa seda pidada pikaajaliseks lahenduseks, kuna Artiklist 12 tulenevad valikulised võimalused ei lahenda Artiklitest 9 ja 11 tulenevaid alusprobleeme.

Kokkuvõttes ei pidanud magistritööle seatud hüpotees paika. Esialgsete eesmärkide vastavus Artiklite 9, 11 ja 12 tegelikele tulemustele eksisteerib teatud ulatuses või puudub. Lisaks eelnevale on Artiklite 9, 11 ja 12 regulatsioonil mitmeid negatiivseid kõrvalmõjusid, mida tuleks võtta arvesse kaitsemehhanismide regulatsiooni muudatuste tegemisel.

ABBREVIATION

SMA – Securities Market Act (Väärtpaberituru seadus)

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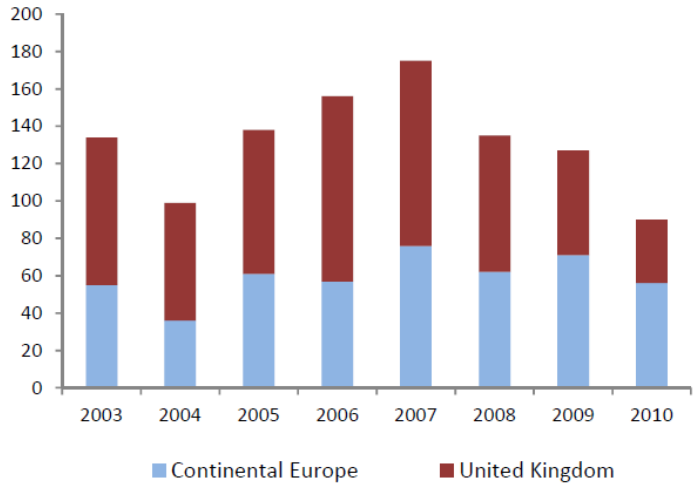
ANNEX

Figure 1. The comparison of the number of takeovers in United Kingdom and Continental Europe



Source: The Takeover Bids Directive Assessment Report. European Commission 2012. – Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf

Figure 2. Economic models

Shareholder-oriented model (UK)	Company-oriented model (Continental Europe)	Management-oriented model (US)
▪ Dispersed shareholders	▪ Blockholders	▪ Dispersed shareholders
▪ No takeover defences	▪ Mild takeover defences	▪ Strong takeover defences
▪ Agency theory (Principal/Agent) or Master/Servant)	▪ Corporate interest	▪ Fiduciary duties

Source: Source: The Takeover Bids Directive Assessment Report, European Commission 2012 available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf

Figure 3: Impact of the takeover regulation

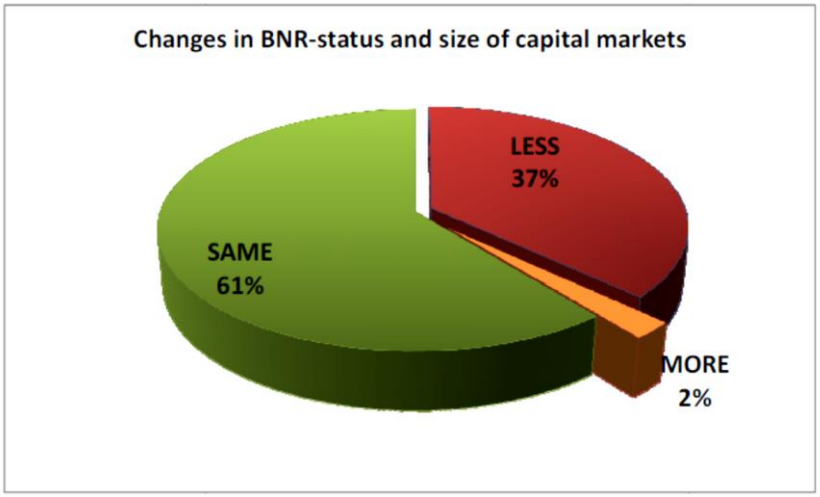
Impact of takeover regulation (± relationship and intensity)

TOD rule	Volume of takeovers		Protection of (minority) shareholders		Disproportionality between ownership and control		Overall impact
	CONCENTRATED OWNERSHIP	DISPERSED OWNERSHIP	CONCENTRATED OWNERSHIP	DISPERSED OWNERSHIP	CONCENTRATED OWNERSHIP	DISPERSED OWNERSHIP	
Mandatory bid rule	–	– –	+ +	+	+	+ +	High
Ownership transparency	+	+ +	+	+ +	–	–	Moderate
	–	– –					
Squeeze-out rule	+ +	+	–	–	+	+	Low
Sell-out rule	– –	–	+ +	+	– –	–	Low
Breakthrough rule	+ +	+	+ +	+	+ +	+	Very high
Board neutrality rule	+ +	+	+	–	+	+ +	Moderate

Source: The Takeover Bids Directive Assessment Report. European Commission 2012. – Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf

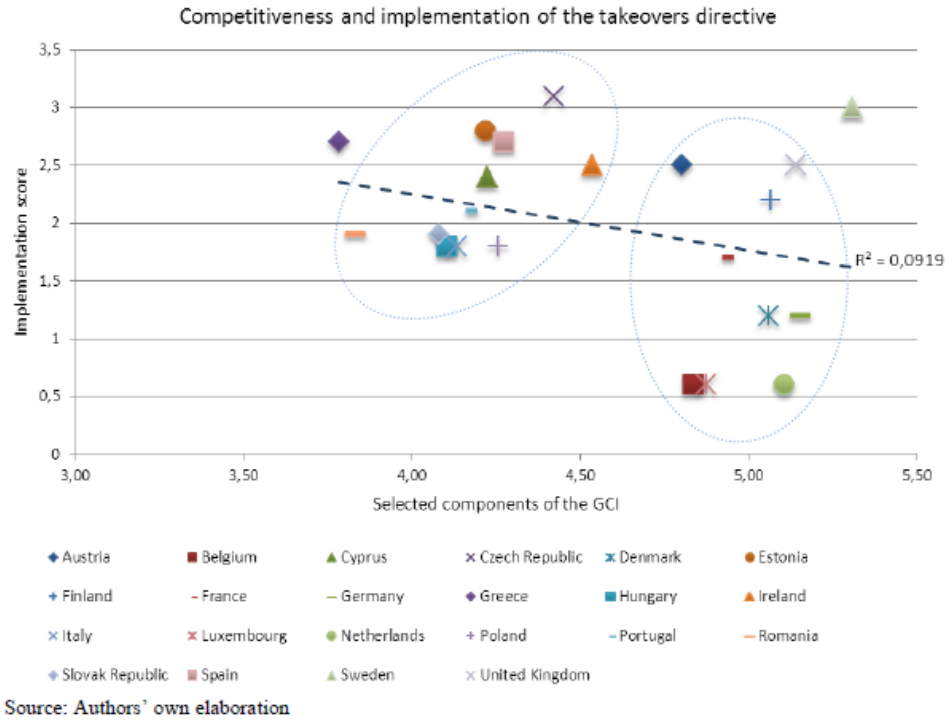
Figure 4. Changes in BNR-status and size of capital markets

Chart 1[203]



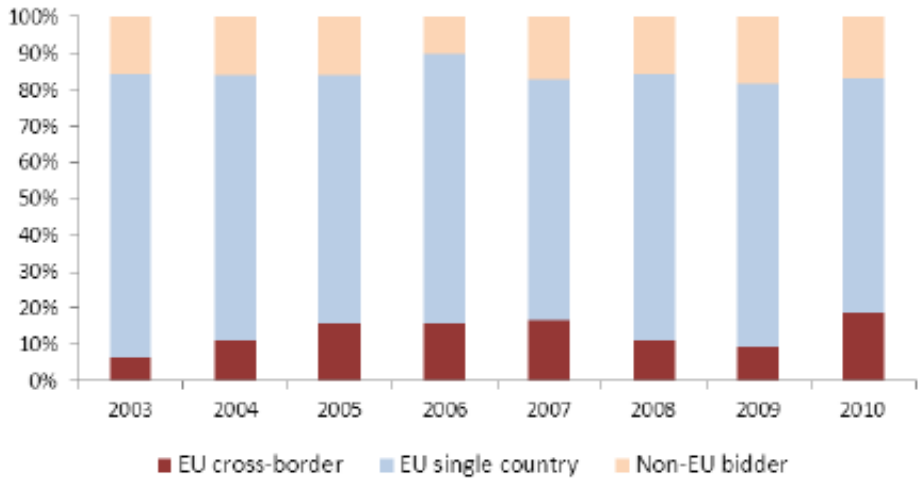
Source: P. Davis, E-P. Schuster, E. van de Walle de Ghelcke. Takeover Directive as a Protectionist Tool?. – European Corporate Governance Intitute Working paper No 141/2010. Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1554616, (12.22.2012)

Figure 5: Competitiveness and transposition of the Takeover Bids Directive



Source: The Takeover Bids Directive Assessment Report. European Commission 2012. – Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf

Figure 6: Number of takeovers by location of the parties



Source: The Takeover Bids Directive Assessment Report. European Commission 2012. – Available: http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf

Figure 7. Listed companies with under control blocking minority of at least 25%

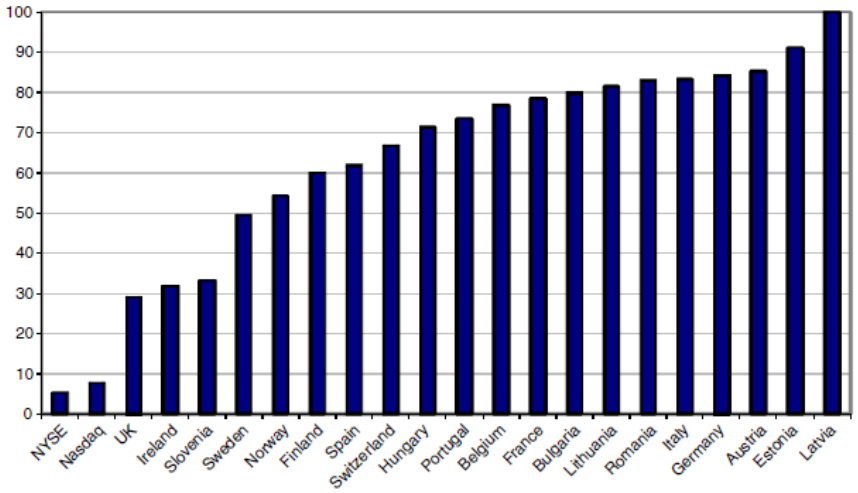
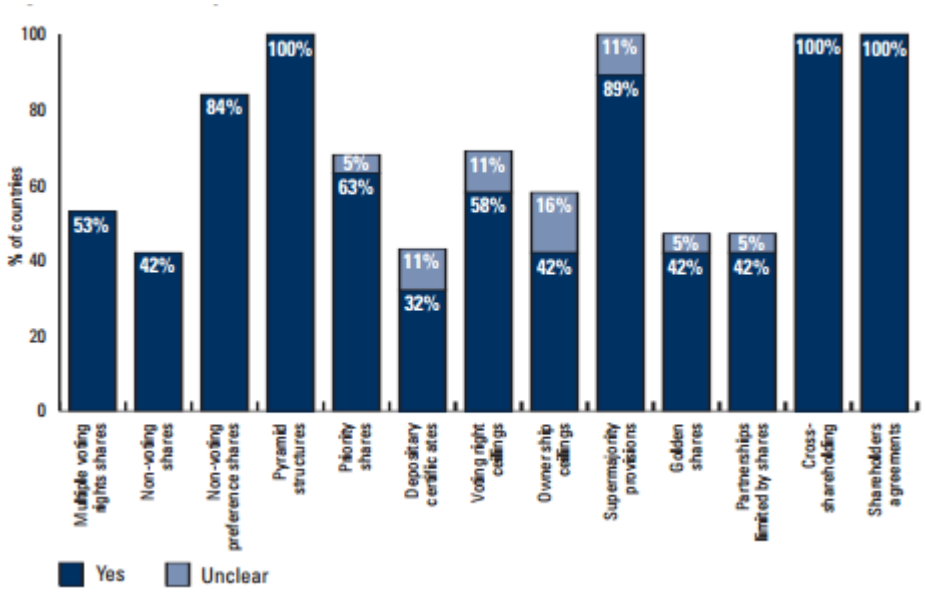


Fig. 2. Percentage of listed companies with a under control blocking minority of at least 25%.
Data source: Faccio and Lang (2002) for European countries with law of English, German, French, and Scandinavian origin, Barca and Becht (2001) for the US, and the ECGI project "Corporate Governance & Disclosure in the Accession Process" (2001) for the EU accession countries.

Source: M. Faccio, L.H.P. Lang. The ultimate ownership of Western European corporations. – Journal of Financial Economics, 2002/65 No 3 in Shearman & Sterling LLP. Proportionality between ownership and control in EU listed companies: Comparative Legal Study. 2007 External study commissioned by the European Commission. – Available: http://www.ecgi.org/osov/documents/study_report_en.pdf, (12.01.2014)

Figure 8.



Source: Shearman & Sterling LLP. Proportionality between ownership and control in EU listed companies: Comparative Legal Study. 2007 External study commissioned by the European Commission. – Available: http://www.ecgi.org/osov/documents/study_report_en.pdf, (12.01.2014)

Figure 9.

Country	Multi. voting right shares	Non voting shares	Non Voting pref. shares	Pyramid structure	Priority shares	Dep. certif.	Voting right ceilings	Ownership ceilings	Super-majority provisions	Golden shares	Partnerships ltd. by shares	Cross share holdings	Shareholders agreements
BE	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DE	No	No	Yes	Yes	Yes	No	No	No	Yes	No	Yes	Yes	Yes
DK	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
EE	No	No	Yes	Yes	Yes	Yes	No	No	Yes	Yes	No	Yes	Yes
FI	Yes	Yes	Yes	Yes	No	No	Yes	No	Yes	No	No	Yes	Yes
FR	Yes	Yes	Yes	Yes	Yes	No	Yes	No	Unclear	Yes	Yes	Yes	Yes
GR	No	No	Yes	Yes	No	No	No	No	Yes	No	No	Yes	Yes
HU	Yes	No	Yes	Yes	No	No	Yes	Unclear	Yes	No	No	Yes	Yes
IE	Yes	Yes	Yes	Yes	Yes	Unclear	Yes	Yes	Unclear	No	Yes	Yes	Yes
IT	No	Yes	Yes	Yes	Unclear	No	No	Yes	Yes	Yes	Yes	Yes	Yes
LU	No	No	Yes	Yes	Unclear	Yes	Unclear	Unclear	Yes	Unclear	Yes	Yes	Yes
NL	Yes	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
PL	No	No	Yes	Yes	No	No	Yes	Unclear	Yes	Yes	No	Yes	Yes
SE	Yes	No	No	Yes	Yes	Unclear	Yes	No	Yes	No	No	Yes	Yes
SP	No	No	Yes	Yes	No	No	Yes	No	Yes	No	Yes	Yes	Yes
UK	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	No	No	Yes	Yes

Source: Shearman & Sterling LLP. Proportionality between ownership and control in EU listed companies: Comparative Legal Study. 2007 External study commissioned by the European Commission. – Available: http://www.ecgi.org/osov/documents/study_report_en.pdf, (12.01.2014)

Figure 10.

Ranking	CEMs	Availability of CEMs	Actual use of CEMs
1	Pyramid Structure	100%	75%
1	Shareholders' Agreements	100%	69%
1	Cross-Shareholdings	100%	31%
2	Supermajority Provisions	87%	NA
3	Non Voting Preference Shares	81%	44%
4	Voting Right Ceilings	69%	56%
5	Priority Shares	56%	12%
6	Multiple Voting Rights Shares	50%	44%
7	Golden Shares	44%	31%
7	Partnerships Limited by Shares	44%	0%
7	Depository Certificates	44%	6%
8	Ownership Ceilings	37%	25%
9	Non Voting Shares	31%	6%

Source: Shearman & Sterling LLP. Proportionality between ownership and control in EU listed companies: Comparative Legal Study. 2007 External study commissioned by the European Commission. – Available: http://www.ecgi.org/osov/documents/study_report_en.pdf, (12.01.2014)

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